



# Chesnara

—  
Annual Report & Accounts  
2016

# WELCOME TO THE CHESNARA ANNUAL REPORT & ACCOUNTS FOR 2016.

## **Cautionary statement**

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, Dutch 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.

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# SECTION A: OVERVIEW

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# AN INTRODUCTION TO CHESNARA

Chesnara plc is a life assurance and pensions consolidator. It has operations in the UK, Sweden and the Netherlands.

Our primary focus is the efficient management of life assurance and pension policies to give good and fair outcomes to our customers, generating profits to provide attractive dividends and value growth to our investors. Periodically we seek to create further value and sustain our dividend policy by acquiring new companies or books of business. Our acquisition strategy looks beyond the UK and we will consider opportunities across other European countries where there is sufficient value and strategic and cultural fit.

Although primarily a closed book business, we do write new business where we are confident that conditions will ensure the sales are value adding. The new business operations will always be based on realistic market share expectations and hence the writing of new business will not detract from our core objective of managing in-force books to provide good returns to policyholders and investors.

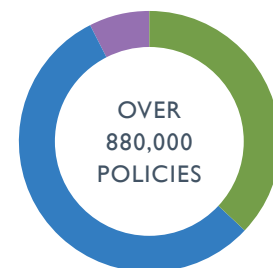
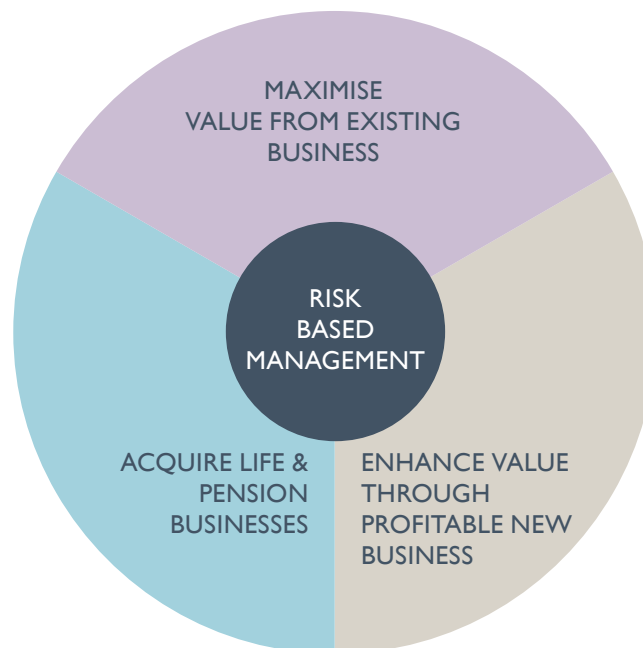
Chesnara's long established culture and values underpin the delivery of our core strategic objectives. Risk and solvency management are at the heart of our robust governance framework and the group is well capitalised. Throughout its history Chesnara has delivered good and consistent returns to policyholders and shareholders.

## ABOUT CHESNARA

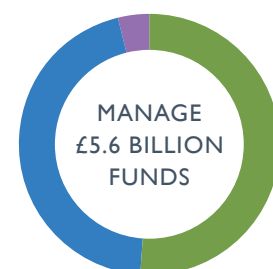
### Who we are

- We are a responsible and profitable company engaged in the management of life and pension policies in the UK, Sweden and the Netherlands.
- Chesnara plc was formed in 2004 and is listed on the London Stock Exchange.
- The group initially consisted of Countrywide Assured, a closed life and pensions book demerged from Countrywide plc, a large estate agency group.
- Since incorporation the group has grown through the acquisition of three predominantly closed UK businesses, an open life and pensions business in Sweden and a closed-book group in the Netherlands.

### What we do



UK  
SWEDEN  
NETHERLANDS



## How we operate

- Chesnara devolves management to the three divisions but the divisions operate within a centrally defined governance and risk management framework.
- A central UK team has significant experience and a proven track record in governing, acquiring and successfully integrating life and pension businesses.
- In the UK we adopt an outsourced operating model to the fullest extent possible whereas our overseas divisions use outsourced services on a more limited basis.
- Acquisitions are assessed against stringent financial criteria adopting a robust risk-based due diligence process.
- We maintain strong solvency levels.

## How we create value

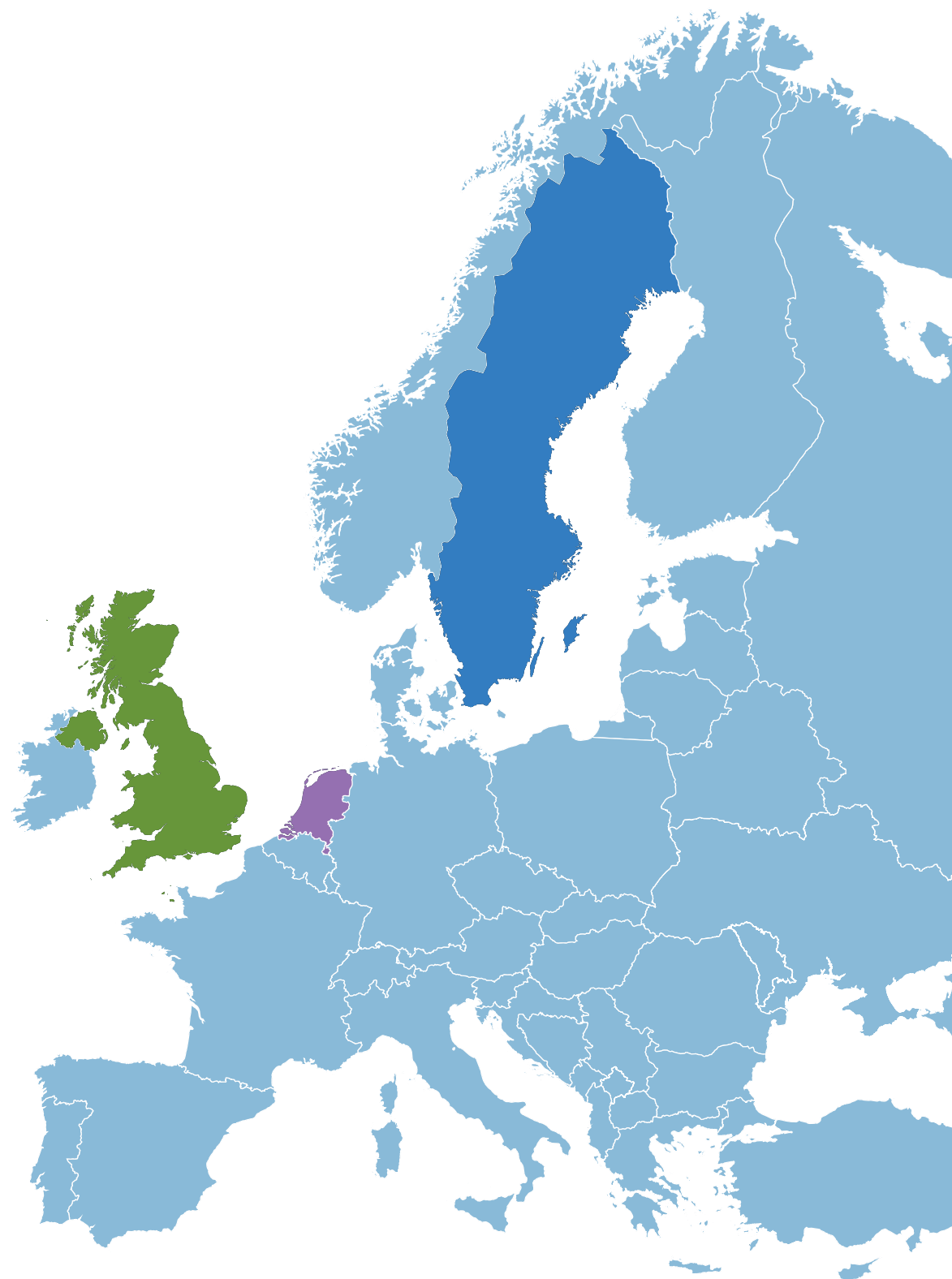
### Policyholder

- Providing security through strong solvency. Effective customer service operations together with competitive fund performance, whilst giving full regard to all regulatory matters, support our aim to ensure policyholders receive good returns and service in line with policy expectations.

### Shareholder

- Because of efficient management of the policy base and good capital management practices, surpluses emerge from the in-force books of business. These surpluses enable dividends to be made from the subsidiaries to Chesnara, which fund the attractive dividend strategy and support our wish to be a share held for the long-term by our shareholders.
- Growth from both the proven acquisition model and from writing profitable new business in Sweden has had a positive impact on the Economic Value of the business.

**WE AIM TO PROVIDE VALUE FOR MONEY TO OUR CUSTOMERS AND INVESTORS IN A COMPLIANT MANNER.**



# DELIVERING OUR STRATEGY

Our company history has helped shape our business, which in turn enables us to deliver against our objectives.

## COMPANY HISTORY

2004

Chesnara is born – Countrywide estate agency group divests its life insurance business and this becomes the inaugural portfolio of Chesnara plc with an opening Embedded Value of £126m.

2005

Chesnara makes its first acquisition – City of Westminster Assurance, adding £30.3m of Embedded Value.

2007

Chesnara becomes established as an attractive dividend stock after three years of attractive dividend growth.

2009

Chesnara plc moves into Europe with the acquisition of a Swedish business now called Movestic. The group's Embedded Value reaches £263m. Unlike the UK operation, Movestic is open to new business which adds a further source of Embedded Value growth.

2010

The acquisition of Save and Prosper takes the group's assets under management to over £4 billion.

2013

Direct Line's life assurance business is acquired and by the end of 2014 total group Embedded Value rises above £400m.

2015

Expansion into a new territory with the acquisition of the Waard Group in the Netherlands.

2016

Building upon our entry to the Dutch market we announce the acquisition of Legal & General Nederland at a 33% discount to its Economic Value of £202.5m.

## WHAT WE'VE DONE

**6** successful acquisitions, including LGN, across **3** territories.

Our deals **demonstrate flexibility and creativity** where appropriate:

- Tactical 'bolt-on' deals to more transformative deals
- Open minded regarding deal size
- Willingness to find value beyond the UK
- Flexible and efficient deal funding solutions
- Capability to find expedient solutions to de-risk where required.

We are **not willing to compromise on quality, value or risk.**

All deals have:

- been at a competitive discount to value
- satisfied our dual financial requirements of generating medium-term cash and enhancing long-term value
- been within Chesnara's risk appetite
- been subject to appropriate due diligence
- been either neutral or positive in terms of customer outcomes
- supported Chesnara's position as an income investment.

OUTCOMES



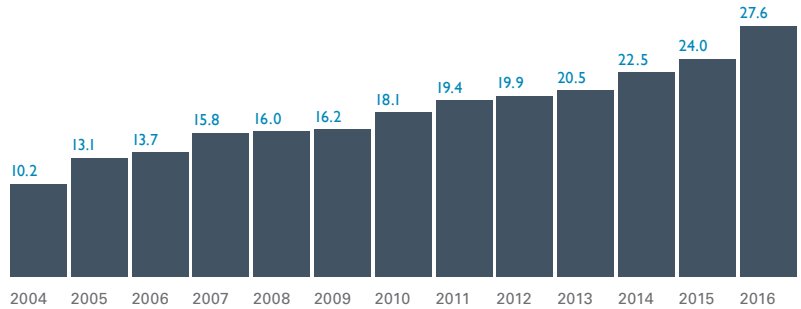


## DIVIDEND HISTORY

### 12 successive years of dividend growth.

We recognise the importance of providing stable and attractive dividends to our shareholders. A full year 2016 dividend of 19.49p per share represents an increase of 2.9% on the prior year, and is Chesnara's twelfth successive year of dividend growth.

Dividend payment history  
£m

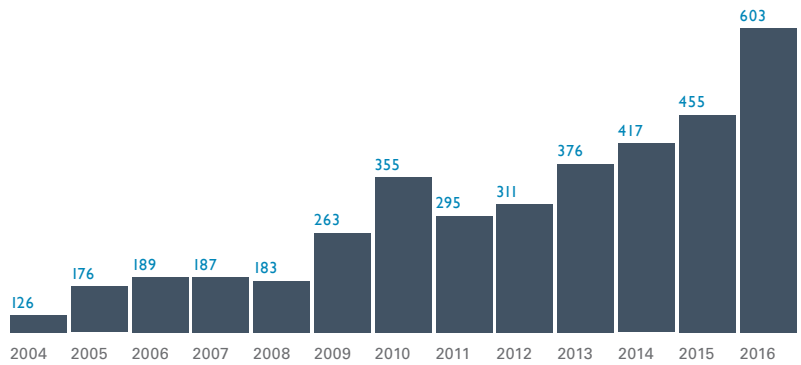


## VALUE GROWTH

### Economic Value of over £600m.

Value growth is achieved through a combination of efficient management of the existing policies, acquisitions and writing profitable new business. The growth includes c£148m of new equity throughout the 12 year period but is net of c£218m of cumulative dividend payments.

Embedded/Economic Value growth  
£m

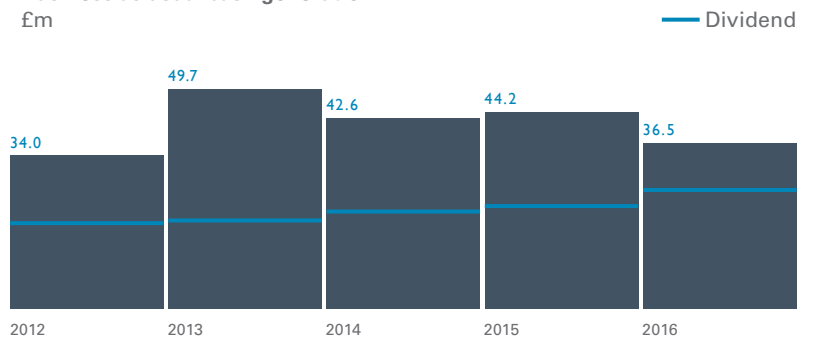


## CASH GENERATION

### Cash generation continues to support dividends.

Ultimately the group needs to generate cash to service its dividends. Cumulative cash generation over the last five years represents 181% of the total dividends over the same period.

Business as usual cash generation  
£m



## POLICYHOLDERS

### Our primary responsibilities remain to our policyholders.

- Customers can be confident that they have policies with a well capitalised group where financial stability is central to our culture and values.
- Our investment returns remain competitive across the group.
- We have delivered good customer service levels across the group.

# 2016 HIGHLIGHTS

## FINANCIAL



### IFRS

#### IFRS PRE-TAX PROFIT

2015 £42.8M\*

\*includes gain on acquisition of Waard Group of £16.6m.

[Financial review page 32](#)

**£40.7M**



### SOLVENCY

#### GROUP SOLVENCY

2015 146%

We are well capitalised at both group and subsidiary level and have not used any elements of the long-term guarantee package, including transitional arrangements.

[Capital management page 29](#)

**158%**

#### IFRS TOTAL COMPREHENSIVE INCOME **£55.4M**

2015 £39.6M

Includes foreign exchange gain of £20.1m (£0.2m foreign exchange loss for year ended 31 December 2015).

[Financial review page 32](#)

#### GROUP SOLVENCY EXCLUDING THE IMPACT OF EQUITY RAISED DURING THE YEAR **144%** NOTE 1

2015 146%

[Capital management page 29](#)



### ECONOMIC VALUE

#### ECONOMIC VALUE NOTE 1

2015 £453.4M

Movement in the year is stated after dividend distributions of £24.2m and includes the impact of LGN equity raise.

[Financial review page 35](#)

**£602.6M**



### CASH GENERATION

#### TOTAL GROUP CASH GENERATION

2015 £82.4M\*\*

\*includes impact of LGN equity raise  
\*\*includes cash on acquisition of Waard Group

[Financial review page 33](#)

**£85.4M\***

#### ECONOMIC VALUE EARNINGS

2015 £57.5M

Excludes impact of LGN equity raise (year ended 31 December 2015 £57.5m is on an EEV basis).

[Financial review page 34](#)

**£72.5M**

#### DIVISIONAL CASH GENERATION

2015 £50.9M

[Financial review page 33](#)

**£34.3M**

#### MOVESTIC NEW BUSINESS PROFIT

2015 £5.7M

[Business review page 25](#)

**£11.7M**

#### GROUP CASH GENERATION EXCLUDING THE IMPACT OF EQUITY RAISED DURING THE YEAR NOTE 1

[Financial review page 33](#)

**£36.5M**

#### Note 1: ACQUISITION OF LEGAL & GENERAL NEDERLAND

During 2016 we announced the acquisition of Legal & General Nederland which will complete in 2017. We raised £70m of equity in the year. In the interest of balance, we have included additional solvency and cash generation metrics which show the results excluding the impact of the equity raised. The full positive impact of the acquisition will be recognised on completion in the 2017 results.

## OPERATIONAL & STRATEGIC



### DIVIDEND

#### FULL YEAR DIVIDEND INCREASE

Total dividends for the year increased by 2.9% to 19.49p per share (6.80p interim and 12.69p proposed final). This compares with 18.94p in 2015 (6.61p interim and 12.33p final).



### ACQUISITIONS

#### ANNOUNCEMENT OF LEGAL & GENERAL NEDERLAND ACQUISITION

Announcement of purchase of Dutch business for agreed price of €160m, expected to complete in 2017.



### ECONOMIC BACKDROP

#### EQUITY GROWTH, FALLING BOND YIELDS, WEAKENING STERLING

Despite the low interest environment, interest rates have fallen further during the year from their opening position. Equity markets in all territories have performed well.



### MOVESTIC DIVIDEND

#### FIRST DIVIDEND PAID TO CHESNARA

Several years of growth have generated sufficient Solvency II surplus for Movestic to declare its maiden dividend of £2.7m (30mSEK).



### SOLVENCY

#### SOLVENCY II DELIVERED

New reporting requirements embedded with successful quarterly submissions to the regulator.

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

- IFRS
- Cash generation [NOTE 1](#)
- Economic Value
- Economic Value earnings
- Solvency
- Dividend/Total shareholder return
- Part VII
- Operational performance
- Compliance
- New business market share
- Acquisitions
- Risk appetite

**Notes:**

1. Cash generation represents the movement in the surplus assets that exists within the group over and above the level of capital that is required to be held. The level of capital required to be held takes account of the buffers that the board has set to hold over and above the solvency requirements imposed by our regulators. From 1 January 2016 cash generation has been determined with reference to the Solvency II prudential regime. Previously cash generation was determined with reference to Solvency I.

# CHAIRMAN'S STATEMENT



2016 has been a year of positive development for the Chesnara group and we have delivered strongly against all of our strategic objectives.

The value of our existing businesses has grown across all territories, with cash emergence sufficient to fund a further increase in the annual dividend, the twelfth successive year of dividend growth.

The increase in value includes an increasingly material contribution from new business profits in Sweden where we have delivered our best ever results.

Finally, the acquisition of Legal & General Nederland, announced in November 2016, represents a continuation of Chesnara's successful acquisition strategy. The acquisition will create significant scale in the Netherlands making Chesnara a well balanced three territory group. Legal & General Nederland is expected to have a significant positive impact on the Economic Value of the group and will further enhance ongoing cash generation thereby supporting the continuation of our dividend strategy.

A handwritten signature in black ink, appearing to read 'P. Mason'.

Peter Mason, Chairman

2016 has been one of the busiest and most successful years in Chesnara's history. We have delivered against each of our core strategic objectives and continued to embed Solvency II. This has been achieved whilst remaining true to our well established culture and values of treating customers fairly and adopting a robust approach to regulatory compliance. Importantly the business growth has been achieved without compromising our risk appetite, which is important given our position as a predictable and low risk investment.

### MAXIMISE VALUE FROM EXISTING BUSINESS

**18.2% growth in group Economic Value** Note 1.

Note 1 – Excludes the impact of equity raised and costs incurred for the acquisition of Legal & General Nederland.

See pages 22-26 for further information.

### ACQUIRE LIFE AND PENSIONS BUSINESSES

**Acquisition of Legal & General Nederland at an expected 33% discount to Economic Value, creating an expected positive Economic Value impact of c£56m on completion in 2017.**

See page 27 for further information.

### ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

**Record new business profits from Movestic of £11.7m.**

See page 24 for further information.

#### Maximise value from existing business

The existing books, particularly in the UK, remain the primary source of cash to fund our dividend strategy. As such, the increase in Economic Value, which implies an increase in future positive cash flows, is a positive outcome.

During the year our operating divisions have generated £34.3m of cash.

#### DESPITE THE LOW INTEREST RATE ENVIRONMENT, WE HAVE CONTINUED TO GENERATE CASH AT LEVELS IN EXCESS OF THE COST OF THE FULL YEAR DIVIDEND.

The UK's cash generation, given the turbulent political backdrop and in a period of low and declining yields, is reassuring. Also, the declaration of an inaugural dividend from Movestic of £2.7m and a positive cash contribution from the Waard Group are encouraging developments with regards to supporting the Chesnara dividend strategy.

#### EXCLUDING THE IMPACT OF EQUITY RAISED FOR THE IMMINENT ACQUISITION OF LEGAL & GENERAL NEDERLAND, THE ECONOMIC VALUE OF THE GROUP HAS INCREASED BY 18.2%. WE EXPECT TO CREATE A FURTHER C9.5% OF VALUE GROWTH WHEN THE DEAL COMPLETES.

##### Acquire life and pensions businesses

In November 2016 we announced our intended acquisition of Legal & General's Dutch life subsidiary. The acquisition scored highly against our established assessment criteria and at a 33% discount to Economic Value is expected to add approximately £56m of value on completion in 2017. The deal is funded by a mix of new equity, additional debt and investment of some of our existing own funds. The support from existing and new investors for the £70m of new equity is testament to the attractiveness of the acquisition. The business is generally recognised as being a high quality operation as illustrated by the fact LGN have been awarded prestigious best insurers award in 2016. As a profitable and well capitalised business, we expect that as we integrate the business into the group it will contribute to ongoing cash generation and value growth through efficient management of the existing book and from writing profitable new business.

#### Enhance value through profitable new business

The record level of new business profit delivered by Movestic is encouraging. Not only is the impact on Economic Value most welcome but importantly it demonstrates that meaningful levels of new business profit can be delivered from realistic market shares, if the focus on product offering, pricing, service and expenses is clear and the right management is in place. This creates a proven 'blueprint' that supports the intention to continue to run the newly acquired LGN business as an 'open to new business' operation and gives comfort that resultant increase in new business focus can be delivered without compromising Chesnara's primary specialism of acquiring and managing in-force books.

#### RECORD LEVELS OF NEW BUSINESS PROFIT FROM MOVESTIC OF £11.7M.

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**THE IMMINENT COMPLETION OF THE ACQUISITION OF LEGAL & GENERAL NEDERLAND WILL CONTINUE CHESNARA'S EVOLUTION FROM A UK OPERATION TO BECOMING A BALANCED THREE TERRITORY EUROPEAN GROUP. THIS ENHANCES THE OUTLOOK IN TERMS OF CASH GENERATION POTENTIAL, ACQUISITION OPPORTUNITIES AND CREATES OPTIONS TO OPTIMISE OUR GOVERNANCE MODEL.**



## **Solvency II**

Solvency II has continued to have a significant two fold impact on the business during the year. Firstly, I am pleased to report that we have complied with all the requirements of the regime, including the production of the Pillar 3 reports and the development of the first narrative reports due in 2017. Our risk management framework has continued to be enhanced to ensure we deliver a best practice Solvency II governance framework.

Secondly, 2016 has been the first year of managing the business in a Solvency II world. As expected, deepening analysis of the Solvency II capital requirements has given an improved understanding of how economic conditions and general business decisions impact the Solvency Capital Requirements. Based on this ever increasing understanding of the dynamics of solvency post Solvency II, it is clear there is an opportunity to develop management actions to optimise capital efficiencies across the group. The evolution from 'understanding and reporting solvency' to 'a more proactive management of solvency' is a core objective and opportunity for 2017 and beyond.

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**AN INCREASED UNDERSTANDING OF THE DYNAMICS OF SOLVENCY II IS EXPECTED TO CREATE AN OPPORTUNITY TO BENEFIT FROM CAPITAL OPTIMISATION IN THE FUTURE.**

## **Regulation**

Compliance with regulation, not least Solvency II, remains a priority for the group. We have continued to maintain a positive and constructive relationship with regulatory bodies across the group.

I am pleased to report that the FCA's review 'Fair treatment of long-standing customers in the life industry sector' that was initially announced on 3 March 2016 has now, following a period of consultation, been issued as final guidance. The guidance is in line with our expectations and we are fully supportive of this industry-wide enhancement programme. With the clarity of the final guidance, CA will progress with its improvement plan which includes an enhanced customer strategy. Our 2016 results include our best estimate of the financial impact of delivering to the revised best practice standards.

The investigation into how Countrywide Assured disclosed exit fees to customers, initially announced on 3 March 2016, is ongoing. We have provided the FCA with all information requested during the year. Discussions are ongoing and we have recently received a request for further information. Given the narrow scope of the investigation we retain our opinion that the outcome from the investigation should not have a material impact on the company.

## **Investment proposition**

Given Chesnara shares are primarily held by those requiring predictable and attractive income, I am pleased to report a 2.9% increase in our full year dividend, which represents a yield of 6.1% based on the average share price for the year.

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**2.9% INCREASE IN FULL YEAR DIVIDEND.**

## People

2016 has been one of the busiest years of Chesnara's history during which we have delivered record new business in Sweden, announced a major acquisition in the Netherlands and managed the Legacy Review in the UK.

The board is extremely aware of the demands this has placed on management and staff across the group. I would like to take this opportunity to thank my colleagues for their dedication, expertise and commitment to making 2016 a successful year.

At the end of 2016 Peter Wright retired from the board and Jane Dale, who we welcomed on to the board in May 2016, took over as the Chair of the Audit and Risk Committee. Frank Hughes stepped down from the board and will leave the company at the end of April following the restructure of our UK operations. Ken Hogg was appointed CEO of the UK operations in October 2016. Lars Nordstrand, the CEO of Movestic, will hand over to Linnea Ecorcheville in April this year. I would like to thank Peter, Frank and Lars for all their hard work over the years and wish Ken, Jane and Linnea every success for the future.

With all our acquisitions, forming a view of the quality, commitment and cultural fit of the management and staff of the target organisation is a key consideration. During the extensive due diligence process for the acquisition of Legal & General Nederland, it became clear that Chesnara will be inheriting a dedicated and capable team and I very much look forward to welcoming new colleagues into the group during 2017.

## Governance and risk management

Following the enhancements to our risk and governance systems in 2015, much of the activity in 2016 was focused on refinement, embedding and consistency of approach across the group, where appropriate. This was informed by a full group-wide attestation of our governance maps and risk and control policies. The results of the attestation exercise demonstrated significant progress with embedding the recently enhanced standards, but also recognised that further work is needed to achieve the desired level of consistency of approach.

Enhanced risk reporting in 2016, such as Own Risk and Solvency Assessment and the quarterly CRO report have provided greater insight and assurance to the board that risk is being controlled within the group's risk appetite. For example, 'continuous solvency monitoring and recovery planning protocol' was improved and introduced into regular reporting routines during the year, providing greater comfort that timely actions can be taken, as appropriate, in the event of a decline in solvency resulting from changes in financial conditions.

The Legal & General Nederland acquisition demonstrated the strength and effectiveness of our risk-based acquisition process, which includes a risk driven due diligence process, along with risk function oversight throughout. This will be refined further in 2017, based on learnings from the LGN acquisition.

We continue to place great importance on the continuous enhancement of our risk and governance system, and have a number of developments underway. Embedding activity continues with significant focus in 2017 on continuing to increase consistency of approach across the group, and particularly with the integration of LGN.

## Outlook and Brexit

In my 2015 statement I mentioned that we did not believe a vote to 'leave' the EU would materially affect Chesnara's business. After the result of the referendum we retain the view that leaving the union will have minimal impact other than any knock-on effect on general economic conditions. Should the decision to leave the European Union result in unexpected changes to regulatory requirements, then our operating model is suitably flexible for Chesnara to potentially adopt an alternative regulatory model where there are benefits for stakeholders.

Over recent years, management has invested significant time and effort in ensuring we comply with Solvency II. As we move on from the development phase, I see increasing potential opportunities for the business from optimising our use of Solvency II capital.

Finally, the outlook is greatly enhanced by the acquisition of LGN; directly, in terms of future cash generation and value growth, and indirectly, in terms of strengthening the foundations for further acquisitions in the Netherlands. I also remain optimistic that as the uncertainty created by matters such as Solvency II and the FCA Legacy Review reduces, the UK acquisition market will become more active. I am confident that with our tried and tested acquisition track record and flexible funding strategy Chesnara is well positioned to take advantage of future opportunities that meet our stringent assessment criteria.

I remain optimistic that Chesnara can continue to deliver against its strategic objectives and provide value to policyholders and shareholders.



Peter Mason  
Chairman  
30 March 2017

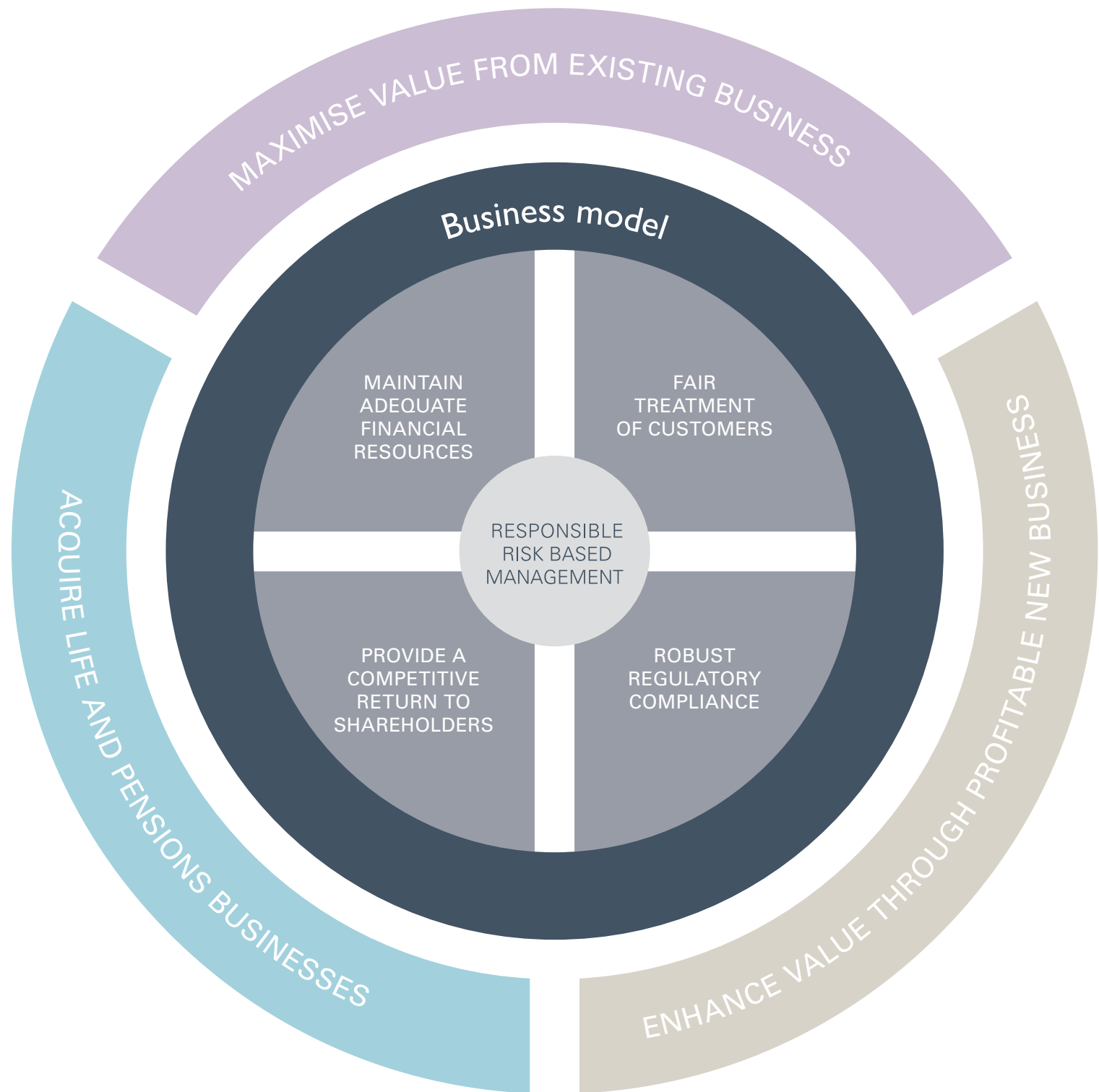
# SECTION B: STRATEGIC REPORT



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# OVERVIEW OF STRATEGY, CULTURE & VALUES AND BUSINESS MODEL

Our strategy focuses on delivering value to policyholders and shareholders. The strategy is delivered through a proven business model underpinned by a robust risk management and governance framework and our established culture & values.



STRATEGIC OBJECTIVES,  
CULTURE & VALUES

OVERVIEW

CULTURE & VALUES

OUR STRONG CULTURE & VALUES UNDERPIN EVERYTHING WE DO.  
PAGES 18-19

BUSINESS MODEL

OUR STRATEGIC OBJECTIVES, CULTURE & VALUES ARE DELIVERED THROUGH OUR PROVEN BUSINESS MODEL, WHICH IS OPERATED ACROSS THREE TERRITORIES.  
PAGE 20

MAXIMISE VALUE FROM EXISTING BUSINESS

MANAGING OUR EXISTING CUSTOMERS FAIRLY AND EFFICIENTLY IS CORE TO DELIVERING OUR OVERALL STRATEGIC AIMS.  
PAGES 20-21

DIVISIONAL UPDATE

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ACQUIRE LIFE AND PENSIONS BUSINESSES

ACQUIRING AND INTEGRATING COMPANIES INTO OUR BUSINESS MODEL IS KEY TO CONTINUING OUR GROWTH JOURNEY.  
PAGES 20-21 AND PAGE 27

STRATEGY

ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

WRITING PROFITABLE NEW BUSINESS SUPPORTS THE GROWTH OF OUR GROUP AND HELPS MITIGATE THE NATURAL RUN-OFF OF OUR BOOK.  
PAGES 20-21

DIVISIONAL UPDATE

SWEDEN  
PAGE 24

# CULTURE & VALUES

Our long established and proven culture & values underpin the delivery of our core strategic objectives. Risk management is at the heart of our robust governance framework. Our values are strongly influenced by the recognition of our responsibility to a range of key stakeholders including policyholders, regulators, employees and our investors.

## CULTURE & VALUES

## WHY IMPORTANT

Responsible risk-based management for the benefit of all of our stakeholders

Maintaining adequate financial resources is at the heart of good business conduct. Effective capital management is a key requirement that underpins our cultural objectives. Further information regarding the group's solvency position is included on pages 28 to 29.

Risk taking is a key part of our business model – taking the 'right risks' and managing them well is essential to our success. We achieve this by understanding the key risk drivers of the business plan and strategy, and by making sure we monitor these risks and take appropriate risk-based decisions in a timely fashion, for the benefit of all of our stakeholders.

Fair treatment of customers

The fair treatment of customers across the group is our primary responsibility. It is also important to the Chesnara business strategy as it promotes stronger relationships with our customers and regulators. When applying the terms of our customer contracts, coupled with the developing guidance from local regulators on the application of policy conditions, we place a high priority on taking account of the treatment of our customers while balancing the interests of our other stakeholders.

Provide a competitive return to our shareholders

As a public company it is imperative that we offer an attractive investment case. Given the majority of our investors hold our shares in 'income funds', it is important that we deliver an attractive and sustainable dividend. We also recognise the benefit of being an investment that offers clarity and consistency of performance.

Robust regulatory compliance

Working constructively with our regulators and complying with regulatory requirements is imperative to the delivery of our objectives. The regulators' desire for robust and responsible governance is very much part of our culture and a principal aim of the Chesnara directors.

## WHAT WE HAVE DONE

- Embedded governance maps across the group.
- Strengthened the CA plc board with some new appointments, including a new CEO and a new non-executive director, independent of Chesnara plc.
- Adopted SII across the group, and started embedding our understanding of the complex capital dynamics of the regime, particularly ensuring the linkage to our risk-based decision making processes.
- Refreshed our capital management policies to ensure they are fully reflective of the Solvency II regime.
- Delivered our inaugural divisional and group Own Risk and Solvency Assessments (ORSAs) to the relevant prudential regulator. The ORSA process is proving to be a powerful internal reporting and analysis process supporting the group in making informed risk-based decisions.
- Applied our risk-based acquisition process with regards to the LGN acquisition.

- Across the group we have delivered a good standard of customer service.
- In the UK our administrative outsource service partners have delivered within stringent service level requirements.
- Service standards in Sweden remain strong as evidenced by external surveys of brokers undertaken by independent organisations.
- Unit-linked policy returns in Movestic remain competitive based on both fund benchmarks and external unit-linked policy performance surveys.
- Where complaints do arise we continue to manage them in accordance with regulatory best practice.
- Across the group we closely monitor any regulatory developments to ensure we continue to treat customers fairly in accordance with regulatory requirements and their contract terms where those terms are deemed to remain fair.

- Announced acquisition of LGN, which is due to complete in 2017, at an approximate 33% discount to EcV.
- Delivered EcV growth across the group.
- Continued our dividend strategy.

- Effective implementation of Solvency II.
- Positive relationship with the DNB built up through the Waard Group acquisition and retained throughout the LGN acquisition process.
- Continued to fully support the work performed by the FCA in relation to its investigation into the disclosure of exit fees in customer correspondence.
- Developed an action plan supporting the delivery of the FCA's final guidance on treating customers fairly, issued in December 2016.

## OUTCOME

- Strengthened controls reducing risk likelihood and impact of adverse outcomes for shareholders and policyholders.
- Increased board awareness of the risk drivers and solvency position.
- More focused and timely board awareness of material risk matters.
- Stronger linkage between risk, capital and strategy.
- More carefully considered risk taking and risk-based decision making.
- More robust governance.
- Positive regulatory relationships.
- Delivered robust risk-based diligence prior to announcing the acquisition of LGN.

- General low level of complaints that have been received across the group has continued.
- In the UK the Financial Ombudsman Service continues to agree with our decision on the majority of complaints referred to them for adjudication.
- Good service standards and customer outcomes in Sweden have supported continued IFA new business levels within our target market share range and reduced levels of transfers out.
- Movestic unit-linked fund average performance of 7.5% exceeds Swedish stock market of 5.8%.
- Fund performance in the UK was above benchmark for all three primary managed funds (see pages 22 to 23 for further detail).

- Dividend track record continues.
- **2.9%** dividend growth.
- Dividend yield of **6.1%** based on the average share price for the year.

- Ongoing constructive relationship with UK, Swedish and Dutch regulators.
- No material breaches of any internal governance policies and principles.
- The ongoing legacy review investigation, coupled with the release of the final guidance for the 'Fair treatment of long-standing customers in the life insurance sector', has created significant work for management and staff. We've reflected these additional requirements in estimates of future servicing costs.

# OUR STRATEGY

## STRATEGIC OBJECTIVE

## WHY THIS MATTERS

## HOW WE DELIVER OUR BUSINESS MODEL

### MAXIMISE VALUE FROM OUR EXISTING BUSINESS

The existing in-force books are the principal source of cash generation and are hence at the heart of the investment case for our shareholders.

In the UK Chesnara adopts an outsourced business model. Governance oversight and corporate management is provided by a highly experienced centralised governance team. This governance team also ensures robust and consistent governance practice across the group, although operational autonomy is devolved to Sweden and the Netherlands to ensure we benefit from our strong divisional management teams. Core operations are not outsourced in Sweden or the Netherlands because it would not suit the open business model or inherited model in those territories respectively.

### ACQUIRE LIFE AND PENSIONS BUSINESSES

Chesnara is primarily a closed-book operation and as such will inevitably lose scale over time. Acquisitions maintain the effectiveness of the operating model. In addition, well considered and appropriately priced acquisitions will create a source of value enhancement and sustain the cash generation potential of the group.

Identify potential deals through an effective network of advisers and industry associates.

We assess deals applying well established criteria which consider the impact on cash generation and Economic Value under best estimate and stressed scenarios.

We work cooperatively with regulators.

The financial benefits are viewed in the context of the impact the deal will have on the enlarged group's risk profile.

Transaction risk is minimised through stringent risk-based due diligence procedures and the senior management team's acquisition experience and track record.

We fund deals with debt, equity or cash depending on the size and cash flows of each deal.

### ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

Whilst new business profits are a relatively modest component of the Chesnara financial model, they are an important and welcome regular source of value growth which supplements growth delivered from our periodic acquisitions.

Currently new business activity is only carried out in Sweden, where we primarily focus on unit-linked pensions and savings. We distribute through IFAs and target a realistic share of our target market of between 10-15%. To achieve higher volumes would require a pricing strategy that may compromise the keen focus on ensuring the business we write is profitable.








## HOW WE MEASURE DELIVERY

## RISKS:

### WHAT CAN STOP US MEETING THIS OBJECTIVE

### WHAT CAN WE DO ABOUT THIS

## UPDATE

 Cash generation	<p>We measure cash generated by the closed books, which is defined as the movement in the surplus of capital resources over capital requirements set by the board. As such cash can be generated by either profits arising in the period or a reduction in capital requirements.</p>	<ul style="list-style-type: none"> <li>– Adverse investment market conditions can result in lower assets under management and hence lower fee income for unit-linked business. For products with guarantees, this can increase the cost of fulfilling the guarantees.</li> <li>– Increased lapses on cash generative/value enhancing products. Loss of key brokers can result in increases in the level of transfers-out.</li> <li>– Regulatory change can potentially impact the cash flows arising from the existing business.</li> <li>– Expenditure levels could exceed those assumed.</li> <li>– Foreign currency fluctuations can impact the sterling value emerging from overseas operations.</li> </ul>	<ul style="list-style-type: none"> <li>– Active investment management with the aim of delivering competitive policyholder investment returns.</li> <li>– Outsourcer service levels that ensure strong customer service standards.</li> <li>– Customer retention processes.</li> <li>– Expense assumptions are deemed to be realistic and the cost base is well controlled, predictable and within direct management influence.</li> <li>– Close monitoring of persistency levels and strong customer service standards help manage lapse rates and ensure customers do not unknowingly exit when it is not in their interest to do so.</li> </ul>	<p>UK: Pages 22-23</p>
 Value optimisation	<p>Value is measured by reference to the movement in Economic Value.</p>	<ul style="list-style-type: none"> <li>– Regulatory change can potentially impact the cash flows arising from the existing business.</li> <li>– Expenditure levels could exceed those assumed.</li> <li>– Foreign currency fluctuations can impact the sterling value emerging from overseas operations.</li> </ul>	<ul style="list-style-type: none"> <li>– Close monitoring of persistency levels and strong customer service standards help manage lapse rates and ensure customers do not unknowingly exit when it is not in their interest to do so.</li> </ul>	<p>Sweden: Pages 24-25</p>
 Customer outcomes	<p>This is measured through monitoring:</p> <ul style="list-style-type: none"> <li>– customer service metrics;</li> <li>– policyholder fund performance against industry and market expectations;</li> <li>– customer complaint levels; and</li> <li>– our compliance with regards to regulatory conduct matters.</li> </ul>	<ul style="list-style-type: none"> <li>– Regulatory change can potentially impact the cash flows arising from the existing business.</li> <li>– Expenditure levels could exceed those assumed.</li> <li>– Foreign currency fluctuations can impact the sterling value emerging from overseas operations.</li> </ul>	<ul style="list-style-type: none"> <li>– Close monitoring of persistency levels and strong customer service standards help manage lapse rates and ensure customers do not unknowingly exit when it is not in their interest to do so.</li> </ul>	<p>Netherlands: Page 26</p>
 Cash generation	<p>Collectively our future acquisitions must be suitably cash generative to continue to fund the Chesnara dividend strategy.</p>	<ul style="list-style-type: none"> <li>– There is the risk that if a lack of suitable acquisition opportunities come to market at a realistic valuation, the investment case for Chesnara diminishes over time.</li> <li>– There is the risk that we make an inappropriate acquisition that adversely impacts the financial strength of the group.</li> <li>– As our acquisition strategy currently places greater focus on non-UK markets we become increasingly exposed to currency risk.</li> </ul>	<ul style="list-style-type: none"> <li>– Operating in three territories increases our options thereby reducing the risk that no further value adding deals are done.</li> <li>– A broader target market also reduces the risk of inappropriate opportunities being progressed.</li> <li>– Flexibility over the timing of subsequent capital extractions and dividend flows provide an element of management control over the sterling value of cash inflows.</li> <li>– We have enhanced our financial deal assessment modelling which improves the quality of financial information available to management and the board, mitigating the risk of a bad deal being pursued.</li> </ul>	<p>Page 27</p>
 Value enhancement	<p>Acquisitions are required to have a positive impact on the Economic Value per share under best estimate and certain more adverse scenarios.</p>	<ul style="list-style-type: none"> <li>– As our acquisition strategy currently places greater focus on non-UK markets we become increasingly exposed to currency risk.</li> </ul>	<ul style="list-style-type: none"> <li>– Operating in three territories increases our options thereby reducing the risk that no further value adding deals are done.</li> <li>– A broader target market also reduces the risk of inappropriate opportunities being progressed.</li> <li>– Flexibility over the timing of subsequent capital extractions and dividend flows provide an element of management control over the sterling value of cash inflows.</li> <li>– We have enhanced our financial deal assessment modelling which improves the quality of financial information available to management and the board, mitigating the risk of a bad deal being pursued.</li> </ul>	<p>Page 27</p>
 Customer outcomes	<p>Acquisitions must ensure we protect, or ideally enhance, customer interests.</p>	<ul style="list-style-type: none"> <li>– As our acquisition strategy currently places greater focus on non-UK markets we become increasingly exposed to currency risk.</li> </ul>	<ul style="list-style-type: none"> <li>– Operating in three territories increases our options thereby reducing the risk that no further value adding deals are done.</li> <li>– A broader target market also reduces the risk of inappropriate opportunities being progressed.</li> <li>– Flexibility over the timing of subsequent capital extractions and dividend flows provide an element of management control over the sterling value of cash inflows.</li> <li>– We have enhanced our financial deal assessment modelling which improves the quality of financial information available to management and the board, mitigating the risk of a bad deal being pursued.</li> </ul>	<p>Page 27</p>
 Risk appetite	<p>Acquisition should normally align with the group's documented risk appetite. If a deal is deemed to sit outside our risk appetite the financial returns must be suitably compelling.</p>	<ul style="list-style-type: none"> <li>– As our acquisition strategy currently places greater focus on non-UK markets we become increasingly exposed to currency risk.</li> </ul>	<ul style="list-style-type: none"> <li>– Operating in three territories increases our options thereby reducing the risk that no further value adding deals are done.</li> <li>– A broader target market also reduces the risk of inappropriate opportunities being progressed.</li> <li>– Flexibility over the timing of subsequent capital extractions and dividend flows provide an element of management control over the sterling value of cash inflows.</li> <li>– We have enhanced our financial deal assessment modelling which improves the quality of financial information available to management and the board, mitigating the risk of a bad deal being pursued.</li> </ul>	<p>Page 27</p>
 Value enhancement	<p>We measure the amount of Economic Value added through the writing of new contracts. The value added takes full account of all costs incurred so as to ensure the profit represents true incremental value.</p>	<ul style="list-style-type: none"> <li>– The attractiveness of products can be influenced by economic conditions especially as some traditional products offer guaranteed returns in uncertain times.</li> <li>– New business volumes are sensitive to the quality of service to the IFA and the end customer.</li> <li>– New business remains relatively concentrated towards several large IFAs.</li> <li>– The competitive market puts pressure on new sales margins.</li> </ul>	<ul style="list-style-type: none"> <li>– Continue to extend the breadth of IFA support.</li> <li>– Ensure high quality of service to existing IFA network.</li> <li>– Focus on other margin drivers beyond product pricing, for example the fund management operation.</li> </ul>	<p>Sweden: Pages 24-25</p>

The UK division manages 323,000 policies and is in run-off. The division follows an outsourcer-based operating model, with functions such as customer services, investment management and accounting and actuarial services being outsourced. A central governance team is responsible for managing all outsourced operations.

MAXIMISE VALUE FROM EXISTING BUSINESS

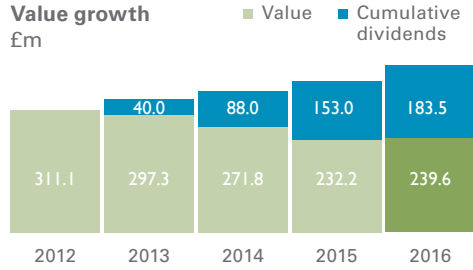
	BACKGROUND	INITIATIVES & PROGRESS IN 2016
<b>CAPITAL &amp; VALUE MANAGEMENT</b>	<ul style="list-style-type: none"> <li>– As a closed book the division creates value through managing the following key value drivers: costs, policy attrition, investment growth and reinsurance strategy.</li> <li>– In general surplus regulatory capital emerges as the book runs off. Following the implementation of Solvency II, the surplus capital available is more closely linked with the level of risk that the division is exposed to. Management’s risk-based decision making process seeks to continually manage and monitor the balance of making value enhancing decisions whilst maintaining a risk profile in line with the board’s risk appetite.</li> <li>– At the heart of delivering our strategy is ensuring that the division is governed well from a regulatory and customer perspective.</li> <li>– The valuation and capital position of the division is strongly influenced by investment market factors, particularly equity markets and longer-term bond yields.</li> </ul>	<ul style="list-style-type: none"> <li>– Positive performance in equity markets contributes to growth in value of the UK division.</li> <li>– Falling bond yields have put downward pressure on value in the year.</li> <li>– During 2016 we implemented the recommendations from our strategic asset review of the assets backing the S&amp;P with-profit funds, improving the position of the funds.</li> <li>– Our outsourcers and investment managers have delivered in line with plans and budgets.</li> <li>– Cash of £21.3m has been generated by the division.</li> <li>– The overall Economic Value of the division, before the impact of dividend distributions, has increased by £38m during the year.</li> <li>– Positive mortality and morbidity experience.</li> </ul>
<b>CUSTOMER OUTCOMES</b>	<ul style="list-style-type: none"> <li>– Treating customers fairly is our primary responsibility. We seek to do this by having effective customer service operations together with competitive fund performance whilst giving full regard to all regulatory matters. This supports our aim to ensure policyholders receive good returns, appropriate communication, and service in line with policy expectations.</li> <li>– In December 2016 the FCA issued final guidelines entitled ‘FG 16/8 Fair treatment of long-standing customers in the life insurance sector’. The guidance provides more detail supporting how firms should treat customers to ensure fair outcomes.</li> </ul>	<ul style="list-style-type: none"> <li>– During March 2016 the FCA announced an investigation into the level of disclosure of exit charges to customers. Full support has been provided to the FCA during the year. The investigation is ongoing.</li> <li>– An action plan has been created to ensure compliance with the draft and final guidelines of FG 16/8 that were issued by the FCA during the year. Good progress made to date.</li> <li>– Establishment of customer committee to further embed customer focus.</li> <li>– Enhancements to our product review framework to support ongoing assessment that products remain fit for purpose.</li> <li>– Preparations for implementation of the 1% exit fee cap on all pension products where the policyholder is over 55. The financial impact of this fee cap amounts to approximately £3.5m and has been fully reflected in the 2016 financial results.</li> <li>– Delivered policyholder returns in three main managed funds in excess of benchmark, representing a significant proportion of the assets under management.</li> </ul>
<b>GOVERNANCE</b>	<ul style="list-style-type: none"> <li>– Maintaining effective governance and a constructive relationship with regulators underpins the delivery of the division’s strategic plans.</li> <li>– Ensuring that appropriate time and resources are dedicated to delivering robust governance processes provides management with a platform to deliver the other aspects of the business strategy. As a result a significant proportion of management’s time and attention continues to be focused on ensuring that both the existing governance processes, coupled with future developments, are delivered.</li> </ul>	<ul style="list-style-type: none"> <li>– A number of new appointments have been made to strengthen the CA board during the year as part of delivering a more divisionalised group structure, including the appointment of a new CEO and a new non-executive director, independent of the Chesnara board.</li> <li>– Successful transition to new Solvency II capital management and reporting regime.</li> <li>– Continued embedding of risk management framework, including full implementation of governance.</li> <li>– Solid delivery of outsourced services.</li> </ul>



During the year the UK division has focused on designing and implementing its customer strategy to reflect recent regulatory requirements, something that will continue into 2017. From a results perspective, cash has been generated broadly in line with plans and value continues to emerge, despite falling bond yields in the year.

**PRIORITIES IN 2017**      **KPIs UP TO 2016**

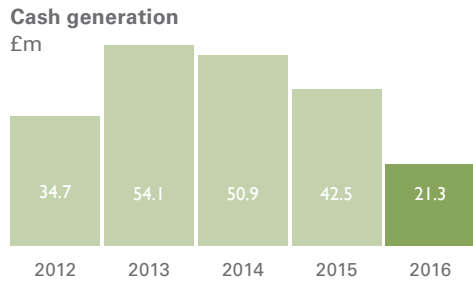
- Gain a deeper understanding of the Solvency II balance sheet to ensure that the financial consequences of strategic decisions are appropriately considered. This will be delivered through establishing and embedding a Capital Optimisation Advisory Group, a sub-committee of the division's executive committee, which will be tasked with identifying and prioritising the management actions to be delivered.
- Continued focus on managing the cost base.



2012-15: EEV/2016: EcV

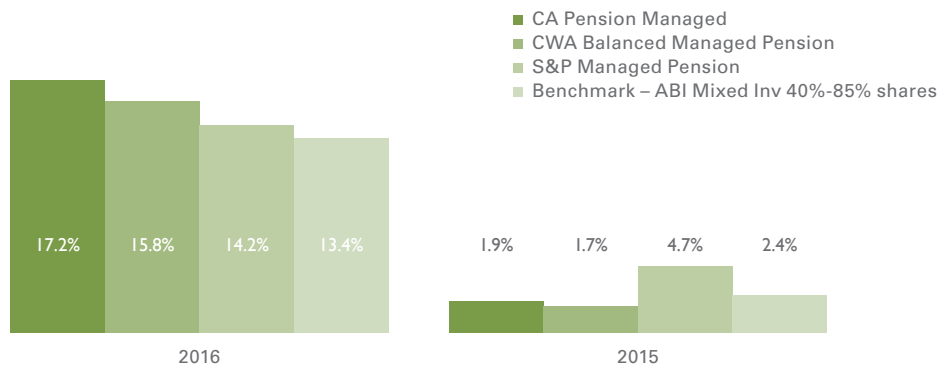
**A steady growth in value, before the impact of dividends.**

Cash generation for 2016 is below that of prior years. Cash generation is a function of movements in both own funds and required capital. Under Solvency II, in rising equity markets the capital requirement tends to increase, thereby reducing short-term cash. The opposite dynamic exists in falling equity markets. See pages 28 and 29 for further insights on Solvency II.



- Deliver the division's new customer strategy framework. This includes:
  - Delivery of our action plan as communicated to the FCA.
  - Embedding our newly created customer committee.
  - Delivery of enhanced product review framework.
- Continue to support the FCA's investigation work into how exit and surrender charges have been disclosed to customers.
- Implement 1% exit fee cap on all pension products where the policyholder is over 55.

**Policyholder fund performance:**



- Continue to embed and develop the risk management framework.
- Ensure compliance with SII regime, notably the inaugural publication of the Solvency and Financial Condition Report and the submission of the Regular Supervisory Report to our regulator.
- Remain abreast of financial reporting developments, particularly the new accounting standard for insurance contracts, 'IFRS 17 insurance contracts'.

**Divisional solvency ratio:**  
**2016: 151%\***  
**2015: 135%**

\*stated before the impact of the proposed year end 2016 dividend of £30.0m, the fulfilment of which remains subject to completion of a 'no objection' process with the PRA. After this proposed dividend our closing 2016 solvency ratio is 128%.

Movestic is currently the only part of the Chesnara group which delivers against the core objective ‘Enhance value through profitable new business’. From its Stockholm base, Movestic operates as a challenger brand in the Swedish life insurance market. It offers transparent unit-linked pension and savings solutions through Independent Financial Advisors. Movestic is currently one of the most selected providers of advised occupational pension plans within the fund insurance segment in Sweden.

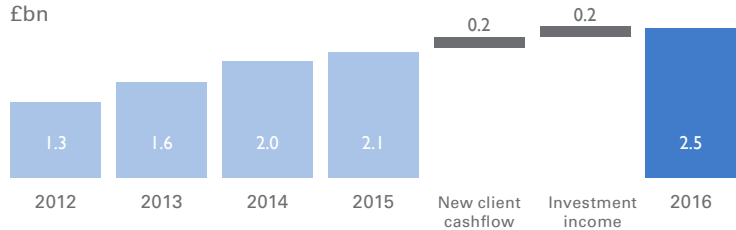
	BACKGROUND	INITIATIVES & PROGRESS IN 2016	
MAXIMISE VALUE FROM EXISTING BUSINESS	<b>CAPITAL AND VALUE MANAGEMENT</b>	<ul style="list-style-type: none"> <li>– Movestic creates value predominantly by generating growth in the unit-linked assets under management and by optimising the income that the assets generate, without compromising the fees incurred by policyholders. AuM growth is dependent upon positive client cash flows and positive investment performance. Capital surplus is a factor of both the value and capital requirements and hence surplus can also be optimised by effective management of capital requirements.</li> </ul>	<ul style="list-style-type: none"> <li>– Favourable equity market performance predominantly drives AuM growth (14.5%) and EcV growth (20%).</li> <li>– Significant improvements in policyholder cash flows as a result of reductions in lapse levels and an increase in new business.</li> <li>– Increase to the solvency capital requirement (SCR), largely due to the impact of the positive growth in value, has resulted in Solvency II surplus remaining broadly unchanged during the year.</li> <li>– Optimising fee income by developing SICAV, white label funds and Movestic funds.</li> <li>– Inaugural dividend declared of 30mSEK.</li> </ul>
	<b>CUSTOMER OUTCOMES</b>	<ul style="list-style-type: none"> <li>– Movestic places great importance on providing quality service to both customers and IFAs, with simple, clear unit-linked products, supported by an attractive and broad investment fund range. The aim of Movestic is to offer policyholders the best funds and management services on the market. Year after year, customers have enjoyed good returns on their savings. This means that they can offer a real chance of a better future when the time comes for their customers’ retirement.</li> </ul>	<ul style="list-style-type: none"> <li>– Fund range development including improved sustainability rating.</li> <li>– Competitive unit-linked fund returns.</li> <li>– Reduced lapse rates.</li> <li>– Operational and fund performance improvements result in improved IFA assessment ratings.</li> </ul>
	<b>GOVERNANCE</b>	<ul style="list-style-type: none"> <li>– Movestic operates to exacting regulatory standards and adopts a robust approach to risk management.</li> </ul>	<ul style="list-style-type: none"> <li>– Full compliance with Solvency II reporting requirements.</li> <li>– Deepened understanding and analysis of Solvency II dynamics.</li> <li>– Enhancement of Governance and Risk Management framework, including ORSA and risk reporting.</li> <li>– CEO announced his intention to retire during 2017 and replacement appointed.</li> </ul>
ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS	<b>PROFITABLE NEW BUSINESS</b>	<ul style="list-style-type: none"> <li>– As an ‘open’ business, Movestic not only adds value from sales but as it gains scale, will become increasingly cash generative which will fund further growth or contribute towards the group’s dividend strategy. Movestic has a clear sales focus and targets a market share of 10 -15% of the advised occupational pension market. This focus ensures we are able to adopt a profitable pricing strategy.</li> </ul>	<ul style="list-style-type: none"> <li>– Record new business profits of £11.7m.</li> <li>– Successful pricing strategy attracts increased levels of high value and higher margin transfer business.</li> <li>– Market shares within target range.</li> <li>– Increases in average gross margins.</li> </ul>

2016 has been a positive year for Movestic. Improved fund ranges and investment performance, quality servicing and a smart pricing strategy for new transfer business have resulted in record levels of new business profit. This new business profit together with a marked reduction in lapse rates and a positive investment return has created a significant increase in AuM with a corresponding 20% increase in Economic Value. The growth in value has contributed to an increase in capital requirements and hence the absolute capital surplus remains broadly unchanged during the year.

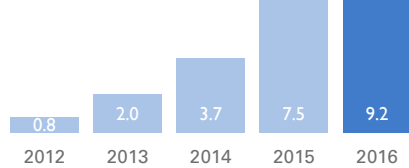
**PRIORITIES IN 2017**      **KPIs**

- Continue to generate positive client cash flows by:
  - maintaining lapse levels at 2016 levels.
  - strategic pricing to maintain transfers-in to 2016 levels or above.
- Identify management actions to optimise the capital requirement.
- Provide a sustainable and predictable dividend to Chesnara plc.

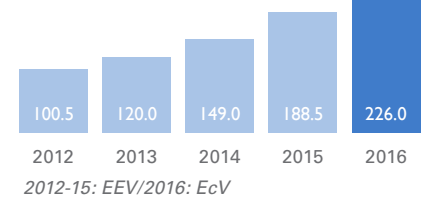
**Growth in assets under management: £bn**



**IFRS profit £m**

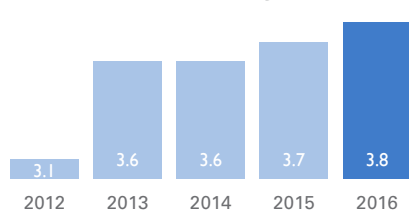


**Value growth £m**



- Fund range development in line with customer and market requirements.
- Deliver competitive unit-linked fund returns.
- Consolidate the recent operational and fund performance improvements to maintain IFA assessment ratings.

**Broker assessment rating (out of 5)**



**2016 policyholder average investment return:**  
**7.5%**  
 (Swedish stock market 5.8%)

- Manage a smooth transition to the new CEO.
- Produce Solvency II annual and narrative reports.

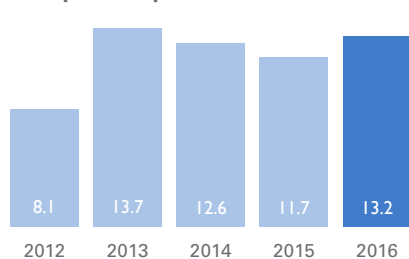
**Divisional solvency ratio**

**2016: 142%\*    2015: 155%**

\*stated before the impact of the proposed year end 2016 dividend of £2.7m. After this proposed dividend closing 2016 the solvency ratio is 140%.

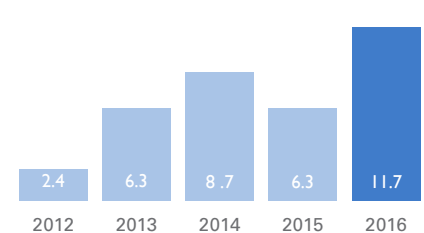
- Continue to write new business with a market share around 15% without any reductions in gross margins thereby delivering total profits at a similar level to 2016.
- Continue to target higher margin transfer business.

**Occupational pension market share %**



All comparatives have been presented at 2016 exchange rates.

**New business profit £m**



2012-15: EEV/2016: EcV

The Waard Group was acquired by Chesnara in May 2015. The group manages life and income protection run-off portfolios and serves as a hub to implement Chesnara's acquisition strategy for the Netherlands.

2016 was a year in which the businesses developed rapidly on many fronts, both externally, through targeting the acquisition market, and internally through the embedding in to the Chesnara group, and implementing Solvency II.

MAXIMISE VALUE FROM EXISTING BUSINESS

		INSIGHT
CAPITAL AND VALUE MANAGEMENT	BACKGROUND	<ul style="list-style-type: none"> <li>– Waard Group's capital and value management aims to make capital available for the Chesnara group for it to successfully pursue its acquisition strategy in the Netherlands and to provide a predictable dividend stream.</li> <li>– The businesses of Waard are in run-off and cash is released as the capital requirements of the business reduce in line with the attrition of the book. By aiming for capital efficient transactions, such as in-asset allocation and reinsurance programmes, capital releases can be accelerated for the benefit of the parent company, without impairing the solvency position of the business.</li> </ul>
	2016 UPDATE	<ul style="list-style-type: none"> <li>– Obtained further reductions in capital requirements, by implementing revised reinsurances and restructuring the asset portfolio (diversification, reduced concentration).</li> <li>– Accelerated growth of surplus by investment in a portfolio of mortgage loans, generating higher returns with lower risk as compared with the assets held previously.</li> </ul>
	2017 PRIORITIES	<ul style="list-style-type: none"> <li>– Continue to generate cash flows and release capital by:                             <ul style="list-style-type: none"> <li>• integrating the business of Waard Leven and Hollands Welvaren Leven (merge into one risk carrier).</li> <li>• fine-tune asset allocation to improve the balance of returns generated from capital held versus solvency capital requirements (SCR).</li> <li>• insource certain activities to reduce cost.</li> <li>• cooperating with our new sister business in the Netherlands.</li> </ul> </li> <li>– During 2017 the business will continue to seek opportunities to acquire portfolios or entities in the life insurance sector.</li> </ul>
CUSTOMER OUTCOMES	BACKGROUND	<ul style="list-style-type: none"> <li>– Waard Group places great importance on providing high quality service to its existing customers, whilst also maintaining a platform that exceeds the needs of its current portfolio, in anticipation of further acquisitions in the Netherlands.</li> </ul>
	2016 UPDATE	<ul style="list-style-type: none"> <li>– Completed the AFM's (national conduct regulator) programme to pro-actively communicate with all unit-linked policyholders on the appropriateness of the insurance product that they originally purchased.</li> <li>– Continued investment in customer friendly tools, such as the re-design of the website and the roll out of the digital policy and transaction platform to a wider customer base, whilst also expanding it to provide further information and services.</li> </ul>
	2017 PRIORITIES	<ul style="list-style-type: none"> <li>– Review potential additions to the existing platform infrastructure in respect of supplementary products for life insurance portfolios.</li> </ul>
GOVERNANCE	BACKGROUND	<ul style="list-style-type: none"> <li>– Waard Group operates in a regulated environment and aims to comply with the rules and regulations both from a prudential and from a financial conduct point of view.</li> </ul>
	2016 UPDATE	<ul style="list-style-type: none"> <li>– During 2016 Solvency II reporting has been embedded and successfully delivered, both for quantitative and qualitative requirements.</li> <li>– Aligning the governance and risk management framework to Chesnara practices, including ORSA, RSR, SFCR and risk reporting.</li> <li>– Year end 2016 divisional solvency ratio of 712% (31 December 2015: 597%).</li> </ul>
	2017 PRIORITIES	<ul style="list-style-type: none"> <li>– Successfully complete first full cycle of Solvency II related reporting.</li> </ul>

# ACQUIRE LIFE & PENSIONS BUSINESSES

We announced the acquisition of Legal & General Nederland for cash consideration of €160m in November which, at the time of writing, is nearing completion. The acquisition is very much in line with our strategy and confirms our belief that the acquisition of the Waard Group in the Netherlands in 2015 would bring further market consolidation opportunities. The deal not only provides immediate financial benefits (which, other than the equity raise, are not included in our 2016 results) but creates sufficient scale and presence to progress further value adding deals in the Dutch market.

**Highlights of LGN acquisition:**

- Purchase price of €160m
- 33% discount to Economic Value
- Potential for phased, orderly extraction of excess capital
- Attractive risk profile well aligned to our existing risk appetite

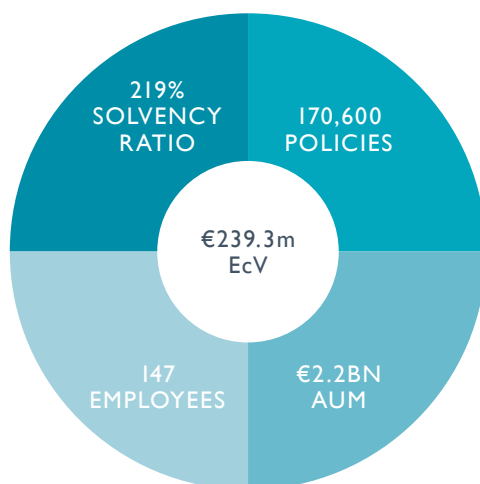
## Acquisition of Legal & General Nederland

On 24 November 2016 we announced the acquisition of Legal & General Nederland, which was subject to regulatory approval. We expect to complete the transaction shortly.

### Overview of Legal & General Nederland

Legal & General Nederland is a long established, award winning specialist insurer in the Netherlands. It has approximately 170,000 policies, predominantly individual protection and savings contracts and operates on a stand alone basis with few direct links to its existing parent company. It is open to new business and sells protection, individual savings and group pensions contracts via an IFA-led distribution model.

Figures in chart are stated as at 30 June 2016



### Deal structure and funding

The deal is financed through an efficient funding model which includes £70m of equity, c£52m of incremental debt and c£23m of Chesnara’s own cash.

### The investment case

**CASH GENERATION**

- Significant cash generation is expected from the business.
- Material excess capital above the SCR despite conservative capital requirement model based on the standard formula and with no transitional measures.

**VALUE ENHANCEMENT**

- 33% discount to Economic Value.
- c£56m increase in Economic Value (excluding equity raise) expected on completion.

**CUSTOMER OUTCOMES**

- Chesnara’s focus on good business governance means we represent a ‘safe hands to safe hands’ transfer.
- Continuity of the investment and operating model will ensure existing high quality customer outcomes are not compromised.

**RISK APPETITE**

- A thorough due diligence process identified that the risks associated with the Legal & General Nederland business align with the appetite of the Chesnara group.

## Acquisition outlook

Chesnara is an established life and pensions consolidator with a proven track record. This, together with a good network of contacts in the adviser community, who understand the Chesnara acquisition model and are mindful of our track record and good reputation with our regulators, ensures we are aware of most viable opportunities in the UK and Western Europe.

There has recently been a gradual increase in closed-book market activity in the UK, driven in part by reduced uncertainty regarding Solvency II and regulatory developments. We believe the factors which will drive further consolidation persist, namely larger financial organisations wishing to re-focus on core activities and the desire to release capital or generate funds from potentially capital intensive life and pension businesses.

The acquisition of Legal & General Nederland creates scale and presence in the Dutch market and we are well positioned to take advantage of any further value adding opportunities that may arise.

Our financial foundations are strong and we continue to have strong support from shareholders and lending institutions to progress our acquisition strategy. In addition our operating model which consists of well established outsourcing arrangements plus efficient, modern in house solutions, means we have the flexibility to accommodate a wide range of potential target books. With all this in mind, we are confident that we are well positioned to continue the successful acquisition track record in the future.

# CAPITAL MANAGEMENT – SOLVENCY II

## WHAT IS SOLVENCY AND CAPITAL SURPLUS?

- Solvency is a measure of how much the value of the company exceeds the level of capital it is required to hold.
- The value of the company is referred to as its own funds (OF) and this is measured in accordance with the rules of the newly adopted Solvency II regime.
- The capital requirement is again defined by Solvency II rules and the primary requirement is referred to as the Solvency Capital Requirement (SCR).
- Solvency is expressed as either a ratio: OF/SCR % or as an absolute surplus OF less SCR

SOLVENCY SURPLUS → CASH GENERATION

Subject to ensuring other constraints are managed, surplus capital is a useful proxy measure for liquid resources available to fund matters such as dividends, acquisitions or business investment. As such Chesnara defines cash generation as the movement in surplus, above management buffers, during the period.

## MORE ABOUT OWN FUNDS

### What are own funds?

A valuation which reflects the net assets of the company and includes a value for future profits expected to arise from in-force policies.

**The own fund valuation is deemed to represent a commercially meaningful figure with the exception of:**

**Contract boundaries:** Solvency II rules do not allow for the recognition of future cash flows on certain policies despite a high probability of receipt.

**Risk margin:** The Solvency II rules require a 'risk margin' liability which is deemed to be above the realistic cost.

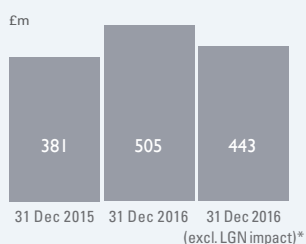
We define Economic Value (EcV) as being the own funds adjusted for the items above. As such our own funds and EcV have many common characteristics and tend to be impacted by the same factors.

Transitional measures are available to temporarily increase own funds. To ensure clarity of the ultimate solvency position Chesnara does not take advantage of such measures.

### How do own funds change?

Own funds (and Economic Value) are sensitive to economic conditions. In general, positive equity markets and increasing yields lead to OF growth and vice versa. Other factors that improve own funds include writing profitable new business, reducing the expense base and improvements to lapse rates.

## CHESNARA GROUP OWN FUNDS



	Group solvency ratio	Group solvency surplus
31 Dec 2016	158%	£184.7m
31 Dec 2016 (excl. LGN impact*)	144%	£134.7m
31 Dec 2015	146%	£120.5m

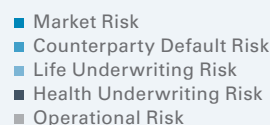
\*Excluding impact of equity raise and acquisition costs for LGN acquisition.

## MORE ABOUT THE CAPITAL REQUIREMENT

### What is capital requirement?

The solvency capital requirement can be calculated using a 'standard formula' or 'internal model'. Chesnara adopts the 'standard formula'.

The standard formula requires capital to be held against a range of risk categories. The following chart shows the categories and their relative weighting for Chesnara:



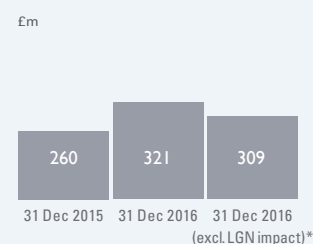
### There are three levels of capital requirement:

<b>Min dividend paying requirement</b>	The board sets a solvency level above the SCR which creates a more prudent level applied when making dividend decisions.
<b>Solvency capital requirement</b>	Amount of capital required to withstand a 1 in 200 year event. The SCR acts as an intervention point for supervisory action including cancellation or the deferral of distributions to investors.
<b>Min capital requirement</b>	The MCR is between 45% and 25% of the SCR. At this point Chesnara would need to submit a recovery plan which if not effective within 3 months may result in authorisation being withdrawn.

### How does the SCR change?

Given the largest component of Chesnara's SCR is market risk, changes in investment mix or changes in the overall value of our assets has the greatest impact on the SCR. For example, equity assets require more capital than low risk bonds. Also, positive investment growth in general creates an increase in SCR. Book run-off will tend to reduce SCR but new business will result in an increase.

## CHESNARA GROUP SCR



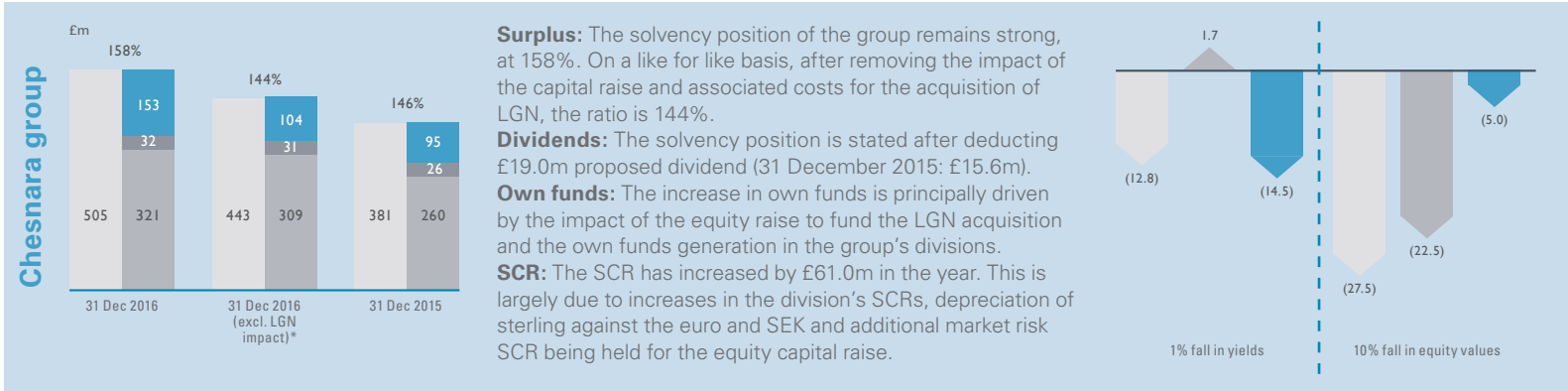
Managing the group and subsidiaries' capital positions appropriately is a critical part of ensuring we remain true to the group's culture & values.

We are well capitalised at both a group and subsidiary level, and we have not used any elements of the long-term guarantee package.

**Solvency position**

**Analysis**

**Sensitivities**

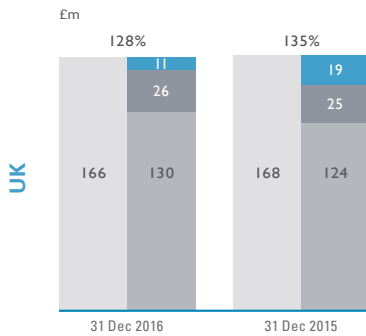


**Surplus:** The solvency position of the group remains strong, at 158%. On a like for like basis, after removing the impact of the capital raise and associated costs for the acquisition of LGN, the ratio is 144%.

**Dividends:** The solvency position is stated after deducting £19.0m proposed dividend (31 December 2015: £15.6m).

**Own funds:** The increase in own funds is principally driven by the impact of the equity raise to fund the LGN acquisition and the own funds generation in the group's divisions.

**SCR:** The SCR has increased by £61.0m in the year. This is largely due to increases in the division's SCRs, depreciation of sterling against the euro and SEK and additional market risk SCR being held for the equity capital raise.

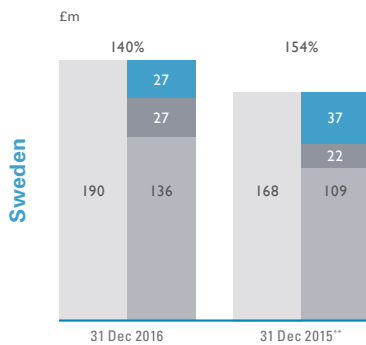
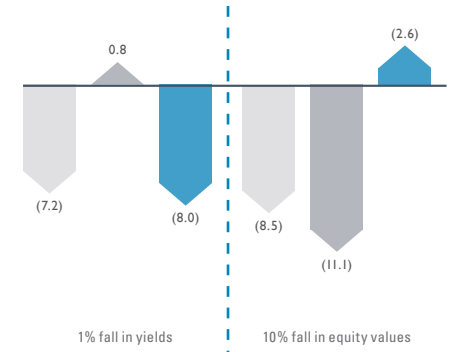


**Surplus:** £11m above the board's capital management policy.

**Dividends:** The solvency position is stated after deducting £30.0m proposed dividend (31 December 2015: £30.5m). The dividend remains subject to completion of a 'no objection' process with the PRA.

**Own funds:** Positive growth, before dividends, of £28m, driven by positive equity markets and positive experience variance, predominantly mortality and morbidity.

**SCR:** Slight increase in year driven largely by higher market risk capital being held largely due to equity growth and spread risk due to investment portfolio changes.

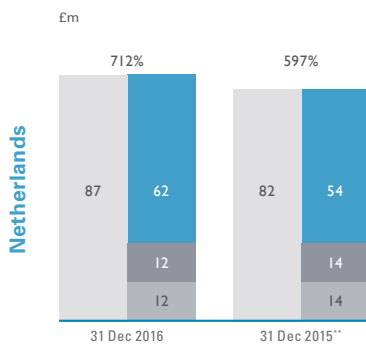
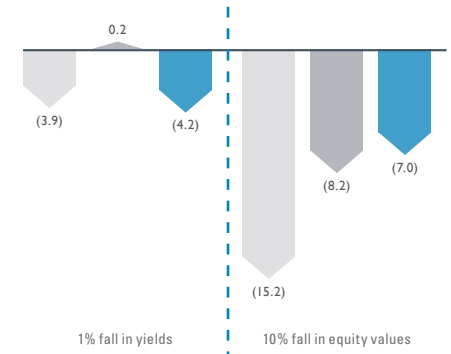


**Surplus:** £27m above the board's capital management policy.

**Dividends:** The solvency position is stated after deducting £2.7m proposed dividend (31 December 2015: £nil).

**Own funds:** Growth largely driven by positive economic experience due to positive equity markets coupled with positive operating experience on in-force policies.

**SCR:** Increase is largely due to increased market risk capital being held due to equity growth in year and higher currency stress. In addition, refined modelling for capital required for mass lapse risk has resulted in a c£5.0m increase in the SCR.

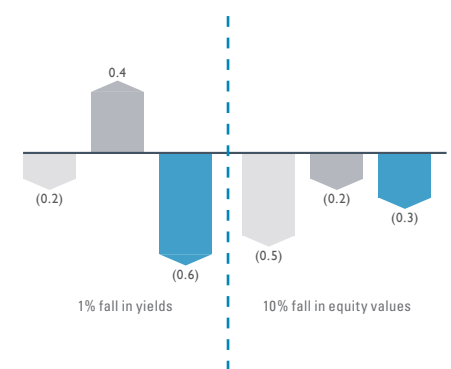


**Surplus:** £62m above the board's capital management policy.

**Dividends:** No dividends are planned to be paid out of the Dutch division (31 December 2015: £nil). However, a dividend of c£31m is planned to be paid by the insurance companies within the division to the Dutch holding company to part-fund the acquisition of LGN.

**Own funds:** Increase driven by positive impact of lapse assumption changes and economic experience due to yield curve reductions, off-set by the negative impact of updating expense modelling assumptions.

**SCR:** Overall reduction over the year. Movement includes an increase in SCR due to the investment in a mortgage portfolio, offset by SCR reductions arising from the sale of two CDO assets and a 'life insurance risk' SCR reduction as a result of a new reinsurance treaty.



\*Excluding impact of equity raised for LGN acquisition and associated costs  
 \*\*Restated using 31 Dec 2016 exchange rates

Own Funds (post Div)    SCR    Buffer    Surplus

The graphs on this page present a divisional view of the solvency position which may differ to the position of the individual insurance company(ies) within that division.



# FINANCIAL REVIEW

The key performance indicators below are a reflection of how we have performed in delivering our three strategic objectives and our core culture and values. 2016 has seen cash generation, before the impact of the LGN acquisition, which exceeds the full year dividend, IFRS profits in line with last year and robust EcV earnings, resulting in a closing EcV of £602.6m.

These two pages provide a 'snapshot' of our key financial measures and some insight into what's driving the outcome in 2016. Further analysis can be found on pages 32 to 35.

	IFRS PRE-TAX PROFIT	IFRS TOTAL COMPREHENSIVE INCOME:	Further detail on page 32
	£40.7M 2015: £42.8M	£55.4M 2015: £39.6M	

## What is it?

The presentation of the results in accordance with International Financial Reporting Standards (IFRS) aims to recognise the profit arising from the longer-term insurance and investment contracts over the life of the policy.

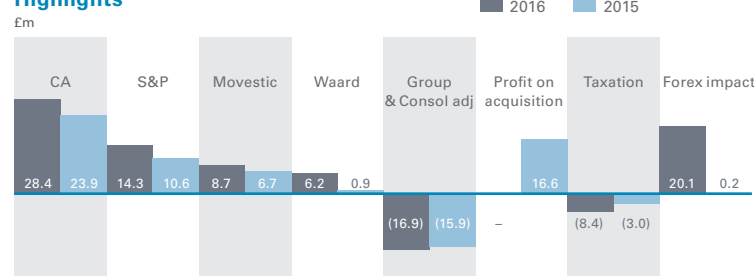
## Why is it important?

IFRS profit is an indicator of the value that has been generated within the long-term insurance funds of the divisions within the group, and is a key measure used both internally and by our external stakeholders in assessing the performance of the business. IFRS profit is an indicator of how we are performing against our stated strategic objective of 'maximising value from the existing business' and can also be impacted by one-off gains arising from delivering against our stated objective of 'acquiring life and pensions businesses'.

## Risks

The IFRS profit can be affected by a number of our principal risks and uncertainties as set out on pages 39 to 41. In particular, volatility in equity markets and bond yields can result in volatility in the IFRS pre-tax profit, and foreign currency fluctuations can affect total comprehensive income.

## Highlights



- Strong pre-tax results across all segments.
- IFRS pre-tax profit of £40.7m broadly in line with prior year. The prior year result included a one-off gain of £16.6m relating to the acquisition of the Waard Group and therefore the underlying result has improved by 53%.
- All segments have delivered results ahead of 2015, supported by positive equity markets during the year.
- Total comprehensive income includes a large foreign exchange gain of £20.1m (2015: £0.2m loss) relating to sterling's depreciation against both the euro and Swedish krona.

	GROUP CASH GENERATION	DIVISIONAL CASH GENERATION	Further detail on page 33
	£85.4M 2015: £82.4M*	£34.3M 2015: £50.9M	

## What is it?

Cash generation is a measure of how much distributable cash has been generated in the period. Cash generation is driven by the change in solvency surplus in the period, taking into account board-approved capital management policies.

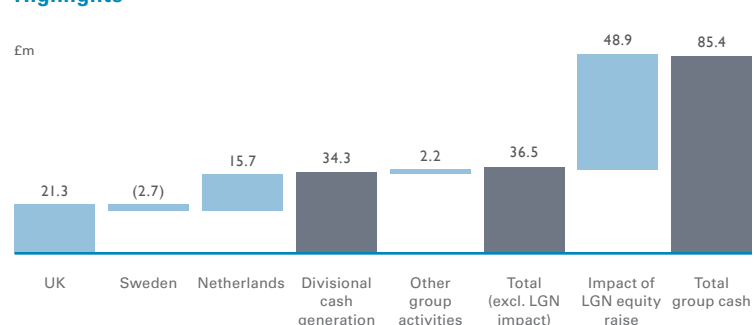
## Why is it important?

Cash generation is a key measure, because it is the net cash flows to Chesnara from its life and pensions businesses which support Chesnara's dividend-paying capacity and acquisition strategy. Cash generation can be a strong indicator of how we are performing against our stated objective of 'maximising value from the existing business'. However, our cash generation is always managed in the context of our stated value of maintaining strong solvency positions within the regulated entities of the group.

## Risks

The ability of the underlying regulated subsidiaries within the group to generate cash is affected by a number of our principal risks and uncertainties as set out on pages 39 to 41. Whilst cash generation is a function of the regulatory surplus, as opposed to the IFRS surplus, they are impacted by similar drivers, and therefore factors such as yields on fixed interest securities and equity and property performance contribute significantly to the level of cash generation within the group.

## Highlights



## Divisional cash

- Positive cash contributions from UK and Netherlands, with Netherlands cash generation being a function of exchange rate gains.
- Overall divisional cash generation is lower than last year largely due to a reduction in the UK.
- This is off-set by small negative generation in Sweden as we continue to invest in our new business operations.

## Total cash generation

- At a group level this includes the positive impact of the new equity capital that was raised to part-fund the LGN acquisition, due to complete in 2017. This has had a significant temporary positive benefit on our cash generation in the period. The temporary impact includes a positive £70m from the equity raise offset by £7.9m of one-off costs and a £13.2m associated increase in capital requirement.

\*includes one-off cash generation of £39.9m arising on the acquisition of the Waard Group.





## ECONOMIC VALUE (ECV)

£602.6M 31 December 2015: £453.4M

Further detail on page 35

### What is it?

Economic Value (EcV) has been introduced in the year by Chesnara as a replacement metric for European Embedded Value. This has been introduced following the introduction of Solvency II at the start of 2016, with EcV being derived from Solvency II own funds. Conceptually EcV is broadly similar to EEV in that both reflect a market-consistent assessment of the value of existing insurance business, plus adjusted net asset value of the non-insurance business within the group.

### Why is it important?

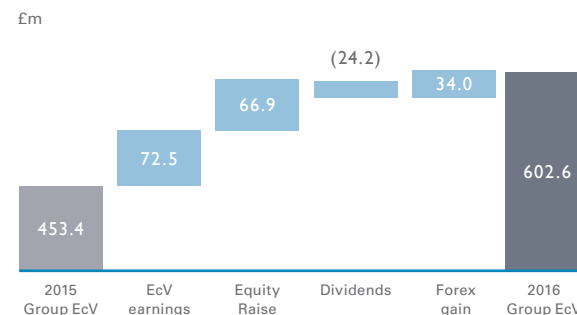
EcV aims to reflect the market-related value of in-force business and net assets of the non-insurance business and hence is an important reference point by which to assess Chesnara's intrinsic value. A life and pensions group may typically be characterised as trading at a discount or premium to its Economic Value. Analysis of EcV provides additional insight into the development of the business over time.

The EcV development of the Chesnara group over time can be a strong indicator of how we have delivered to our strategic objectives, in particular the value created from acquiring life and pensions businesses and enhancing our value through writing profitable new business. It ignores the potential of new business to be written in the future (the franchise value of our Swedish business) and the value of the company's ability to acquire further businesses.

### Risks

The Economic Value of the group is affected by economic factors such as equity and property markets and yields on fixed interest securities. In addition to this, whilst the other KPIs (which are all 'performance measures') remain relatively insensitive to exchange rate movements, the EcV position of the group can be materially affected by exchange rate fluctuations. For example a 10.0% weakening of the Swedish krona and euro against sterling would reduce the EcV of the group by 3.4% and 1.3% respectively, based on the composition of the group's EcV at 31 December 2016.

### Highlights



- Economic Value at the end of the year exceeds £600m for the first time, having increased by £149m since the start of the year.
- Growth includes impact of equity raise and associated costs to fund the LGN acquisition in 2016, expected to complete in 2017. A further EcV gain is expected to arise on acquisition.
- Strong earnings and large foreign exchange gains contribute to the overall growth in the year.



## ECV EARNINGS NET OF TAX

£72.5M 2015: £57.5M\*

Further detail on page 34

### What is it?

In recognition of the longer-term nature of the group's insurance and investment contracts, supplementary information is presented that provides information on the Economic Value of our business.

### The principal underlying components of the Economic Value result are:

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

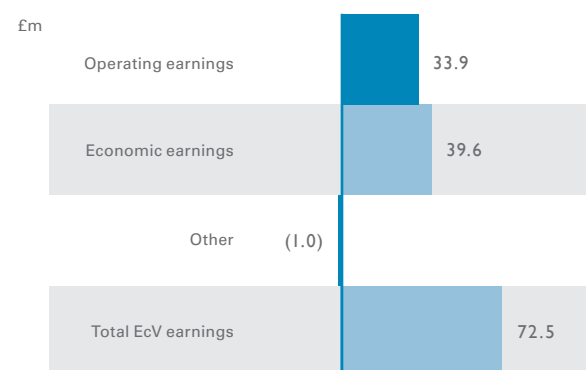
### Why is it important?

By recognising the market-related value of in-force business (in-force value), a different perspective is provided in the performance of the group and on the valuation of the business. Economic Value earnings are an important KPI as they provide a longer-term measure of the value generated during a period. The Economic Value earnings of the group can be a strong indicator of how we have delivered against all three of our core strategic objectives. This includes new business profits generated from writing profitable new business, Economic Value profit emergence from our existing businesses, and the Economic Value impact of acquisitions.

### Risks

The EcV earnings of the group can be affected by a number of factors, including those highlighted within our principal risks and uncertainties as set out on pages 39 to 41. In addition to the factors that affect the IFRS pre-tax profit and cash generation of the group, the EcV earnings can be more sensitive to other factors such as the expense base and persistency assumptions. This is primarily due to the fact that assumption changes in EcV affect our long-term view of the future cash flows arising from our books of business.

### Highlights



- EcV earnings of £72.5m in the year, driven by a combination of strong operating and economic earnings.
- Strong operating earnings driven by new business profits in Sweden and positive operating experience items on in-force policies.
- Economic earnings primarily driven by strong equity performance across Europe.

\*comparative is measured on an EEV basis.



## IFRS PRE-TAX PROFIT

£40.7M 2015: £42.8M

## IFRS TOTAL COMPREHENSIVE INCOME

£55.4M 2015: £39.6M

**Executive summary**

The group IFRS results reflect the natural dynamics of the segments of the group, which can be characterised in three major components:

**(1) Stable core:** At the heart of surplus, and hence cash generation, are the CA and Waard Group segments. The requirements of these books are to provide a predictable and stable platform for the financial model and dividend strategy. As closed books, the key is to sustain this income source as effectively as possible. The IFRS results below show that the stable core continues to deliver against these requirements.

**IFRS results**

The financial dynamics of Chesnara, as described above, are reflected in the following IFRS results:

	2016 £m	2015 £m	Note
CA	28.4	23.9	1
S&P	14.3	10.6	2
Movestic	8.7	6.7	3
Waard Group	6.2	0.9	4
Chesnara	(9.7)	(9.5)	5
Consolidation adjustments	(7.2)	(6.4)	6
<b>Profit before tax and profit on acquisition</b>	<b>40.7</b>	<b>26.2</b>	
Profit on acquisition of the Waard Group	–	16.6	4
<b>Profit before tax</b>	<b>40.7</b>	<b>42.8</b>	
Tax	(5.4)	(3.0)	
<b>Profit after tax</b>	<b>35.3</b>	<b>39.8</b>	
Foreign exchange translation differences	20.1	(0.2)	7
<b>Total comprehensive income</b>	<b>55.4</b>	<b>39.6</b>	

**Note 1:** The CA segment has reported results for the period in excess of those in 2015. Positive mortality experience has resulted in a positive change in mortality assumptions being reflected in the results. Modest economic profits of c£2m have been reported, reflecting the impact of positive equity markets, offset by a fall in yields in the year.

**Note 2:** The S&P segment has reported an increase in profits on the prior year. Positive economic profits of c£4m arise from the net impact of positive equity markets offset by falling bond yields. Positive assumption changes of c£5m include the positive impact of lapse assumption changes and a change in annuity pricing assumptions, offset by a £3.5m charge in relation to the 1% exit fee cap on all policies where the policyholder is over 55.

**Note 3:** Movestic has reported its most successful result since its acquisition in 2009. This is principally driven by strong growth in assets under management and increased premium volumes, coupled with positive performance fees in the investment management side of the business.

**Note 4:** The Waard Group has reported a significant growth in profit compared with the prior year. In part this is because the prior year results are only for the short post-acquisition period. In addition the 2016 result has benefitted from the investment in a mortgage portfolio and the sale of other investments during the year. The group was purchased on 19 May 2015 and a one-off gain on acquisition of £16.6m was recognised in 2015.

**Note 5:** The Chesnara result represents holding company expenses, with 2016 costs being broadly in line with 2015. The current year includes one-off expenses of £3.8m relating to the acquisition of LGN. The prior year includes a one-off foreign currency re-translation loss of £3.5m arising from holding euros prior to the completion of the Waard Group purchase.

**Note 6:** Consolidation adjustments relate to items such as the amortisation of intangible assets and remain in line with prior year.

**Note 7:** As a result of sterling weakening against both the euro and Swedish krona in the period the IFRS result includes a large foreign exchange gain.

**(2) Variable element:** The S&P component can bring an element of short-term earnings volatility to the group, with the results being particularly sensitive to investment market movements.

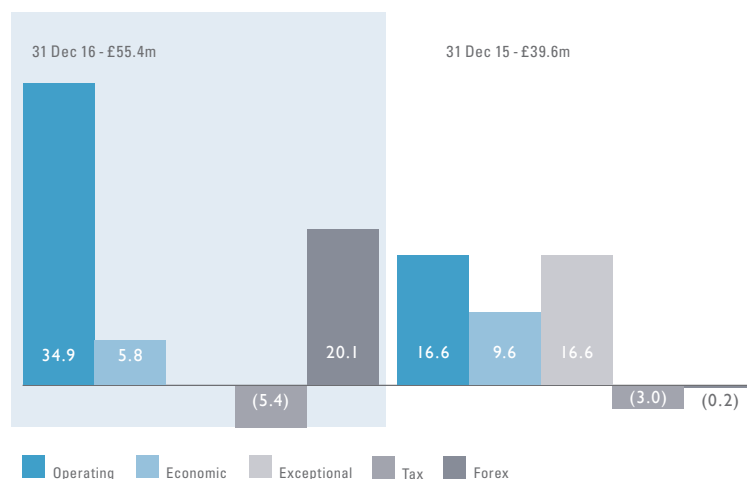
**(3) Growth operation:** The long-term financial model of Movestic is based on growth, with levels of new business and premiums from existing business being targeted to more than offset the impact of policy attrition, leading to a general increase in assets under management and, hence, management fee income.

	2016 £m	2015 £m	Note
Operating profit	34.9	16.6	8
Economic profit	5.8	9.6	9
<b>Profit before tax and profit on acquisition</b>	<b>40.7</b>	<b>26.2</b>	
Profit on acquisition of the Waard Group	–	16.6	4
<b>Profit before tax</b>	<b>40.7</b>	<b>42.8</b>	
Tax	(5.4)	(3.0)	
<b>Profit after tax</b>	<b>35.3</b>	<b>39.8</b>	
Foreign exchange translation differences	20.1	(0.2)	7
<b>Total comprehensive income</b>	<b>55.4</b>	<b>39.6</b>	

**Note 8:** The operating result demonstrates the strength and stability of the underlying business, driving the generation of profit. Product based income and favourable movements in operating experience and assumption changes, specifically mortality, have supported performance in the UK. Strong premium growth and favourable movement in transfers contribute to the Movestic operating result, whilst the Waard result benefitted from the investment in a mortgage portfolio.

**Note 9:** Economic profit represents the components of the earnings that are directly driven by movements in economic variables, e.g. the impact of yield movements on the cost of guarantees reserves. During 2016 the economic profit is generally driven by the net impact of positive equity markets, offset by falling bond yields in the year.

**Note:** Movestic and Waard Group economic surplus is not readily determinable. While there is an element of movement due to economic conditions, they are immaterial in comparison to non-economic items, therefore all surplus is treated as derived from operating activities.

**Analysis of IFRS total comprehensive income (£m)**

## CASH GENERATION



## TOTAL GROUP CASH GENERATION

£85.4M 2015: £82.4M

## DIVISIONAL CASH GENERATION

£34.3M 2015: £50.9M

Cash in the business is generated from increases in the group's surplus funds. Surplus funds represent the excess of assets held over management's internal capital needs, as defined in the capital management policies across the group. These are based on regulatory capital requirements, with the inclusion of additional 'management buffers'. This year is the first period that our cash generation metric has been calculated with reference to capital management policies based on Solvency II. Comparatives as reported applied our previous Solvency I based capital policies.

## HIGHLIGHTS

## UK

- The UK continues to generate levels of cash in line with plans despite being hampered by falling bond yields in the year.
- Own funds growth is the main driver of cash generation in the UK, which has benefited from favourable equity markets and positive mortality and morbidity experience.
- Off-setting this is an increase in required capital, principally due to additional market risk capital being held due to higher equity growth and a change in investment mix in the year.

## SWEDEN

- Sweden has a negative cash generation in 2016 despite positive Swedish krona exchange gains against sterling.
- Own funds have benefited from equity returns driving growth in assets under management, whilst premium volume growth has also contributed to the increase in surplus.
- Under Solvency II regulations the movement in the equity market has also had an adverse impact of the level of capital the business is required to hold, driving the increase in management capital requirement. In addition the increase in required capital includes a one-off capital increase for 'mass lapse' risk due to a modelling change during the year.

## NETHERLANDS

- The Netherlands continued the solid cash generation witnessed throughout the year with positive underlying movements in both own funds and capital requirements.
- Growth in own funds has benefited from returns generated from the mortgage portfolio investment and also the sale of other investments.
- Euro exchange gains against sterling however remain fundamental to the final result.

31 Dec 2016 (£m)	Movement in own funds	Movement in management's capital requirement	Forex impact	Cash generated
UK	28.7	(7.4)	–	<b>21.3</b>
Sweden	23.5	(29.9)	3.7	<b>(2.7)</b>
Netherlands	5.0	2.1	8.5	<b>15.7</b>
<b>Divisional cash</b>	<b>57.2</b>	<b>(35.1)</b>	<b>12.2</b>	<b>34.3</b>
Other group activities	1.5	0.7	–	<b>2.2</b>
<b>Group cash pre LGN equity raise</b>	<b>58.8</b>	<b>(34.4)</b>	<b>12.2</b>	<b>36.5</b>
Impact of LGN equity raise and acquisition costs	62.1	(13.2)	–	<b>48.9</b>
<b>Total group cash generation</b>	<b>120.9</b>	<b>(47.6)</b>	<b>12.2</b>	<b>85.4</b>

## OTHER GROUP ACTIVITIES:

- Other group activities include Chesnara holding company activities coupled with consolidation adjustments.
- Movement in own funds of £1.5m is largely as a result of group level expenses being offset by a tax credit in the year.
- From a capital requirements perspective, this is driven by movements in required capital at a Chesnara holding company level coupled with consolidation adjustments. At a Chesnara holding company level capital is principally required to be held for the market risk associated with the Movestic and Waard Group equity holdings.

## TOTAL GROUP CASH GENERATION

- Cash has continued to be generated across the group, with total cash generation in the period of £85.4m. This includes the impact of the equity raise and associated costs for the LGN acquisition.
- Adjusting for this the group has generated £36.5m of cash which continues to be of a magnitude that would support our levels of dividend.
- Cash generation in the prior period benefitted from a one-off positive contribution of £39.9m, arising on the acquisition of the Waard Group.
- Other group activities also reflected the residual group expenses and the impact of consolidation routines, specifically movements in capital requirements determined at a group level.



ECV EARNINGS

£72.5M 2015: £57.5M

Despite the level of variability in investment markets over the year, with falling bond yields, significant sterling depreciation and volatile yet growing equity markets, the group has reported significant EcV earnings in the period reflecting the resilience and diversity of the business.

**Analysis of the EcV result in the period by earnings source:**

	31 Dec 2016 £m
Expected movement in period	6.0
New business	11.9
Operating variances	22.7
Operating assumption changes	0.6
Other operating variances	(7.3)
<b>Total operating earnings</b>	<b>33.9</b>
Economic experience variances	77.9
Economic assumption changes	(38.3)
<b>Total economic earnings</b>	<b>39.6</b>
Other non-operating variances	0.8
Risk margin movement	(3.8)
Tax	2.0
<b>Total EcV earnings</b>	<b>72.5</b>

**Analysis of the EcV result in the year by business segment:**

	31 Dec 2016 £m	Note
UK	42.2	1
Sweden	30.8	2
Netherlands	5.9	3
Group and group adjustments	(8.4)	4
<b>EcV earnings before tax</b>	<b>70.5</b>	
Tax	2.0	5
<b>EcV earnings after tax</b>	<b>72.5</b>	

\*This is the first period that EcV earnings have been reported. Consequently comparative information has not been presented.

**Economic conditions:** As with our previously reported EEV metric, the EcV result is sensitive to investment market conditions. Key investment market conditions in the period are as follows:

- The FTSE All Share Index has increased by 12.5%;
- The Swedish OMX All Share Index has increased by 6.6%; and
- 10 year UK gilt yields have fallen from 2.01% to 1.28%.

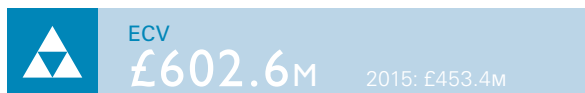
**Note 1 – UK:** The UK reported significant pre-tax earnings of £42.2m for the period. Operating earnings of £25.2m demonstrate the strength and robustness of the underlying business. The result was supported by favourable movements in relation to assumptions on mortality and guaranteed policies. Economic profits of £20.5m were driven by positive equity market growth. This was partially offset by the negative impact of yield curve reductions across the year and resultant increase in risk margin.

**Note 2 – Sweden:** The Swedish division has reported a large EcV movement in the year. Operating earnings of £16.6m were underpinned by strong new business performance, owing to transfer volumes and increased average policy premiums. Substantial operating earnings on the in-force business are offset by a negative movement in operating assumptions, predominantly relating to lower than expected fund rebates. An economic profit of £13.9m was also reported, driven by the recovery of equity markets in the latter stages of 2016. Following challenging conditions experienced in the first six months of the year, 2016 closed with a considerable total annual return of 7.6% achieved for the portfolio.

**Note 3 – Netherlands:** The Dutch division has reported earnings of £5.9m in the period. This is primarily all economic earnings supported by the disposal of CDO investments and returns generated on the property portfolio investment, following a decline in yield curve rates witnessed in the year.

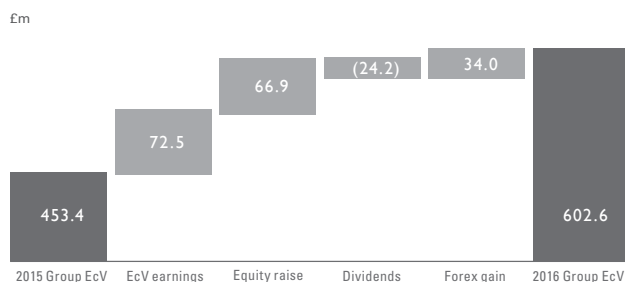
**Note 4 – Group:** A loss has been reported in the group component. This includes the impact of costs incurred in relation to LGN and also underlying group level expenses and consolidation activities.

**Note 5 – Tax:** The business is reporting a tax credit of £2.0m in the period. This is driven by a combination of deferred tax on the loss in the period relating to group level activities, coupled with a modelling adjustment for deferred tax when compared with the opening period.



The Economic Value of Chesnara represents the present value of future profits of the existing insurance business, plus the adjusted net asset value of the non-insurance business within the group. EcV is an important reference point by which to assess Chesnara’s intrinsic value.

**Value movement: 1 Jan 2016 to 31 Dec 2016**



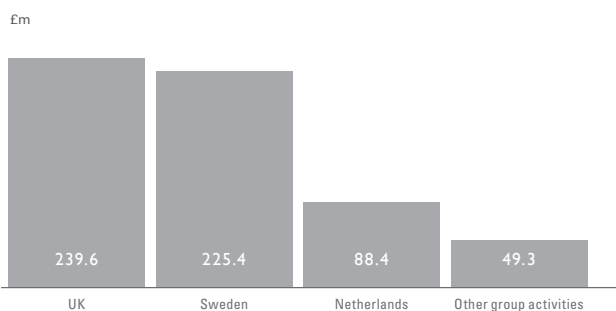
**EcV earnings:** Positive EcV earnings have been reported in the year, a result of strong operating profits and positive economic profits, driven by the net impact of equity market growth in the year offset by falling bond yields. Further detail can be found on page 34.

**Equity raise:** In December 2016 the group announced that new equity had been raised with the intention to purchase LGN, which is expected to complete during 2017. Consequently the growth in EcV reflects the proceeds of the equity raise.

**Dividends:** Under EcV, dividends are recognised in the period in which they are paid. Dividends of £24.2m were paid during 2016, being the final dividend from 2015 and interim 2016 dividend.

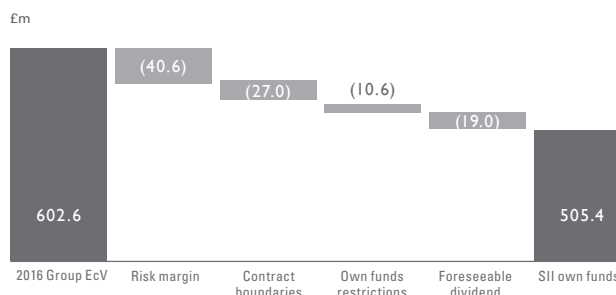
**FX gain:** The EcV of the group benefited from large foreign exchange gains that were reported in the period as a result of sterling depreciation against both the euro and Swedish krona.

**EcV by segment at 31 Dec 2016**



The above graph shows that the EcV of the group is diversified across its different markets. In particular, the EcV of the UK and Swedish operations are of similar sizes, showing that we are well-balanced and not over-exposed to one particular geographic market.

**EcV to Solvency II**



Our reported EcV is based on a Solvency II assessment of the value of the business, but adjusted for certain items where it is deemed that Solvency II does not reflect the commercial value of the business. The above waterfall shows the key difference between EcV and SII, with explanations for each item below.

**Risk margin:** Solvency II rules require a significant ‘risk margin’ which is held on the Solvency II balance sheet as a liability, and this is considered to be materially above a realistic cost. We therefore reduce this margin for risk for EcV valuation purposes from being based on a 6% cost of capital to a 3% cost of capital.

**Contract boundaries:** Solvency II rules do not allow for the recognition of future cash flows on certain in-force contracts, despite the high probability of receipt. We therefore make an adjustment to reflect the realistic value of the cash flows under EcV.

**Ring-fenced fund restrictions:** Solvency II rules require a restriction to be placed on the value of certain ring-fenced funds. These restrictions are reversed for EcV valuation purposes as they are deemed to be temporary in nature.

**Foreseeable dividends:** The proposed final dividend of £19.0m is recognised for SII regulatory reporting purposes. It is not recognised within EcV until it is actually paid.

**Replacement of EEV**

During the year we have replaced the previous group valuation metric, European Embedded Value, with a new metric, Economic Value (EcV). This has been introduced to align our valuation metric with Solvency II, with EcV being derived from the Solvency II balance sheet.

As expected, the new valuation metric gives a broadly similar value of the Chesnara plc group. At 31 December 2015 our previously reported EEV was £455.2m, compared with an opening EcV of £453.4m.

Our Embedded Value figures have historically been subject to an external audit opinion addressed to the directors of Chesnara plc. This reflected the significance of the Embedded Value figures and was consistent with industry best practice.

The Economic Value figures are at this stage not subject to audit opinion other than to the extent the general audit opinion of the Financial Statements considers their consistency with the Financial Statements.

External audit requirements cover Solvency II disclosures and as such given the Economic Value figures are derived from the Solvency II balance sheet the Economic Value figures benefit from a degree of external audit comfort.

# FINANCIAL MANAGEMENT

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

The following diagram illustrates the aims, approach and outcomes from the financial management framework:

## OBJECTIVES

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

Maintain solvency targets	Meet the dividend expectations of shareholders	Optimise the gearing ratio to ensure an efficient capital base	Ensure there is sufficient liquidity to meet obligations to policyholders, debt financiers and creditors	Maintain the group as a going concern
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## HOW WE DELIVER TO OUR OBJECTIVES

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

1. Monitor and control risk and solvency	2. Longer-term projections	3. Responsible investment management
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## OUTCOMES

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



1. Solvency	2. Shareholder returns	3. Capital structure	4. Liquidity and policyholder returns	5. Maintain the group as a going concern
Group solvency ratio 158%	2016 TSR 15.7% 2016 dividend yield 6.1%  Based on average 2016 share price and full year 2016 dividend of 19.49p.	Gearing ratio of 13.4%  This does not include the financial reinsurance within the Swedish business.	Policyholders' reasonable expectations maintained.  Asset liability matching framework operated effectively in the year.  Sufficient liquidity in the Chesnara holding company.	Group remains a going concern  (see page 37)

## Outcomes from implementing our financial management objectives

### 1. Capital structure

The group is funded by a combination of share capital, retained earnings and debt finance, with the debt gearing (excluding financial reinsurance in Sweden) being 13.4% at 31 December 2016 (17.8% at 31 December 2015).

The level of debt that the board is prepared to take on is driven by the group's 'Debt and leverage policy' which incorporates the board's risk appetite in this area.

Over time, the level of gearing within the group will change, and is a function of:

- funding requirements for future acquisitions (i.e. debt, equity and internal financial resources); and
- repayment of existing debt that was used to fund previous acquisitions.

As referred to above, acquisitions are funded through a combination of debt, equity and internal cash resources. The ratios of these three funding methods vary on a deal-by-deal basis and are driven by a number of factors including, but not limited to:

- size of the acquisition;
- current cash resources of the group;
- current gearing ratio and the board's risk tolerance limits for additional debt;
- expected cash generation profile and funding requirements of the existing subsidiaries and potential acquisition;
- future financial commitments; and
- regulatory rules.

In addition to the above, Movestic uses a financial reinsurance arrangement to fund its new business operation.

### 2. Maintain the group as a going concern

The directors have considered the ability of the group to continue on a going concern basis. As such the board has performed an assessment as to whether the group can meet its liabilities as they fall due for a period of at least twelve months from the date which the Report & Accounts have been signed.

In performing this work, the board has considered the current cash position of the group and company, coupled with the group's and company's expected cash generation as highlighted in its recent business plan, which covers a three-year period. The business plan considers the financial projections of the group and its subsidiaries on both a base case and a range of stressed scenarios, covering projected IFRS, EcV and solvency. These projections also focus on the cash generation of the life insurance divisions and how these flow up into the Chesnara parent company balance sheet, with these cash flows being used to fund debt repayments, shareholder dividends and the head office function of the parent company.

The information set out on page 29 indicates a strong solvency position as at 31 December 2016 as measured at both the divisional and group levels. As well as being well-capitalised the group also has a healthy level of cash reserves to be able to meet its debt obligations as they fall due, and does not rely on the renewal or extension of bank facilities to continue trading. The group's subsidiaries do, however, rely on cash flows from the maturity or sale of fixed interest securities which match certain obligations to policyholders, which brings with it the risk of bond default. 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.

In light of the above information, the board has concluded that the group and company has a reasonable expectation that the group and company have adequate resources to continue in operational existence for the foreseeable future, and, as stated in the Directors Report on page 82, the financial statements have continued to be prepared on a going concern basis.

### 3. Longer-term viability statement

In accordance with provision C.2.2 of the 2014 revision of the UK Corporate Governance Code, the directors have assessed the prospect of the company over a longer period than the twelve months required by the going concern provision. The board conducted this review for a period of three years because the group's business plan covers a three year period and includes an assessment of group cash generation and group solvency margins over that time period.

The group business plan considers the group's cash flows, the group's ability to remain above target solvency levels and other key financial measures over the period, assuming continuation of the group's established dividend payment strategy. These metrics are subject to scenario analysis representing the principal risks to which the group is most sensitive, both individually and in unison. Where appropriate this analysis is carried out to evaluate the potential impact of adverse economic and other experience effects, including, but not limited to:

- Equity market declines
- Reduction in yield curves
- Adverse mortality and lapse experience
- Adverse expense experiences
- Reduced new business volumes
- Adverse exchange rate experience

Based on the results of this analysis, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the three year period of their assessment.



# PRINCIPAL RISKS AND UNCERTAINTIES

## Risk management processes

Risk taking is a key part of our business model – taking the appropriate risks and managing them well is essential to our success. We achieve this by understanding the key risk drivers of the business plan and strategy, and making sure we monitor these closely and take appropriate risk-based decisions in a timely fashion.

Chesnara applies the ‘Three Lines of Defence’ model, modified for our business, across the group with a single set of Risk and Governance Principles applying consistently across the business, underpinned by board-approved Group and divisional governance maps and policies.

In all divisions we maintain processes for identifying, evaluating and managing all material risks faced by the group, which are regularly reviewed by the divisional and group Audit & Risk Committees. Our risk assessment processes have regard to the significance of risks, the likelihood of their occurrence and take account of the controls in place to manage them. The processes are designed to manage the risk profile within the board’s approved risk appetite.

At the subsidiary level, in the UK we have clear accountability for risk management via explicitly documented risk and risk policy ownership. This is enhanced by the Senior Insurance Managers Regime which became effective in 2016. Accordingly, the identification, assessment and control of risks are firmly embedded within the organisation and the procedures for the monitoring and updating of risks are robust. As part of this we have a CA plc Audit and Risk Committee, which comprises solely of non-executive directors. The committee reports directly to the CA plc board which also reviews reports from the Compliance and Internal Audit functions.

In the Swedish business, at the Movestic subsidiary level, there is full compliance with the regulatory requirement in that the board and CEO take 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 a responsibility for ensuring that the company has a Risk Management 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 and Audit & Risk Committee. Also, quarterly returns to the Swedish regulator, Finansinspektionen, which sets out capital requirements in respect of insurance, market, credit, liquidity, currency and operational risks.

The Dutch business has a risk management framework aligned to the group and in compliance with SII as well as guidance issued by the local regulators (DNB for prudential supervision and AFM for financial conduct supervision). The Dutch business comprises a two-tier governance structure consisting of a Management Board and a Supervisory Board. The Risk Function facilitates Quarterly Risk Reviews with the risk owners, which include the identification and response to newly emerging risks, and reports to the Audit and Risk Committee and Management and Supervisory Boards. The risks identified and corresponding mitigating internal control measures are centrally registered and appropriate monitoring is overseen by the Risk Function.

Group and divisional 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. The results, conclusions and any recommended actions are included within Divisional and Group ORSA Reports to the relevant boards. 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 any identified internal control weaknesses together with suggested improvements.

There have been a number of refinements to risk management processes during 2016. These include:

- further enhancements to and embedding and monitoring of the boards’ risk appetite and tolerance limits;
- continued embedding of risk policies and the introduction of an attestation process for risk policies and controls;
- a more forward-looking approach to risk identification and assessment;
- the strengthening of links between the setting and execution of the business strategy and risk and solvency management; and
- enhancement and embedding of Continuous Solvency Monitoring and Recovery Protocol.

## Principal risks and uncertainties

**Risks 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 profile whilst delivering good service and fair outcomes for our customers.**

**The Chesnara group Audit and Risk Committee (A&RC) reviews, challenges and approves the group Executive Committee’s assessment of the group’s Principal Risks and the adequacy of the controls in place to manage those risks on a quarterly basis. The assessment is based on pre-defined criteria for what constitutes a Principal Risk, and corresponding materiality levels, which is subject to annual review and approval by the Chesnara A&RC.**

The specific principal risks and uncertainties are determined taking into account the following:

- i) the group’s core operations centre on the run-off of closed life and pensions businesses in the UK and the Netherlands;
- ii) notwithstanding this, the group has a material segment which comprises an open life and pensions business; 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 table outlines the principal risks and uncertainties of the group and the controls in place to mitigate or manage their impact. It has been drawn together following regular assessment performed by the Audit and Risk Committee of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. These have remained largely unchanged from those reported in the 2015 Annual Report and Accounts.

Risk: Adverse mortality/morbidity/longevity experience	Control
<p><b>Impact:</b> In the event that actual mortality or morbidity rates vary from the assumptions underlying product pricing and subsequent reserving, more or less profit will accrue to the group.</p>	<ul style="list-style-type: none"> <li>– Effective underwriting techniques and reinsurance programmes.</li> <li>– Regular investigations, and industry analysis, to support best estimate assumptions and identify trends.</li> <li>– The option on certain contracts to vary premium rates in the light of actual experience, subject to fair treatment of customers.</li> <li>– Partial risk diversification in that the group has a portfolio of annuity contracts where the benefits cease on death.</li> </ul>
Risk: Adverse persistency experience	Control
<p><b>Impact:</b> If persistency is significantly lower than that assumed in product pricing and subsequent reserving, this will lead to reduced group profitability in the medium to long-term. Further, for parts of the business such as Movestic, where retention is to a degree dependent on broker relationships, the business is exposed to losses arising from 'mass lapse' events.</p>	<ul style="list-style-type: none"> <li>– Active investment management to ensure competitive policyholder investment funds.</li> <li>– Stringent management of customer service delivery and adherence to principles of treating customers fairly.</li> <li>– Product distributor relationship management processes.</li> <li>– Close monitoring of persistency levels across all groups of business to support best estimate assumptions and identify trends.</li> <li>– Movestic seeks to maintain good relationships with brokers. This is independently measured via yearly external surveys that considers broker's attitude towards different insurers.</li> <li>– Movestic has clawback arrangements with brokers.</li> </ul>
Risk: Expense overruns and unsustainable unit cost growth	Control
<p><b>Impact:</b> For the closed UK and Dutch businesses, the group is exposed to the impact on profitability of fixed and semi-fixed expenses, in conjunction with a diminishing policy base. 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.</p>	<ul style="list-style-type: none"> <li>– For the UK business the group pursues a strategy of outsourcing functions with charging structures such that the policy administration cost is more aligned to the book's run-off profile.</li> <li>– The Swedish operations assume growth through new business such that the general unit cost trend is positive.</li> <li>– The Dutch business pursues a low cost-base strategy using a designated service company. The cost base is supported by service income from third party customers.</li> <li>– For all three divisions, the group maintains a strict regime of budgetary control.</li> <li>– In the mid/longer-term inorganic growth through acquisitions is expected to result in cost synergies and sharing of fixed overheads.</li> </ul>
Risk: Significant and prolonged reduction in the market value of asset holdings	Control
<p><b>Impact:</b> A significant part of the company's income and, therefore, overall profitability derives from fees received in respect of the management of policyholder and investor funds. Fee levels are generally proportional to the value of funds under management and any material fall in their value will impact on future income. In addition, for with profits products with guarantees, a sustained fall in the market value of assets can increase the cost of meeting the guaranteed benefits.</p> <p>The most material risk is equity risk, as overall investment funds comprise a significant equity content. However, material market risks also exist if there is a sustained fall in the value of fixed interest holdings, a fall in the value of property holdings and exchange rate risk in respect of overseas investments held by policyholders.</p> <p>Income levels may also reduce if policyholders switch from equity based funds to lower-margin, fixed interest funds, as a consequence of a material fall in the market value of equities.</p>	<ul style="list-style-type: none"> <li>– Wide range of investment funds and managers to avoid significant concentrations of risk</li> <li>– Individual fund mandates are intended to give rise to a degree of diversification of risk.</li> <li>– Established investment governance framework to provide review and oversight of external fund managers, and monitor adherence to investment policy</li> <li>– Operation of controls which limit the level of exposure to any single counterparty and impose limits on exposure by credit rating.</li> <li>– Certain investment management costs are also proportional to fund values and thereby reduce in the event of market falls. Hence some cost savings arise which partially offset the negative impact of reduced income.</li> </ul>

# PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

<p><b>Risk: Counterparty failure</b></p> <p><b>Impact:</b> The group carries significant inherent risk of counterparty failure in respect of:</p> <ul style="list-style-type: none"> <li>– its fixed interest security portfolio;</li> <li>– cash deposits; and</li> <li>– payments due from reinsurers.</li> </ul>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Operation of guidelines which limit the level of exposure to any single counterparty and which impose limits on exposure to credit ratings.</li> <li>– In respect of a significant exposure to one major reinsurer, Reassure (formerly known as Guardian), the group has a floating charge over the reinsurer's related investment assets, which ranks the group equally with Reassure's policyholders.</li> </ul>
<p><b>Risk: Adverse movements in yields on fixed interest securities</b></p> <p><b>Impact:</b> The group maintains portfolios of fixed interest securities <b>(i)</b> in order to match its insurance contract liabilities, in terms of yield and cash flow characteristics, and <b>(ii)</b> 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 liability valuation interest rates.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– The group maintains rigorous matching programmes to ensure that exposure to mismatching is minimised.</li> <li>– Active investment management such that, where appropriate, asset mixes will be changed to mitigate the potential adverse impact of a decline in bond yields.</li> </ul>
<p><b>Risk: Failure of outsourced service providers to fulfil contractual obligations</b></p> <p><b>Impact:</b> The group's UK life and pensions businesses are heavily dependent on outsourced service providers to fulfil a significant number of their core functions. In the event of failure by any of the service providers to fulfil their contractual obligations, in whole or in part, to the requisite standards specified in the contracts, the group may suffer losses, poor customer outcomes, or reputational damage as its functions degrade.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Rigorous service level measures and management information flows under its contractual arrangements.</li> <li>– Continuing and close oversight of the performance of all service providers.</li> <li>– The supplier relationship management approach is conducive to ensuring the outsource arrangements deliver to their obligations.</li> <li>– Ongoing monitoring and testing of business continuity plans and financial assessments of outsourced service providers.</li> <li>– 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.</li> </ul>
<p><b>Risk: Key man dependency</b></p> <p><b>Impact:</b> The nature of the group is such that it relies on a number of key individuals who have particular knowledge, experience and know how. The group is, accordingly, exposed to the sudden loss of the services of these individuals.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– The group promotes the sharing of knowledge and expertise to the fullest extent possible.</li> <li>– 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.</li> <li>– The group maintains succession plans and remuneration structures which comprise a retention element.</li> <li>– The group complements its internal expertise with established relationships with external specialist partners.</li> </ul>
<p><b>Risk: Adverse regulatory and legal changes</b></p> <p><b>Impact:</b> 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. During 2016 this risk has been compounded by the increased political uncertainties following the UK referendum to leave the EU and US Presidential elections, which may lead to further change. Significant issues which have arisen and where there is continuing uncertainty as to their full impact on the group include:</p> <ol style="list-style-type: none"> <li>i) the FCA's review of legacy business and other reviews such as the Asset Management market study;</li> <li>ii) the introduction of a cap on exit charges on UK pensions business;</li> <li>iii) consultations regarding commission and rebate income changes in Sweden;</li> <li>iv) the embedding of Solvency II requirements, including Pillar 3 Disclosure implementation; and</li> <li>v) the changes in pensions legislation in April 2015.</li> </ol> <p>The group is therefore exposed to the one-off costs of addressing regulatory change as well as any permanent increases in the cost base in order to meet enhanced standards. Further, the group is exposed to the risk of fines or censure in the event that it fails to deliver changes to the required regulatory standards on a timely basis.</p>	<p><b>Control</b></p> <p>Strong project management disciplines are applied when delivering regulatory change programmes.</p> <p>Chesnara seeks to limit any potential impacts of regulatory change on the business by:</p> <ul style="list-style-type: none"> <li>– Having processes in place for monitoring changes, to enable timely actions to be taken, as appropriate;</li> <li>– Being a member of the ABI and utilising other means of joint industry representation;</li> <li>– Performing internal reviews of compliance with regulations; and</li> <li>– Utilising external specialist advice and assurance, when appropriate.</li> </ul> <p>Chesnara maintains strong relationships with all key regulators including regular and open dialogue about areas of potential change that could affect any of the Chesnara businesses.</p> <p>Through the Risk Management Framework, regulatory risk is monitored and scenario tests are performed to understand the potential impacts of adverse regulatory or legal changes, along with consideration of actions that may be taken to minimise the impact, should they arise.</p>

<p><b>Risk: Adverse exchange rate movements against sterling</b></p> <p><b>Impact:</b> Exposure to adverse sterling: swedish krona and sterling: euro exchange rate movements (sterling appreciating) arises from cash flows between Chesnara and its overseas subsidiaries and from the impact on reported IFRS and EcV results which are expressed in sterling.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– The group monitors exchange rate movements and would consider the cost/benefit of hedging the currency risk on cash flows when appropriate.</li> <li>– The impact of any adverse currency movements can be reduced by timely movement of cash flows from subsidiaries to group, if appropriate given various other applicable criteria for transfers.</li> </ul>
<p><b>Risk: Inconsistent regulation across territories</b></p> <p><b>Impact:</b> Chesnara currently operates in three regulatory domains and is therefore exposed to inconsistent application of regulatory standards across its divisions, such as the imposition of higher Capital Buffers over and above regulatory minimums.</p> <p>Potential consequences of this risk for Chesnara are constraints on the efficient and fluid use of capital within the group, or creating a non-level playing field with respect to future deal assessments.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Strong and open relationships are maintained with all regulators. Evidence is provided to regulators that demonstrates consistent stability and control across the divisions, achieved through strong risk management and governance standards.</li> <li>– In extremis, Chesnara could consider the re-domiciling of subsidiaries or a legal restructure of the business.</li> </ul>
<p><b>Risk: Availability of future acquisitions</b></p> <p><b>Impact:</b> Chesnara’s inorganic growth strategy is dependent on the availability of attractive future acquisition opportunities. Hence, the business is exposed to the risk of a reduction in the availability of suitable acquisition opportunities in Chesnara’s current target markets, for example arising as a result of a change in competition in the consolidation market or from regulatory change influencing the extent of life company strategic restructuring.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Chesnara’s financial strength and market reputation for successful execution of transactions enables the company to adopt a patient and risk-based approach to assessing acquisition opportunities.</li> <li>– Operating in multi-territories provides some diversification against the risk of changing market circumstances in one of the territories.</li> <li>– Maintaining strong relationships and reputation as a ‘safe hands acquirer’ via regular contact with regulators, banks and target companies.</li> </ul>
<p><b>Risk: Defective acquisition due diligence</b></p> <p><b>Impact:</b> Through the execution of acquisitions, Chesnara is exposed to the risk of erosion of value or financial losses arising from risks inherent within businesses or funds acquired which are not adequately priced for or mitigated within the transaction.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Structured board approved risk-based acquisition process including group CRO involvement in due diligence process.</li> <li>– Management team with significant and proven mergers and acquisitions experience.</li> <li>– Cautious risk appetite and pricing approach.</li> </ul>
<p><b>Risk: Cyber risk</b></p> <p><b>Impact:</b> Cyber risk is a growing risk affecting all companies, particularly those who are custodians of customer data. The most pertinent risk exposure relates to information security (i.e. protecting business sensitive and personal data) and can arise from failure of internal processes and standards, but increasingly companies are becoming exposed to potential malicious cyber attacks, organisation specific malware designed to exploit vulnerabilities, phishing attacks etc. The extent of Chesnara’s exposure to such threats also includes third party service providers.</p> <p>The main potential impacts of this risk include financial losses, inability to perform critical functions, disruption to policyholder services, loss of sensitive data and corresponding reputational damage or fines.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Information security policy embedded in all key operations and development processes.</li> <li>– Ongoing specialist external advice, modifications to IT infrastructure and updates as appropriate.</li> <li>– Regular staff training and attestation of the information security policy</li> <li>– Penetration and vulnerability testing, including third party service providers.</li> <li>– Chesnara and supplier business continuity plans regularly monitored and tested.</li> </ul>
<p><b>Risk: Liquidity risk</b></p> <p><b>Impact:</b> Chesnara and each of its subsidiaries have obligations to make future payments, which are not always known with certainty in terms of timing or amounts, prior to the payment date. This includes primarily the payment of policyholder claims, reinsurance premiums, debt repayments and dividends. The uncertainty of timing and amounts to be paid gives rise to potential liquidity risk, should the funds not be available to make the payment.</p>	<p><b>Control</b></p> <ul style="list-style-type: none"> <li>– Chesnara has a liquidity policy in place which includes various controls to manage liquidity risk such as: <ul style="list-style-type: none"> <li>• Asset/Liability modelling;</li> <li>• Regular liquidity forecasts; and</li> <li>• Cash projections to support strategic initiatives such as acquisitions.</li> </ul> </li> <li>– Chesnara holds a significant amount of surplus in highly liquid tier 1 assets such as cash and gilts.</li> </ul>

# CORPORATE AND SOCIAL RESPONSIBILITY

## Making a positive contribution to our policyholders and shareholders, whilst taking social and environmental issues seriously.

**Our main objective is to ensure we continue to manage the business responsibly and for the long-term benefit of all stakeholders, including our customers, shareholders, employees, regulators, outsourcers and local communities.**

### Equal opportunities

Our people are our greatest assets. We recognise that to be able to meet the expectations that we have set ourselves, we need to ensure, in a competitive market, we continue to attract, promote and retain the best candidates. Our approach is to be open, entrepreneurial and inclusive in how we operate. 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.

The table below shows the gender split of employees of the Chesnara group split across different categories:

	2016		2015	
	Male	Female	Male	Female
Directors of Chesnara plc	5	2	7	1
Senior management of the group	3	–	2	–
Heads of business units and group functions	14	5	14	6
Employees of the group	89	83	79	77
<b>Total</b>	<b>111</b>	<b>90</b>	<b>102</b>	<b>84</b>

The Davies report recommends a board diversity target of 25% for FTSE 350 companies. Gender diversity forms an important part of the board appointment process.

Chesnara are very aware of the benefits of having a better gender balance in key decision making positions. Over the last year and into 2017, five out of the six senior executive and non-executive appointments have been filled by females. Our group Audit and Risk Committee and group Remuneration Committee both have female chairmen and Movestic will shortly have a female CEO.

Senior management includes employees other than group directors who have the responsibility for planning, directing or controlling the activities of the company, or a strategically significant part of the company. Chesnara have only three members of staff who meet the Companies Act definition of senior management. We therefore provide additional information in keeping with the spirit of the company's focus on diversity. We have provided additional disclosures to cover the employees within the group. We have given an analysis of diversity which shows 'Heads of business units and group functions' separately from the remainder of employees within the group.

### 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 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.

### Modern Slavery Act 2015

The Modern Slavery Act 2015 (Slavery Act) requires a commercial organisation over a certain size to publish a slavery and human trafficking statement for each financial year. This statement can be found on the Chesnara plc website. Chesnara plc welcomes the act and with its subsidiaries (together 'Chesnara') is committed to the eradication of human trafficking and slavery. Slavery and human trafficking are abuses of a person's freedom and rights. We are totally opposed to such abuses in our direct operations, our indirect operations and our supply chain as a whole.

The operating model of Chesnara's UK business is directed towards maintaining shareholder value by outsourcing all support activities to professional specialists. The activities typically include policy administration, systems management, accounting, actuarial and investment management. This has been provided by long-term contracts held with only reputable suppliers, and as these are significant, the responsibility of oversight has remained with the central governance team.

We consider that the greatest risk of slavery and human trafficking would be in our supply chain where operational and managerial oversight is out of our direct control and we expect our partners to operate in line with our corporate values.

### Case study of Movestic Livförsäkring AB:

In March 2015, subsidiary, Movestic Livförsäkring AB, began a three-year partnership with adventurer and lecturer Aaron Anderson. When Aaron was seven years old he suffered from cancer in the lower back, and after a year of treatment, he ended up in a wheelchair. Aaron was not defeated, he now has countless medals in athletics, participated in the Paralympics and he has hand-cycled from Sweden to Paris to raise money for the Child Cancer Foundation. He was also the first ever wheelchair person to climb Kebnekaise mountain. When a child gets cancer, it affects the whole family. To help these families and to fight childhood cancer, Movestic teamed up with Aaron.

During 2016, as part of our work with Aaron, Movestic participated in an event hosted by Aaron. This was a fundraising event in aid of the Child Cancer Foundation.

In April 2016, a social media project was launched to promote the importance of pension planning in advance of retirement as well as the importance of health and exercise. Movestic promote healthy living in combination with creating a good working atmosphere.

**Greenhouse gas reporting  
Disclosure of emissions**

Global GHG emissions data for the year to 31 December 2016:

	Tonnes of CO <sub>2</sub> e	
	2016	2015
Emissions from:		
Combustion of fuel and operation of facilities (scope 1)	–	–
Electricity, heat, steam and cooling purchased for own use (scope 2)	94.7	104.9
Travel (scope 3)	132.4	130.3
Company's chosen intensity measurement = tonnes of CO <sub>2</sub> e per square metre of office space occupied	0.074	0.077
<small>Emissions reported above normalised to per tonne of product output</small>		

The above analysis shows that our total emissions have decreased when compared with the prior year. This decrease is predominantly as a result of reduced energy consumption within the Swedish division, offset partially by the additional travel incurred as a result of the proposed acquisition of Legal & General Nederland.

**Methodology used to calculate emissions**

We have followed the requirements of the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) and the Defra Carbon Trust conversion factors to measure and report greenhouse gas emissions, as well as the disclosure requirements in Part 7 of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. The financial control method, which captures the sources that fall within our consolidated Financial Statements, has been used. Although we operate an outsourced model in the UK, these outsourcers do not work exclusively for the group and therefore it is not deemed appropriate to include emissions outside of the group consolidated Financial Statements. The group's carbon reporting falls under three scopes as shown in the table above.

There are 25 company-leased vehicles in total across the group which are used primarily for commuting and not business-related activities. Commuting mileage is a personal expense of the employee and is not therefore included in the consolidated Financial Statements.

**Energy Saving Opportunity Scheme Regulations 2014**

The company has also committed to fully engaging with the Energy Saving Opportunity Scheme Regulations 2014 (ESOS). As part of the ESOS, the company submitted and was externally assessed for the energy usage, in the UK, for the period 31 December 2014 to 31 December 2015. Energy usage examined was in relation to any energy consumed by the company, lighting, heating, fuel to name a few. ESOS operates on a four year compliance phase with the next reporting/ compliance date being December 2019.

Approved by the board on 30 March 2017 and signed on its behalf by:



Peter Mason  
Chairman



John Deane  
Chief Executive Officer

# SECTION C: CORPORATE GOVERNANCE

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# BOARD PROFILE AND BOARD OF DIRECTORS

Jane Dale's appointment in 2016 brings a useful new perspective to the board. She brings a wealth of experience and complements the culture of the company.

The skills, knowledge and experience of our board members ensure we continue to deliver against our strategic objectives. We continue to disclose a board competency profile, as summarised on the right. This summary is based on the core competencies that have been identified as being key to the board discharging its responsibilities and shows the collective score based on the current board make-up.

To provide further insight into the skills, knowledge and experience of each board member, the biographies below now show the specific areas of specialism each member provides, with each letter correlating to the competency matrix on the right. Where a board member has a competency in blue this indicates a primary specialism. A light grey colour indicates that this competency is a secondary specialism for that board member.

## THE BOARD

### PETER MASON CHAIRMAN

Non-executive Chairman of the board, Peter is responsible for the leadership of the board, setting the agenda and ensuring the board's effectiveness in all aspects of its role.

**Appointment to the board:** Appointed to the board in March 2004 and as Chairman in January 2009.

**Committee membership:** Nomination & Governance (Chairman) and a member of the Remuneration Committee. Peter attends the Audit & Risk Committee by invitation.

**Current directorships/business interests:**

- Movestic Livförsäkring AB, Chairman
- Chesnara Holdings BV, Chairman
- Countrywide Assured plc, Chairman
- Countrywide Assured Life Holdings Limited, NED

**Skills and experience:** A B C D E F G H I

### JANE DALE NON-EXECUTIVE DIRECTOR AND CHAIRMAN OF THE AUDIT & RISK COMMITTEE

**Appointment to the board:** Appointed to the Chesnara plc board in May 2016 and as Chairman of the Audit & Risk Committee in December 2016.

**Committee membership:** Audit & Risk and Nomination & Governance.

**Current directorships/business interests:**

- Countrywide Assured plc, Chairman of the Audit & Risk Committee
- Covea Insurance plc, Chairman of the Audit Committee
- Covea Life Limited, Chairman of the Audit Committee
- British Gas Services Limited, NED
- BHSF Group Limited, Chairman, and including:
  - Wellwork Limited
  - M3OH Services Limited
  - BHSF Corporate Healthcare (Holdings) Limited
  - BHSF Employee Benefits Limited
  - BHSF Occupational Health Limited
  - BHSF Limited
  - BHSF Newhall Medical Practice Limited
  - Nexus Healthcare Limited

**Skills and experience:** B D E F G H

### MIKE EVANS SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR

**Appointment to the board:** Appointed to the Chesnara plc board in March 2013. Mike became Senior Independent Director in May 2013.

**Committee membership:** Nomination & Governance, Audit & Risk and Remuneration.

**Current directorships/business interests:**

- Hargreaves Lansdown plc, Chairman
- ZPG plc, Chairman
- Chesnara Holdings BV, NED
- Countrywide Assured plc, NED

**Skills and experience:** A B C D E F G H I K

### JOHN DEANE CHIEF EXECUTIVE

**Appointment to the board:** Appointed to the board in December 2014 and as Chief Executive in January 2015.

**Career, skills and experience:** John is a qualified actuary and has over 30 years' experience in the life assurance industry. John joined Century Life, a closed book acquisition company in 1993. As CEO, he oversaw the creation of the outsourcing company Adepta in 2000. He joined Old Mutual plc in 2003 becoming their Corporate Development Director later that year. In 2007 he joined the board of Royal London with responsibility for its open businesses in the UK, Ireland and Isle of Man.

**Skills and experience:** A B C D E F G H I J K



## BOARD KNOWLEDGE, SKILLS AND EXPERIENCE SUMMARY

KEY	KNOWLEDGE/SKILL/EXPERIENCE	SUMMARY
A	Chesnara company knowledge	● ● ● ● ● ●
B	Industry knowledge – UK	● ● ● ● ● ● ●
C	Industry knowledge – Sweden/Netherlands	● ● ● ● ● ●
D	Governance – actuarial	● ● ● ● ● ●
E	Governance – financial	● ● ● ● ● ●
F	Audit and risk management	● ● ● ● ● ● ●
G	Investment management	● ● ● ● ● ●
H	M & A and business development	● ● ● ● ● ● ●
I	Commercial management	● ● ● ● ● ●
J	Operational change management	● ● ● ● ● ●
K	Operational management	● ● ● ● ● ●

‘Annual assessment confirms that our board continues to hold significant experience in the insurance sector and also have a range of specialisms which ensure all aspects of our competency profile are well covered’.

In the above diagram a blue symbol represents the number of individuals with a primary specialism in that area, with a grey symbol reflecting a secondary area of expertise. Where board members are not deemed to have a level of specialism regarding a specific competency they clearly contribute constructively to those matters through their general level of board and business experience.

### VERONICA OAK

#### NON-EXECUTIVE DIRECTOR, CHAIRMAN OF THE REMUNERATION COMMITTEE

**Appointment to the board:** Appointed to the Chesnara plc board in January 2013.

**Committee membership:** Nomination & Governance, Audit & Risk and Remuneration.

**Current directorships/business interests:**

- Hanley Economic Building Society, Chairman of the Risk Committee
- Hanley Mortgage Services Limited, NED
- Hanley Financial Services Limited, NED
- Sanlam Investment Holdings Limited, NED
- Sanlam UK Limited, NED
- Investment & Life Assurance Group Limited, NED
- Countrywide Assured plc, NED

**Skills and experience:** A B H I J K

### DAVID RIMMINGTON

#### GROUP FINANCE DIRECTOR

**Appointment to the board:** Appointed as Group Finance Director with effect from May 2013.

**Career, skills and experience:** David trained as a chartered accountant with KPMG, has more than 18 years’ experience in financial management within the life assurance and banking sectors and has delivered 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.

**Skills and experience:** A B C D E F H J

### DAVID BRAND

#### NON-EXECUTIVE DIRECTOR

**Appointment to the board:** Appointed to the Chesnara plc board and the board of Movestic Livförsäkring AB in January 2013.

**Committee membership:** Nomination & Governance and Audit & Risk.

**Current directorships/business interests:**

- Exeter Friendly Society, Chairman of the Audit Committee and Investment Committee
- Exeter Cash Plan Holdings Limited, NED
- Exeter Cash Plan Limited, NED
- Movestic Livförsäkring AB, Chairman of the Audit & Risk Committee
- Countrywide Assured plc, NED

**Skills and experience:** A B C D E F G H

#### BOARD CHANGES

**During the year there have been some changes to the board:**

- Frank Hughes stepped down as an executive director on 31 December 2016.
- Peter Wright stepped down as a non-executive director of the company on 31 December 2016. Peter chaired the Audit & Risk Committee up until 14 December 2016.
- Jane Dale was appointed as a non-executive director in May 2016, and took over as Chairman of the Audit & Risk Committee on 14 December 2016.

# GOVERNANCE OVERVIEW FROM THE CHAIRMAN

EFFECTIVE AND ROBUST GOVERNANCE REMAINS CENTRAL TO THE ONGOING SUCCESS OF THE GROUP.

Dear Shareholder,

I am very pleased to present on behalf of the board, our Corporate Governance Report for the year ended 31 December 2016.

This section of the Annual Report and Accounts sets out our governance policies and practices, and includes details of how the company has, during 2016, applied the UK Corporate Governance Code (the 'Code').

The role of the board is to lead the company and to oversee the governance of the group. The board plays a critical role in ensuring that the tone for the group's culture and values is set from the top. I firmly believe that a robust, and effective, governance framework is essential to support management in delivering the company's strategy. We understand that good governance is fundamental to the effective management of the business and its sustainability both in the short and the long-term.

The board continues to maintain an appropriate level of independence and objectivity, and has the correct balance of experience, diversity, skills and experience. I believe the board also has a full understanding of the needs and business requirements across the group. These considerations remain the focus for the board's succession planning arrangements.

The group's Governance Map has well considered terms of reference which sets out the approach and framework that is used consistently across the Chesnara group. The use of the Governance Map ensures that our delegated authority framework is clear and operating correctly and that all decisions are robust and taken by the right people and at the right level.

As our business continues to evolve, both with the development of the group strategy and in response to the ever changing regulatory environment, it is key for the board to ensure that our governance framework also continues to develop to meet these needs. Over the last year there has been a move in regulatory focus towards culture and individual accountability. As a board we need to ensure that our framework progresses to support us at not only a group level but also at a divisional level. The governance framework needs to ensure it meets the needs and supports the business as a whole and the delivery of our strategy.

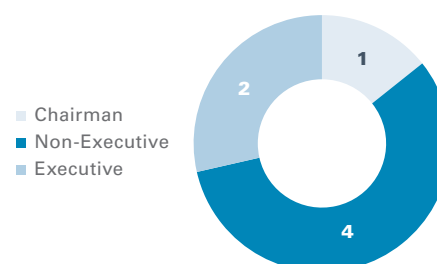
Our shareholders play an important role in supporting the company, and the investor community continues to be an influential force in shaping corporate governance. There are a number of areas of particular focus for shareholders, and boards will continue to face investor scrutiny on their activities. Shareholders provide meaningful contribution to promote effective governance through open and constructive two-way dialogue, and we place great value on this engagement.

We continue to strive towards excellent governance, and this report demonstrates how the board and its committees have fulfilled their governance responsibilities.

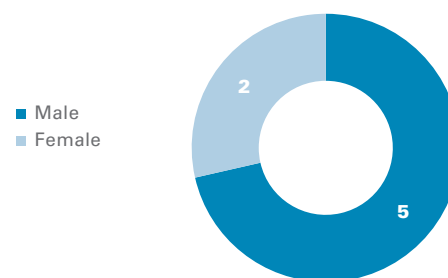


Peter Mason  
Chairman  
30 March 2017

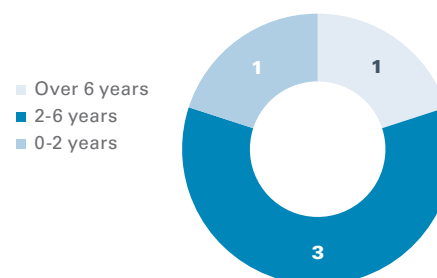
Current balance of executive and non-executive directors



Current gender diversity of the board



Board tenure of NEDs



# CORPORATE GOVERNANCE REPORT

## IT IS ESSENTIAL TO HAVE A WELL DESIGNED AND EFFECTIVE GOVERNANCE FRAMEWORK TO ENSURE THAT STAKEHOLDERS' INVESTMENTS ARE SAFEGUARDED.

The following statement, together with the Directors' remuneration report on pages 58 to 75, the Nomination & Governance Committee Report, and the Audit & Risk Committee Report on pages 76 to 79 describes how the principles set out in the UK Corporate Governance Code 2014 (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 2016.

### Compliance with the Code

The company has complied throughout the year with all of the relevant provisions of the Code. In September 2016 the FRC introduced a new version of the Code, and the revised provisions will apply to the group for the 2017 financial year. The board will therefore report on its implementation of those new responsibilities in next year's Annual Report. The UK Corporate Governance Code is available at [www.frc.org.uk](http://www.frc.org.uk).

### The board

At 31 December 2016, the board comprised a non-executive Chairman, four other non-executive directors and two executive directors.

Biographical details of directors are given on pages 46 and 47 and a board profile, which assesses the core competencies required to meet the group's strategic objectives, is provided on page 47. The board, which plans to meet at least 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 were also directors of Countrywide Assured plc, a UK-based life and pensions subsidiary within the group;
- ii) three directors of the company, being Messrs Mason, Deane and Evans, were also directors of Chesnara Holdings BV throughout the year; and
- iii) three directors of the company, being Messrs Mason, Deane and Brand, were also directors of Movestic Livförsäkring AB throughout the year.

Under local legislation or regulation for all three divisions of the group, the directors 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. The Prudential Regulatory Authority is the group supervisor and maintains oversight of all three divisions of the group through the college of supervisors.

The responsibilities that the board has delegated to the respective executive management teams of the UK, Dutch 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 Group Chief Executive

The division of responsibilities between the Chairman of the board and the Group Chief Executive 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 and supplying timely information, ensuring its effectiveness, encouraging challenge from non-executive directors and setting its agenda. The Chairman has no day-to-day involvement in the management of the group. The Group 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.

### Senior Independent Director

The board has designated Mike Evans 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.

### Directors and directors' independence

The board considers that all non-executive directors are independent and that the Chairman was independent at the date of his appointment.

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, knowledge and number that they are able to challenge the executive directors and their views carry significant weight in the company's decision making.

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.

## THE BOARD DIRECTORS ARE GIVEN REGULAR UPDATES AS WELL AS SPECIFIC SPECIALIST TRAINING.

### 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, their responsibilities and duties which is contained within the group's Governance Map, which covers 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. During the year specific specialist areas of training have also been provided to the board, in particular Solvency II and European governance regulations. Through their membership of the CA plc board all of the directors who served during the period under review have considerable knowledge and experience of the UK-based businesses of the group. Similarly, Messrs Mason, Deane, Evans, Brand and Rimmington, through their membership of the divisional boards, between them have considerable knowledge and experience of both the Swedish and Dutch based businesses 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 subsidiaries within the UK, Dutch and Swedish divisions. These boards hold scheduled meetings, at least quarterly, which are serviced by detailed regular reports and information, which cover all of the key areas relevant to the direction and operation of those subsidiary entities, including but not limited to the following subject areas:

- Business development
- Key projects
- Financial performance and position, covering IFRS, EcV, solvency and cash generation;
- Actuarial, covering assumptions setting and results analysis;
- Compliance;
- Investments;
- Outsourcing;
- Internal audit;
- Risks, including emerging risk, risk-based capital and principal risks;
- Own risk and solvency.

All divisional entities monitor risk management procedures, including the identification, measurement and control of risk through the auspices of a Risk Committee where available. These committees are accountable to and report to their boards on a quarterly basis.

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

In addition, the divisions are 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.

### **Board effectiveness and performance evaluation**

As part of the annual performance, an internal effectiveness evaluation process of the board and its committees was undertaken in the year. This was through an anonymous questionnaire and individual meetings with each director to obtain their views on what was working well and what could be improved.

The discussions were wide-ranging, covering how well the board operates, the process of decision making, the balance between the focus on risk, fair customer outcomes and running the business, the culture and dynamics of the board ensuring its composition and that of its committees are aligned. In addition, using similar methods to those described above, the non-executive directors, led by Mike Evans as Senior Independent Director, met to conduct a formal performance evaluation of the Chairman.

The outcome of the review of the board and its committees indicated that they continue to be effective and that each of the directors demonstrates commitment to his or her role, along with sufficient time to meet the required time commitment to the company. A number of improvements have been made in the year as a result of the actions emanating from the effectiveness review undertaken in 2015. One recommendation was to the quality and delivery of the management information and reporting process. This improvement was delivered through the successful completion of the Management Information Project. Consideration is now being given in 2017 for the development and linkage between the agendas to the new management information reports.

### **Directors' conflicts of interest**

The board has a policy and effective procedures in place for managing and, where appropriate, approving conflicts or potential conflicts of interest. This is a recurring agenda item at all board meetings, giving directors the opportunity to raise any conflicts of interest they may have or to update the board on any changes to previously lodged interests. A director may be required to leave a board meeting whilst such matters are discussed.

The Company Secretary holds a register of interest, and a log of all potential conflicts raised is maintained and updated. Whenever a director takes on additional external responsibilities, the Chairman considers any potential conflicts that may arise and whether or not the director continues to have sufficient time to fulfil his or her duties. The board is empowered to authorise potential conflicts and agree what measures, if any, are required to mitigate or manage them.

### **Company Secretary**

Zoe Kubiak is the Company Secretary and is responsible for advising the board, through the Chairman, on all governance matters. 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](http://www.chesnara.co.uk) or, upon request, from the Company Secretary.

### **Remuneration Committee**

Full details of the composition and work of the Remuneration Committee are provided on pages 56 to 75.

### **Audit & Risk Committee**

Full details of the composition and work of the Audit & Risk Committee are provided on pages 76 to 79.

### **Nomination & Governance Committee**

Full details of the composition and work of the Nomination & Governance Committee are provided on pages 54 to 55.

The attendance record of each of the directors at scheduled board and committee meetings for the period under review is:

	Scheduled board	Nomination & Governance Committee	Remuneration Committee	Audit & Risk Committee
Peter Mason – Non-executive Chairman	11 (11)	6 (6)	5 (5)	n/a
Peter Wright – Non-executive director	11 (11)	6 (6)	n/a	8 (8)
John Deane – Executive director	11 (11)	n/a	n/a	n/a
Frank Hughes – Executive director	10 (11)	n/a	n/a	n/a
Veronica Oak – Non-executive director	11 (11)	6 (6)	5 (5)	8 (8)
David Brand – Non-executive director	11 (11)	6 (6)	n/a	8 (8)
David Rimmington – Executive director	11 (11)	n/a	n/a	n/a
Jane Dale – Non-executive director*	6 (6)	4 (4)	n/a	5 (5)
Mike Evans – Senior Independent Non-executive director	11 (11)	6 (6)	5 (5)	8 (8)

\***Note:** Jane Dale was appointed to the board 19 May 2016 and attended all meetings since her appointment.

The figures in brackets indicate the maximum number of scheduled meetings in the period during which the individual was a board or committee member.

### Relations with shareholders

The Group Chief Executive and the Group Finance Director meet with institutional shareholders 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 Group Chief Executive and the Group Finance Director with shareholders and is responsible for ensuring that the views of shareholders are known to the board. This includes twice yearly feedback prepared by the company's brokers on meetings the executive directors have held with institutional shareholders.

Annual and interim reports are published 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](http://www.chesnara.co.uk)

All shareholders are encouraged to attend the Annual General Meeting ('AGM') at which the results are explained and 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 2017 can be found in the notice of the meeting on pages 163 to 164.

### 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 the FRC's guidance on Risk Management, Internal Control and related financial and business reporting, the board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the group. 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 PRA and SII, the relevant business divisions have maintained and enhanced its 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 Audit & Risk Committee regularly reviews and reports quarterly on risks to the board.

The group also maintains a principal risk register which ensures identification, assessment and control of the significant risks subsisting within the company, CA, Waard Group and Movestic. The principal risks and uncertainties of the group can be found on pages 39 to 41. The maintenance of the principal risk registers is the responsibility of senior management, who report on them quarterly to the respective divisional Audit and Risk Committees and to each Chesnara Audit & Risk Committee meeting. The overseas divisions maintain a risk and responsibility regime which ensures that:

- the boards and Group 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 boards have responsibility for the satisfactory management and control of risks through the specification of internal procedures; and
- there is an explicit risk function, which is supported by compliance and internal control functions.

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

All Chesnara directors are also members of the CA plc board and the company thereby has effective oversight of the maintenance and effectiveness of controls subsisting within CA plc. Regarding the Waard Group and Movestic, such oversight is exercised by way of the membership of a number of the Chesnara directors on their boards, together with quarterly reporting 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 2016, 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 and Compliance 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 UK Internal Audit Function, which reports to the Chairman of the Chesnara Audit & Risk Committee. The Internal Audit functions in Sweden and Netherlands are provided by external consultants who report formally through either their board or Audit & Risk Committee. The Audit & Risk Committee has access to this work and speaks with them on an annual basis.

### **Financial reporting**

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. These controls are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes.

The group has comprehensive planning, budgeting, forecasting and monthly reporting processes in place. A summary of the group's financial results supported by commentary and performance measures is provided to the board before each board meeting.

In relation to the preparation of the group financial statements, the controls in place include:

- the finance governance team review new developments in reporting requirements and standards to ensure that these are reflected in group accounting policies; and
- the finance governance team develop the group's financial control processes and procedures which are implemented across the group.

The reporting process is supported by transactional and consolidation finance systems. Reviews of the applications of controls for external reporting purposes are carried out by senior finance management. The results of these reviews are considered by the board as part of its monitoring of the performance of controls around financial reporting. The Chesnara Audit & Risk Committee reviews the application of financial reporting standards and any significant accounting judgements made by management.

### **Going Concern and Viability Statement**

The directors' Statement on Going Concern is included in the Directors' Report on page 82 and the Long-Term Viability Statement is set out on page 37.



# NOMINATION & GOVERNANCE COMMITTEE REPORT

The Nomination & Governance Committee considers the mix of skills and experience that the board requires to be effective and with focus on talent development and succession planning across the group.

## **Nomination & Governance Committee**

During the period under review, the committee comprised Peter Mason, who also served as Chairman of the committee, David Brand, Veronica Oak, Peter Wright and Mike Evans, all of whom served throughout the period. Jane Dale served on the committee from the date of her appointment. The terms of reference for the committee can be found on the company website, [www.chesnara.co.uk](http://www.chesnara.co.uk)

The role of the Nomination & Governance Committee is to:

- keep under review the balance, structure, size and composition of the board and its committees, ensuring that they remain appropriate;
- be responsible for overseeing the board's succession planning requirements including the identification and assessment of potential board candidates and making recommendations to the board for its approval;
- keep under review the leadership needs of, and succession planning for, the group in relation to both its executive directors and other senior management;
- identify and nominate, for the approval of the board, candidates to fill board vacancies as and when they arise;
- manage the search process for new directors, recommending appointments to the board; and
- evaluate the balance of skills, knowledge, experience and diversity of the board.

This includes consideration of recommendations made by the Group Chief Executive Officer for changes to the executive membership of the board.

During the period, the committee met six times to consider the continuing mix of skills and experience of the directors.

## **The composition of the board**

Much of the committee's focus this year was concerned with succession planning and the composition of the board and its committees, and identifying additional skills and competencies required. After careful consideration, it was agreed that the board would benefit from appointing a new non-executive director. Using an independent external search agency, the priority was to recruit a director who would offer the right skills and complement the remainder of the board. Consideration was also given to which committees would benefit from an additional member and the relevant skills required for these roles.

Having completed the board appointment process, I was delighted to welcome Jane Dale who was appointed, as a non-executive director, to the board on 19 May 2016. Jane brings a wealth of sector relevant experience and skills. Later in 2016 Jane was appointed as Chairman of the Audit & Risk Committee to replace Peter Wright.

On 31 December 2016, Frank Hughes and Peter Wright both stepped down from the board. On behalf of the board, I would like to thank Frank and Peter for their long service and immense contribution to the board and the company.

In light of these changes, the board has remained cognisant of the need to maintain a well-balanced board with the right mix of individuals who can apply their wider business knowledge and experiences to the board and oversight of the group.

The biographical details of the board and the committee membership for each director who served during 2016 can be found on pages 46 and 47.



### **Board appointment process**

The committee adopts a formal and transparent procedure for the appointment of new directors to the board.

The board's process is to use independent external recruitment consultants for appointing directors. The company will provide a brief of the candidate desired, along with a role profile to the recruitment consultant. Any candidate deemed suitable, based on merit and against objective criteria, is submitted to the committee as a potential candidate. The committee will review a short list of suitable candidates against the criteria, and put forward for interview by the board and the executive management team. Any candidate deemed suitable for appointment will, if necessary, first have to go through the fit and proper process as outlined in the Senior Insurance Managers Regime (SIMR) which came into full force on 7 March 2016.

### **Diversity**

The board recognises the benefits of having diversity across all areas of the group. When considering the make-up of the board, the benefits of diversity are appropriately reviewed and balanced where possible and appropriate, including in terms of difference in skills, sector experience, gender, race, disability, age, nationality and other contributions that individuals may make. In identifying suitable candidates the committee will seek candidates from a range of backgrounds, with the final decision being based on merit against the role criteria set.

### **Succession planning**

Succession planning is an important element of good governance, ensuring that Chesnara is fully prepared for planned or sudden departures from key positions throughout the group. The committee has reviewed the succession plans for the board, the group executive committee and senior executives across the group. Senior appointments have been made in the year and the committee has sought to ensure that the most appropriate candidates have been appointed. The following two senior appointments were made in Countrywide Assured plc: Ken Hogg, Chief Executive Officer and Andrew Richards, Finance Director.

### **Non-executive director engagement**

It is important to the board that non-executive directors are provided with training and development both within the business and at a group level. The board believes that ongoing training is essential to maintaining an effective and knowledgeable board. The Company Secretary supports the Chairman in ensuring that all new directors receive a tailored and comprehensive induction programme on joining the board. Continuing education and development opportunities are made available to all board members throughout the year. In 2016 a number of development initiatives have taken place, these included one-to-one sessions for the new non-executive director with key members of the senior management team and training sessions given by external providers.



Peter Mason  
Chairman of the Nomination & Governance Committee  
30 March 2017

# REMUNERATION COMMITTEE CHAIRMAN'S ANNUAL STATEMENT



Dear Shareholder

I am pleased to present the 2016 Directors' remuneration report, for which we seek your support at our forthcoming Annual General Meeting (AGM), in May 2017. As it is three-years since shareholders last approved the remuneration policy, this too is being put to shareholders for a binding vote at our AGM on 17 May 2017 and if approved, will be effective from that date.

## 2016 – A year of delivery

Chesnara has a very clear focus, to recap;

1. Maximise the value from existing business.
2. Acquire life and pension businesses that meet the investment criteria of the company.
3. Enhance value through profitable new business.

This clear strategic focus is underpinned by the culture and values of the group that looks to deliver solid investment returns and value for money for our customers. From a remuneration perspective we seek to achieve strong alignment between the interests of shareholders and executive directors, and continue to operate two executive incentive schemes; the Short-Term Incentive Scheme (STI) and Long-Term Incentive Scheme (LTI).

In 2016 we have seen delivery against all three objectives at a level that has significantly enhanced shareholder value. The full results are set out on page 8, of note is:

1. Cash generation of £36.5m exceeding the funding requirements of the dividend.
2. Announcement of the proposed acquisition of LGN at a 33% discount to Economic Value, increasing the Economic Value of Chesnara by 27.5% as shown in the investor presentation issued in November 2016.
3. The most profitable year for new business written by Movestic since it became part of the group, plus it has provided to Chesnara an inaugural dividend payment of SEK30m (£2.7m).

## Update on organisational and director changes

The management restructure of Chesnara and Countrywide Assured started in 2015 and has been completed with the appointment of Ken Hogg as CEO to Countrywide Assured and the announcement that Frank Hughes has stepped down as a director of Chesnara and Countrywide Assured and, as a result of his role as head of Business Services being removed, Frank will be leaving the organisation later this year. The effect of this has been to reduce the number of executive directors on the Chesnara board from three to two.

## Executive performance in 2016

In light of the performance of the executive team in 2016 relative to the financial targets and strategic objectives set, the Remuneration Committee is satisfied that the reward outcomes are appropriate. Our assessment of the performance outcomes in 2016 under the STI Scheme can be found on page 67.

The first awards made under the 2014 LTI Scheme are due to vest in May 2017 and apply to David Rimmington and Frank Hughes. Details can be found on page 68.

## Changes to the directors' salary

In line with our remuneration policy, it is our normal practice to award executive directors, and indeed all employees, an annual salary increase broadly in line with inflation.

In 2016, employees received an average salary increase of 3%. Frank Hughes received an increase in line with this taking his salary from £205,856 to £212,032. Following the change to the CEO and FD roles and resulting remuneration increases made in 2015 no annual review was due in 2016 for John Deane or David Rimmington and their salaries remained unchanged.

For 2017, employees received an average salary increase of 2%. John Deane received the same increase and David Rimmington received an increase of 5.6%. The latter increase reflects the development David has made in his role since his promotion to Group Finance Director and his resulting salary of £264,000 is within that determined by the committee in 2015 as being appropriate for an experienced Group Finance Director. As Frank Hughes stepped down from the board on 31 December 2016, he was not included in this annual review and I can confirm that no increase to Frank's salary has been made.

## Changes to non-executive fees

The board decided to increase the base fee for all non-executive directors and the Chairman by £3,000 with effect from January 2017 to reflect their increased time commitment and regulatory responsibilities.

## Removal of Business Services Director role

Following the removal of the role of Business Services Director in Chesnara held by Frank Hughes, the committee reviewed and approved the terms of a settlement. Frank has been assessed a 'good leaver' and will receive a pro-rata payment of the LTI awards made in 2015 and 2016 on their normal vesting dates, if they have value. The payments will be subject to the standard rules including deferment. Other payments in deferment will also be subject to the normal scheme rules. More detail is set out on page 70. Frank will not be awarded a 2017 STI Scheme or 2017 LTI Scheme.

#### Review of incentive scheme performance measures

As noted in my report last year, we have considered the performance targets used within the STI and LTI Schemes to ensure that they remain effective and appropriate.

Short-Term Incentive Scheme – under this scheme, the committee has discretion to determine with each award the performance criteria in accordance with the remuneration policy.

The Long-Term Incentive Scheme aims to align executive and shareholder interests via two equally weighted metrics, Total shareholder return and Embedded Value – the latter being a measure of shareholder value. Following the advent of Solvency II, Embedded Value has been replaced with Economic Value. As shown in the presentation of the 2016 half year results the difference between Embedded Value and Economic Value as at 31 December 2015 was shown to be lower by £1.8m or (0.4)%. In view of the very small difference and the belief these measures will develop in a similar manner the committee has agreed to transition the LTI Scheme from EEV to EcV. For performance years starting before 1/1/2016 the measure will be EEV. For performance years starting on or after 1/1/2016 the measure will be EcV.

#### Directors' remuneration policy (the 'Policy')

No significant changes are proposed to the remuneration policy approved by shareholders three-years ago. In particular, there has been no change to pension and other benefits or the LTI or STI Schemes – including their maximum opportunity. All other proposed minor changes take into account comment from the external remuneration advisor engaged for this exercise, KPMG, and feedback from shareholders over the period since the last policy vote. The committee notes the recent publication of the green paper on corporate governance and will consider whether changes are required to the schemes in due course as discussions develop.

As reported in last year's report, on 1 January 2016 the remuneration requirements in the PRA Solvency II Regulations became applicable to all Solvency II firms. Later in the year the PRA issued a Supervisory Statement on the requirements for compliance with Article 275. Chesnara's remuneration arrangements for directors, executives and employees have been reviewed in light of the introduction of these Solvency II requirements and no change has been considered necessary.

The proposed Directors' remuneration policy can be found on pages 58 to 64 and the existing policy is in the Governance Reports section of the company's website- [www.chesnara.co.uk](http://www.chesnara.co.uk)

#### Overall limit of fees payable to non-executive directors

Under the Articles of Association of the company there is a limit of £350,000 on the total fees payable to the directors who do not hold an executive office. The total fees payable in 2017 are estimated to be very close to this limit at £347,500. The board is proposing to increase the limit by special resolution to £500,000. This will allow the board, as and when required, to appoint non-executive directors to replace existing directors, with appropriate handover arrangements, and to add additional non-executive directors or to increase the time commitment of existing directors as required to perform the expanding regulatory duties of the board.

#### Shareholder engagement

The Directors' remuneration report for the year ended 31 December 2016 comprises:

- My report as Remuneration Committee Chairman and our Annual remuneration report, both of which are subject to an advisory shareholder vote at the AGM in May 2017; and
- The proposed Directors' remuneration policy, as set out on pages 58 to 64. The policy will be subject to a binding shareholder vote at the AGM held in May 2017.

The voting outcome at the 2016 AGM in respect of the Directors' remuneration report for the year ended 31 December 2015 is set out on page 74 and reflects the support of both private and institutional shareholders. The committee will continue to be mindful to the interests of shareholders and other stakeholders and I welcome shareholder feedback.

I hope my report, together with our remuneration report, provides a clear account of the operation of the Remuneration Committee during 2016 and how we have put our remuneration policy into practice. I'm very happy to talk to shareholders to discuss any aspect of our activities or decisions.



Veronica Oak  
Chairman of the Remuneration Committee  
30 March 2017

# REMUNERATION POLICY

The current remuneration policy was approved by our shareholders at the Annual General Meeting held on 16 May 2014. This revised remuneration policy will be subject to a binding vote at the AGM to be held on 17 May 2017. The Policy as approved by shareholders can be found on our website [www.chesnara.co.uk/corporate-responsibility/governance-reports](http://www.chesnara.co.uk/corporate-responsibility/governance-reports).

## Introduction

### Remuneration policy

This Policy updates the one that was last approved by shareholders in 2014 and will be subject to a binding shareholder vote at the 2017 Annual General Meeting. If approval is granted, it will be effective from the date of the AGM.

It is the view of the Remuneration Committee (the 'committee') that this remuneration policy makes no significant changes to that approved by shareholders three-years ago. In particular there has been no change to the benefits that the executives enjoy or to the STI and LTI Schemes. Comparisons with the incentive arrangements that existed before 2014 have been removed with a corresponding reduction in the length and complexity of the policy.

The policy has been developed by the committee to provide a clear framework for reward linked to the strategy of the company aligned to the interests of executives and shareholders.

In developing its policy and making decisions about executive director remuneration the committee has taken into account the terms and conditions of employment for employees throughout the company, together with the strategy, objectives and KPIs for the business, and developments in the external marketplace. The company has not consulted with employees.

### Alignment of incentives with strategy

Chesnara plc is a holding company engaged in the management of life and pension books of business in the UK, Sweden and the Netherlands with oversight and governance being provided by a central governance team based in the UK.

The company has three core strategic objectives:

1. Maximise value from existing business;
2. Acquire life and pension business; and
3. Enhance value through profitable new business.

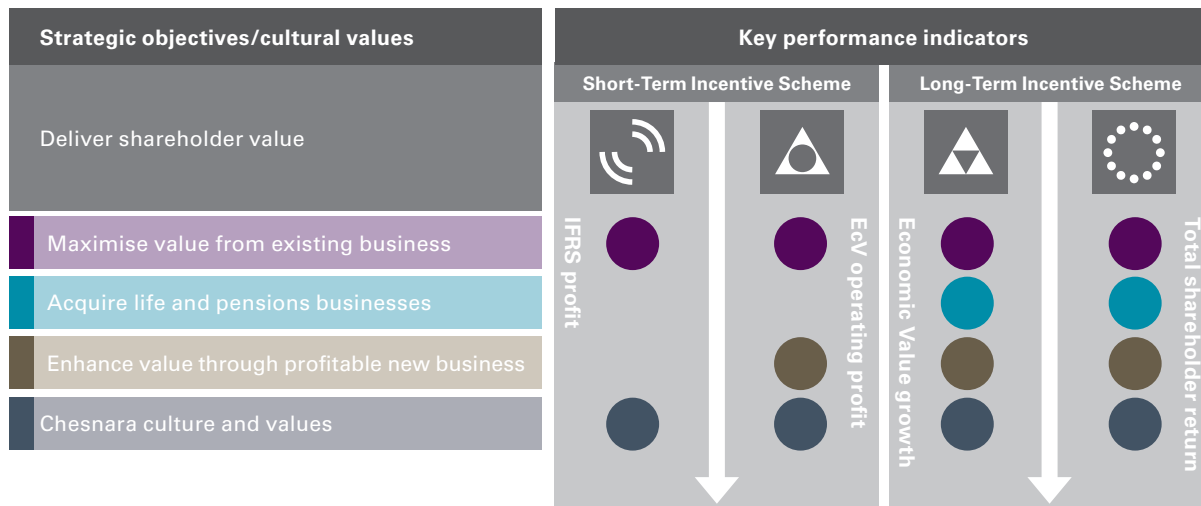
The achievement of these objectives are considered against the culture and risk environment of the company to ensure that rewards do not encourage excessive risk taking or an inappropriate culture to develop.

The schematic below illustrates how the company's KPIs align to its core strategic objectives and, in turn, how those KPIs flow through into the performance measures of the executive's STI and LTI Schemes. Reading across the chart shows how the KPIs align to Chesnara's core strategic objectives. For example, 'Maximise value from existing business', 'Enhance value through profitable new business' and 'Acquire life and pensions businesses' will directly impact the Economic Value growth of the group. Likewise progress against all three objectives should have an impact on the TSR to varying degrees.

The diagram demonstrates that the remuneration policy aligns well to all aspects of the group's objectives. For illustration purposes the diagram below shows the KPIs that the committee has most recently considered appropriate for the incentive schemes but as will be seen on pages 58 to 64 the committee may change the KPIs and/or their weighting for future awards. In addition to the KPIs shown, the Short-Term Incentive Scheme includes objectives for the executives covering key deliverables for the year ahead.

### Overall remuneration policy aims are:

- to maintain a consistent remuneration strategy based on clear principles and objectives;
- to ensure remuneration structures do not encourage or reward excessive risk-taking which is outside the boundaries of our stated risk appetite;
- to link remuneration clearly to the achievement of our business strategy and ensure executive and shareholder reward is closely aligned;
- to enable the company to attract, motivate and retain high-calibre executives; and
- for the policy to be easy to understand and communicate.



**The implementation of this policy involves:**

- paying salaries that reflect individual roles, the individuals’ development in that role and sustained individual performance and contribution, taking account of the external competitive market;
- enabling executives to enhance their earnings by meeting and out-performing stretching short and long-term targets in line with the group’s strategy;
- requiring executives to build and maintain shareholdings in the company;
- rewarding executives fairly and responsibly for their contribution and paying what is commensurate with achievement of these objectives; and
- including malus and clawback provisions, in the STI Scheme (including the deferred share award) and the LTI Scheme.

For the avoidance of doubt, the Directors’ remuneration policy includes authority for the company to honour any commitments entered into with current or former directors that have been disclosed to shareholders in previous remuneration reports. Details of any payments to former directors will be set out in the implementation section of this report as they arise.

The following tables give an overview of the company’s policy on the different elements of the remuneration package.

**The Remuneration Future Policy table**

*Executive directors’ remuneration*

The following tables give an overview of the company’s future policy on the different elements of the remuneration package.

Purpose and link to strategy	Operation	Performance measures and maximum	Changes to the 2014 policy
<b>Basic salary</b>			
To recruit and retain individuals with the skills and experience needed for the role and to contribute to the success of the group.	<p>In setting salaries for new executive roles or reviewing the salaries for existing roles, the committee will take into account, as it considers appropriate, some or all of the following factors:</p> <ul style="list-style-type: none"> <li>– assessment of the responsibilities of the role</li> <li>– the experience and skills of the jobholder on commencement of the role and their development at the review point</li> <li>– the group’s salary budgets and results</li> <li>– the jobholder’s performance</li> <li>– with the use of periodic benchmarking exercises, the external market for roles of a similar size and accountability</li> <li>– inflation and salaries across the company</li> <li>– balance between fixed and variable pay to help ensure good risk management.</li> </ul> <p>Where a new appointment is made, pay may be initially below that applicable to the role and then may increase over time subject to satisfactory performance.</p> <p>Salaries are usually reviewed annually. There may be reviews and changes during the year in exceptional circumstances (such as new appointments to executive positions or significant changes in the jobholder’s responsibilities).</p>	Changes to responsibilities, increased complexity of the organisation, personal and group performance is taken into consideration when deciding whether a salary increase should be awarded.	Slight wording changes of a non-material nature from the 2014 policy.
<b>Taxable benefits</b>			
To recruit and retain individuals with the skills and experience needed for the role and to contribute to the success of the group and to minimise the potential of ill health to undermine executive’s performance.	<p>Executive directors receive life assurance, a company car, fuel benefit and private medical insurance. A cash equivalent may be paid in lieu of a car and fuel benefit.</p> <p>Benefits may be changed in response to changing circumstances whether personal to an executive director or otherwise subject to the cost of any changes being largely cost neutral.</p>	No performance measures attached.	No change from the 2014 policy.

The Remuneration Future Policy table (continued)

Purpose and link to strategy	Operation	Performance measures and maximum	Changes to the 2014 Policy
<b>Pensions</b>			
To recruit and retain individuals with the skills and experience needed for the role and to contribute to the success of the group and to encourage responsible provision for retirement.	The executive directors can participate in a defined contribution pension scheme with employer contributions being 9.5% of basic salary. If pension limits are reached, the executive may elect to receive the balance of the contribution as cash.	No performance measures attached.	No change from the 2014 policy.
<b>Short-Term Incentive (STI) Scheme</b>			
To drive and reward achievement of the group's business plan and key performance indicators. To help retention and align the interests of executive directors with those of shareholders.	<p>The 2014 STI Scheme is discretionary. Awards are based on the committee's assessment and judgement of performance against specific targets and objectives in support of the group's business plan which are assessed over a financial year.</p> <p>Provided the minimum performance criteria is judged to have been achieved then an award will be granted in two parts; at least 35% into deferred share awards in the shape of nil cost options which will vest after a three-year deferral period and the balance in cash.</p> <p>Dividend equivalents accrue in cash with interest thereon in respect of the deferred share awards between the date the share award is granted and the date the options are exercised.</p> <p>It is the intention of the committee to grant awards annually and the performance criteria will be set out in the corresponding remuneration report.</p> <p>The STI Scheme includes malus and clawback provisions.</p>	<p>Performance is measured based on the financial results of the group and its strategic priorities, together with the performance of the executives in relation to specific objectives. The main weighting is given to financial results – typically 80%.</p> <p>The targets may include, but are not limited to, costs, IFRS pre-tax profit, EcV operating profit, cash generation, group strategic objectives and personal performance.</p> <p>STI Scheme targets are commercially sensitive and therefore, not disclosed. Actual targets and results will be disclosed in the Annual Report immediately following each performance period.</p> <p>The committee may substitute, vary or waive the performance measures in accordance with the scheme rules.</p> <p>The maximum award is 100% of basic salary with each participant being assigned a personal maximum to be disclosed in the remuneration report with each award made.</p>	The 2014 policy has been updated to reflect the addition of a clawback provision, effective since January 2015. Otherwise, there has been no change from the 2014 policy.
<b>Long-Term Incentive (LTI) Scheme</b>			
To incentivise the delivery of the longer-term strategy by the setting of stretching targets based on shareholder value, and to help retain key executives and increase their share ownership in the company.	<p>The 2014 LTI Scheme is discretionary. Awards are made under a performance share plan, with no exercise price. The right to receive shares awarded will be based on achievement of performance conditions over a minimum three-year period.</p> <p>It is the intention of the committee to grant awards annually and the performance criteria will be set out in the corresponding remuneration report.</p> <p>The LTI Scheme includes malus and clawback provisions.</p>	<p>Vesting is dependent on two weighted performance measures which the committee for 2017 weights equally but may vary the weighting and the Index as it considers appropriate in future years:</p> <p><b>1.Total shareholder return:</b> Performance conditions are based on total shareholder return of the company when compared to that of the companies comprising the FTSE 350 Higher Yield Index. No payout of this element will be made unless the company achieves at least median performance. Full vesting will be achieved if the company is at the upper quartile compared to the peer group.</p> <p><b>2.Group Economic Value:</b> This target is commercially sensitive and therefore, not disclosed upfront. Actual targets and results will be disclosed in the Annual Report for the year in which an award vests. The assumptions underpinning the calculations are subject to independent actuarial scrutiny.</p> <p>The committee may substitute, vary or waive the performance measures in accordance with the Scheme Rules.</p> <p>The maximum award is up to 100% of basic salary, with each participant being assigned a personal maximum to be disclosed in the remuneration report with each award made.</p>	The 2014 policy has been updated to reflect the addition of clawback provision effective since January 2015. The group Economic Value performance measure is an equivalent post Solvency II replacement for Embedded Value. No other changes from the 2014 policy.



## Non-executive directors' remuneration

Purpose and link to strategy	Operation	Performance measures and maximum	Changes to the 2014 Policy
<b>Fees &amp; expenses</b>			
To recruit and retain independent individuals with the skills, experience and qualities relevant to the role and who are also able to fulfil the required time commitment.	<p>Fees for the Chairman are determined and agreed with the board by the committee (without the Chairman being party to this). Non-executive director fees are determined by the Chairman and the executive directors.</p> <p>Fees are reviewed periodically and in setting fees consideration is given to market data for similar roles in companies of comparable size and complexity whilst also taking account of the required time commitment.</p> <p>All non-executive directors are paid a base fee. Additional fees are paid to the senior independent director, the chair of board committees and to other non-executive directors to reflect additional time commitments and responsibilities required by their role.</p>	<p>Fees for the Chairman and non-executive directors are not performance related.</p> <p>Reflecting the periodic nature of the fee reviews, increases at the time they are made, may be above those paid to executives and/or other employees.</p>	No change from the 2014 policy.

### Explanatory notes:

#### 1. Why these performance measures were chosen and how performance targets are set

**STI Scheme** – The performance measures for the STI Scheme reflect the main financial contributors to sustaining returns for shareholders and the group strategic objectives to ensure that management is incentivised on the important projects needed to support the business plan and strategy. The Remuneration Committee determines the measures, their weighting and the targets for each financial year. The measures will be based upon the most relevant taken from a selection of measures which may include, but are not limited to, costs, IFRS pre-tax profit, EcV operating profit, cash generation, group objectives and personal performance. The maximum potential award requires significant outperformance of budgeted targets.

**LTI Scheme** - The performance measures for the LTI Scheme have been selected for their alignment to shareholder interests using an absolute measure (growth in group EcV) and a comparative measure (TSR). The measures and targets are set by the committee. The maximum potential award for the group EcV measure requires significant outperformance of budgeted targets. The TSR measure uses the FTSE 350 Higher Yield Index over a 3 year period with averaging during the first and last month. The committee currently considers this to be an appropriate comparator given Chesnara's strategic aims and focus on dividend payments.

In setting targets for both schemes, the committee exercises its judgement to try and ensure that there is a balance between stretch in the targets and the company's risk appetite. Full details of the performance measures, weightings and targets and the corresponding potential awards are set out in the remuneration report.

The future remuneration policy table notes that all the financial targets for the STI Scheme are commercially sensitive as is one of the measures for the LTI Scheme. The committee has considered whether it could reasonably use transparent targets but concluded that transparency should not be sought at the expense of choosing the right ones for the alignment of executive director and shareholder interests even if these are not capable of being disclosed upfront.

#### Short-Term Incentive (STI) Scheme

- (i) based on a broad range of measures – including group objectives;
- (ii) performance measures and their weighting are determined by the committee each year to help ensure there is focus on each of the elements necessary to drive sustainable performance. The main weighting will be given to financial measures (typically 80%);
- (iii) maximum potential award up to 100% of salary with each participant having a personal maximum which is to be disclosed in the remuneration report for each award made;
- (iv) award is part cash and part share award deferred for a further 3 years. Currently the intention is to structure the award 65% cash and 35% deferred into shares provided that the total award to a participant is at least £20,000, otherwise the award is 100% cash with no deferral. The committee may increase the weighting for the share award in future years and adjust the de-minimis amount;
- (v) unvested awards may be withheld under the terms of the malus provision. Cash awards are subject to a 2 year clawback provision; and
- (vi) it is the intention of the committee to make a new award each year.

#### Long-Term Incentive (LTI) Scheme

- (i) a performance share plan;
- (ii) uses absolute and comparative measures;
- (iii) in making a new award, the committee will determine the measures, their weighting and targets to maintain a clear focus on longer-term strategic aims;
- (iv) performance period is at least 3 years;
- (v) maximum potential award is up to 100% of salary with each participant having a personal maximum which is to be disclosed in the remuneration report for each award made;
- (vi) includes a malus provision and a 2 year clawback provision; and
- (vii) it is the intention of the committee to make a new award each year.

**Minimum shareholding requirement**

In order to align the executive directors' interests with those of shareholders, a minimum shareholding requirement applies equal to one times salary. There is no timescale attached and it may be achieved by participating in the company's share plans. It is a requirement that shares awarded under the STI and LTI Schemes (net of shares sold to pay for any income tax and National Insurance) must be retained if the minimum requirement has not been met.

**Expenses**

In line with the company's Expenses Policy, all directors may receive reimbursement of reasonable expenses incurred in connection with company business and including settling any tax incurred in relation to these.

**2. Differences in policy compared with other employees:**

The following note outlines any differences in the company's policy on executive director remuneration from other employees of the group.

- **Salary and fees:** There are no differences in policy. The committee takes into account the company's overall salary budget and percentage increases made to other employees.
- **All taxable benefits:** There are no differences in policy although the benefits available vary by personnel and jurisdiction and with job role. For example cars and health insurance benefits are broadly consistent with the equivalent benefits when offered to UK non-director personnel. Executive directors receive fuel allowances which is a benefit not offered to other grades receiving a car allowance.
- **Annual bonus:** This is an integral part of the company's philosophy with all UK employees below board level being eligible to participate in a bonus scheme which is based on personal performance and achievement of financial targets. Senior managers in Sweden participate in annual bonus schemes which reflect the achievement of business targets and personal goals. In line with Swedish regulations part of the payment of this bonus is deferred. Other employees in Sweden participate in a scheme based on the achievement of company-wide business goals. In line with local regulations the remuneration to employees within the Waard Group in the Netherlands does not include any bonus element.
- **Long-term plans:** Only executive directors are currently entitled to participate in the long-term plans as these are the roles which have most influence on and accountability for the strategic direction of the business and the delivery of returns to shareholders. This may be reviewed as appropriate in the light of growth in the company.
- **Pension:** The level of contribution made by the company to executive directors is the same as that offered to other UK employees.

**3. Other**

The company currently operates an SAYE in the UK which expires in 2018. A tax efficient all employee scheme in which executive directors are eligible to participate.

**Approach to remuneration on recruitment**

The following principles apply when recruiting executive directors:

- To offer a remuneration package that is sufficient to attract individuals with the skills and experience appropriate to the role to be filled whilst also being consistent with this Policy. In addition to salary and variable remuneration, this may include pension, taxable benefits and other allowances such as relocation, housing and education.
- Pay levels will be set taking account of remuneration across the company including other senior appointees, and the salary offered for similar roles by other companies of similar size and complexity.
- Each element of remuneration offered will be considered separately and collectively in this context.
- The maximum awards in respect of the STI Scheme and LTI Scheme as set out in the Future Policy table apply in recruitment situations, save that exceptionally the company may award a one-off compensatory bonus or LTI award where the new joiner would lose a bonus or long-term award relating to his or her former role. In the event that such a payment is made, full details will be disclosed in the Annual Report on remuneration for the relevant year.



## Service contracts and loss of office

### Executive directors

Our policy is for executive directors to have service contracts with a rolling twelve-month notice period.

The table below summarises the notice periods and other termination rights of the executive directors and the company. The approach of the company on any termination is to consider all relevant circumstances and to act in accordance with any relevant rules or contractual provisions. Typically, a leaving employee is classified as a 'Good Leaver' if they depart under 'Special Circumstances' (defined in the table below). An employee leaving under any other circumstances is classified as a 'Bad Leaver'.

The committee has discretion to classify an employee as a 'Good Leaver' or a 'Bad Leaver' and to determine the treatment of their outstanding awards upon departure. Regardless of whether a departing executive is deemed to be a 'Good' or 'Bad Leaver', the committee has discretion to pay a departing executive's legal fees subject to any such payment being made in accordance with the terms of a compromise agreement which waives all claims against the company.

Typical treatment in relation to salary, benefits and outstanding incentive awards for leavers under each scenario is shown below:

Nature of termination	Notice period	Salary and Benefits	Short-Term Incentive Scheme	Long-Term Incentive Scheme	Pension
<b>By executive director or company giving notice (and where deemed to be a Bad Leaver).</b>	12 months	Cease on date employment ends.  Payment may be made for any unused holiday entitlement.	No grants following service of notice.  Right to cash payment and unvested deferred share awards cease on date employment ends.  Outstanding options must be exercised within 6 months of date employment ends.	No grants following service of notice.  Unvested awards lapse on date employment ends.  Outstanding options must be exercised within 6 months of date employment ends.	Cease on date employment ends.
<b>By company summarily (Bad Leaver).</b>	None	Cease on date employment ends.	No further grants.  Right to cash payment and unvested deferred share awards cease on date employment ends.  Outstanding options must be exercised within 6 months of date employment ends.	No further grants.  Unvested awards lapse on date employment ends.  Outstanding options must be exercised within 6 months of date employment ends.	Cease on date employment ends.
<b>Under special circumstances: Good Leaver status whether leaving by reason of death, injury or disability, redundancy, retirement with the agreement of the Remuneration Committee, the sale of employing business or company, or other special circumstances at the discretion of the committee.</b>	None prescribed	Normally cease on date employment ends.  Payment may be made for any unused holiday entitlement.  Discretion to company to pay salary and benefits in a single payment or in monthly instalments. Where payments are made monthly the executive is under an obligation to mitigate his or her loss and monthly payments will cease or reduce upon the executive accepting alternative employment.  If leaving by reason of redundancy the payment may include statutory redundancy pay.	Discretion to make further grants during a notice period where this is considered to be in the company's interests.  Where employment ends before deferred share awards made, at the discretion of the committee, the award may be retained.  If retained, the committee has discretion to allow the award to vest in accordance with original terms, or determine award is to vest on ceasing to be employed and will also assess the extent to which targets have been met.  In either case the award will be pro-rated to reflect period of Performance Period that has been worked and will be paid in cash. The committee has discretion to pro-rate using a longer period.  Where employment ends after deferred share awards made, the award will be retained and vest in accordance with original terms. The committee has discretion to allow the award to vest on ceasing to be employed.  All outstanding options must be exercised within 6 months of the date on which employment ends or on which they vest (whichever is later), unless the committee specifies a longer period.	No further grants.  Where employment ends before share awards vest, at the discretion of the committee the award may be retained. If retained, the committee has discretion to allow the award to vest in accordance with original terms or, by exception may determine awards to vest on ceasing to be employed and will also assess the extent to which the targets have been met.  In either case the award will be pro-rated to reflect the period of the Performance Period that has been worked. The committee has discretion to pro-rate using a longer period.  All outstanding options must be exercised within 6 months of the date on which employment ends or on which they vest (whichever is later) unless the committee specifies a longer period.	Cease on date employment ends.

# REMUNERATION POLICY (CONTINUED)

### Non-executive directors

- Appointments are made under a contract for services for an initial term of three-years subject to election by shareholders at the first Annual General Meeting following their appointment and annual re-election thereafter.
- Non-executive directors are typically expected to serve two three-year terms but may be invited by the board to serve for an additional period. Any renewal is subject to board review and AGM re-election.
- The terms of an appointment are set out in a letter of appointment which can be terminated by either party with three months' notice or immediately if termination is as a result of not being elected at the AGM.
- There are no compensation terms regardless of the circumstances that may lead to a contract being terminated.

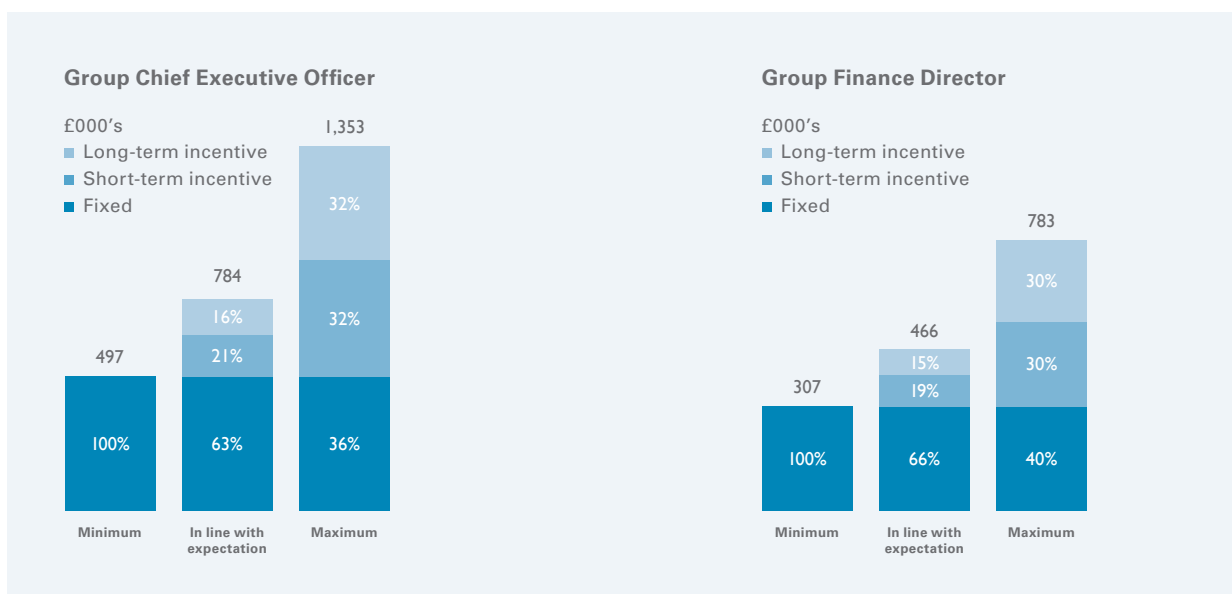
### Other directorships

Executive directors may, if approved by the board, accept appointments as non-executive directors of suitable organisations. Normally fees for such positions are paid to the company, unless the board determines otherwise.

### Illustration of application of remuneration policy

The view of the committee is that there should be balance between fixed and variable pay such that when stretching performance targets have been achieved in full, variable pay should be no more than 200% of salary. The committee believes that this is appropriate given the strategy of the company and its risk appetite.

The charts below provide estimates of the potential future reward opportunities for each executive director, and the potential split between the different elements of remuneration under three different performance scenarios: 'Minimum', 'In line with expectation' and 'Maximum'. The illustration assumes that the 2017 policy applies throughout the period.



In line with expectation performance assumes that the STI and LTI payments are at 37.8% and 29.2% of their maximum respectively for the Group Chief Executive Officer and 34.0% and 26.3% of their maximum for the Group Finance Director. The targets are based on the measures outlined above but are not declared prior to the publication of the accounts for the relevant year as they may be commercially sensitive.

### Minimum

The table below analyses the constitution of the minimum remuneration projection for 2017:

Director	Salary and fees £000	Benefits £000	Pension £000	Total fixed pay £000
Group Chief Executive Officer	428.0	28.0	40.7	496.7
Group Finance Director	264.0	18.0	25.1	307.1

The pension figure above is based on 9.5% of gross basic salary.

### Statement of shareholder views

Given there is very little change in policy between this and our last remuneration policy the committee has not considered it necessary to consult with shareholders.

# ANNUAL REMUNERATION REPORT

## Single total figure of remuneration for each director (audited information)

The remuneration of the executive directors for the years ended 31 December 2015 and 31 December 2016 is made up as follows:

### Executive directors' remuneration as a single figure – year ended 31 December 2016

Name of director	Salary and fees £000	All taxable benefits £000	Non taxable benefits £000	Annual bonuses £000	LTI <sup>2</sup> £000	Pension £000	Total for 2016 £000
John Deane	420	27	2	413	–	40	902
David Rimmington	250	14	4	222	89	24	603
Frank Hughes <sup>1</sup>	212	18	7	167	103	20	527
<b>Total</b>	<b>882</b>	<b>59</b>	<b>13</b>	<b>802</b>	<b>192</b>	<b>84</b>	<b>2,032</b>

#### Notes:

1. Frank Hughes stepped down from the board on 31 December 2016.
2. Amounts shown for LTI are estimates as they relate to an award which is due to vest in May 2017. Details of this LTI award are on page 68.

### Executive directors' remuneration as a single figure – year ended 31 December 2015

Name of director	Salary and fees <sup>1&amp;2</sup> £000	All taxable benefits £000	Non taxable benefits £000	Annual bonuses £000	LTI £000	Pension £000	Total for 2015 £000
John Deane	290	26	3	240	–	37	596
David Rimmington	227	12	6	139	–	18	402
Frank Hughes	206	15	5	127	–	16	369
<b>Total</b>	<b>723</b>	<b>53</b>	<b>14</b>	<b>506</b>	<b>–</b>	<b>71</b>	<b>1,367</b>

#### Notes:

1. John Deane received fees of £100,000 from his directorship appointment with Atom plc, and therefore the salary paid by the company was reduced by this amount.
2. Resulting from the Remuneration Review in 2015, both John Deane and David Rimmington received a salary increase effective from 1 July 2015.

The remuneration of the non-executive directors for the years ended 31 December 2015 and 31 December 2016 is made up as follows:

### Non-executive directors' remuneration as a single figure - year ended 31 December 2015 and 2016

Name of director	2016			2015		
	Salary and fees £000	All taxable benefits £000	Total £000	Salary and fees £000	All taxable benefits £000	Total £000
Peter Mason	108	–	108	106	2	108
Peter Wright <sup>1</sup>	65	–	65	64	1	65
Veronica Oak	55	1	56	54	3	57
David Brand	55	–	55	52	1	53
Mike Evans	55	1	56	52	3	55
Jane Dale <sup>2</sup>	34	–	34	–	–	–
<b>Total</b>	<b>372</b>	<b>2</b>	<b>374</b>	<b>328</b>	<b>10</b>	<b>338</b>

#### Notes:

1. Peter Wright stepped down from the board on 31 December 2016.
2. Jane Dale was appointed to the board on 19 May 2016, and subsequently appointed Chairman of the Audit & Risk Committee on 14 December 2016.

# ANNUAL REMUNERATION REPORT (CONTINUED)

## Salary and fees

Basic salaries are usually reviewed annually by the Remuneration Committee. Assessments are made giving full regard to external factors such as earnings inflation and industry benchmarks and to internal factors such as changes to the role by way of either structural reorganisations or enlargement of the group. In addition, basic pay levels reflect levels of experience. The single earnings figures demonstrate the application of this assessment process.

The remuneration policy for the executive directors is designed with regard to the policy for employees across the group as a whole. Our ability to meet our growth expectations and compete effectively is dependent on the skills, experience and performance of all our employees. Our employment policies, remuneration and benefit packages for employees are regularly reviewed. There are some differences in the structure of the remuneration policy for the executive directors and senior management team compared to other employees reflecting their differing responsibilities, with the principal difference being the increased emphasis on performance related pay for the more senior employees within the organisation.

Employee share ownership is encouraged and facilitated through participation in the SAYE Scheme (subject to minimum service requirement).

Although the committee does not consult directly with employees on directors' pay, the committee does take into consideration the pay and employment conditions of all employees when setting the policy for directors remuneration. In terms of comparison metrics, the committee takes into account the average level of salary increase being budgeted for the UK workforce when reviewing the salary levels of the executive directors. The committee is also mindful of any changes to the pay and benefit conditions for employees more generally when considering the policy for directors' pay.

## Taxable benefits

The taxable benefits for executive directors relate to the provision of a car, fuel allowance and medical insurance. For non-executive directors, the taxable benefits represent the reimbursement of travelling expenses incurred in attending board meetings at the Preston Head Office. These amounts also include an amount to compensate for the personal tax burden incurred.

## Annual bonuses

The amount reported as annual bonuses in 2016 is entirely made up of awards made under the 2014 STI Scheme. The amounts awarded to the executive directors under this scheme are based on performance against three core measures, being IFRS pre-tax profit, EEV operating profit and group strategic objectives. The table below shows the outcome of each measure when compared with the target and the resulting award.

	Upper threshold for minimum performance	Percentage award for minimum performance	On target performance	Percentage award for on target performance	Minimum threshold for maximum performance	Percentage award for maximum performance	Actual result	Actual percentage total award	Actual percentage award, as %age of salary	Total award (£)
<b>John Deane</b>										
IFRS pre-tax result	£19.015m	0%	£25.353m*	15.0%	£50.706m	50.0%	£51.004m*	50.0%	50.0%	210,000
EEV operating result	£9.540m	0%	£10.600m	12.8%	£15.900m	30.0%	£49.802m	30.0%	30.0%	126,000
Group strategic objectives	60% of max	0%	80% of max	10.0%	100%	20.0%	91.4% of max	18.3%	18.3%	76,776
<b>Total</b>				<b>37.8%</b>		<b>100.0%</b>		<b>98.3%</b>	<b>98.3%</b>	<b>412,776</b>
<b>David Rimmington</b>										
IFRS pre-tax result	£19.015m	0%	£25.353m*	13.5%	£50.706m	50.0%	£51.004m*	50.0%	45.0%	112,500
EEV operating result	£9.540m	0%	£10.600m	11.5%	£15.900m	30.0%	£49.802m	30.0%	27.0%	67,500
Group strategic objectives	60% of max	0%	80% of max	9.0%	100%	20.0%	93.8% of max	18.8%	16.9%	42,200
<b>Total</b>				<b>34.0%</b>		<b>100.0%</b>		<b>98.8%</b>	<b>88.9%</b>	<b>222,200</b>
<b>Frank Hughes</b>										
IFRS pre-tax result	£19.015m	0%	£25.353m*	12.0%	£50.706m	50.0%	£51.004m	50.0%	40.0%	84,813
EEV operating result	£9.540m	0%	£10.600m	10.2%	£15.900m	30.0%	£49.802m	30.0%	24.0%	50,888
Group strategic objectives	60% of max	0%	80% of max	8.0%	100%	20.0%	92.5% of max	18.5%	14.8%	31,381
<b>Total</b>				<b>30.2%</b>		<b>100.0%</b>		<b>98.5%</b>	<b>78.8%</b>	<b>167,082</b>

For results between the performance thresholds, a straight-line basis applies.

\*Note – this is stated after certain adjustments, such as consolidation adjustments. The actual results are also adjusted in the same manner.

The following table details the requirements for delivery of the strategic objectives for 2016 and actual outcomes:

Objectives area	Objectives and performance	Outcome
<b>John Deane</b>		
<b>Maximise the value from the in-force book (80%)</b>	Embed Solvency II across the group.	Solvency II is embedded across the group, with the further development of Capital Management providing opportunities for the future.
	Maintain strong working relationships with regulators across the group.	Achieved – which supports the group’s acquisition strategy as well as the existing business.
	Ensure that people and IT development plans are in place to develop the capabilities of the organisation.	Recruitment for the role of Countrywide Assured CEO and the succession for the position of Movestic CEO were completed successfully.  Technology plans in Sweden have been finalised.
<b>Acquire life and pensions businesses (20%)</b>	Progress the acquisition of suitable businesses against the investment criteria and risk based acquisition methodology of the group.	The risk-based acquisition process has been successfully applied in the acquisition of Legal & General Netherland (LGN).
<b>David Rimmington</b>		
<b>Improve Investor Communication (20%)</b>	Enhance the presentation and readability of the company presentations, reporting and the usability of the website.	Positive feedback has been received on the changes in presentations and the introduction of EcV replacing EEV.
<b>Maximise the value from the in-force book (70%)</b>	Embed Solvency II across the group.	Solvency II is embedded across the group, with the further development of Capital Management providing opportunities for the future.
	Improve the quality and extent of management reporting to support the Solvency II risk management and financial management.	Improvements are evidenced in this annual report and company presentations over the last 12 months.
	Replace EEV with EcV and revamp the information requirements of the group.	Achieved as presented in the half year and full year results.
<b>Acquire life and pensions businesses (10%)</b>	Develop the funding model for acquisitions to accommodate euro debt.	Successfully completed as evidenced by the LGN acquisition.
<b>Frank Hughes</b>		
<b>Maximise the value from the in-force book (80%)</b>	Embed Solvency II in CA.	Solvency II is embedded, with the further development of Capital Management providing opportunities for the future.
	Maintain strong working relationships with regulators in the UK.	Achieved - which supports the UK acquisition strategy as well as the existing business.
	Continued enhancement of the UK Division Governance model with a particular focus on Customer Outcomes.	Implementation of improved systems and processes to support the introduction of the UK Governance Map and evidencing of good Customer Outcomes.
<b>Operational change &amp; development (20%)</b>	Senior Insurance Management requirements to be met.	Procedures have been fully implemented and tested over the course of the year.
	Introduction of a new performance management system.	This system was implemented in July.
	Handover and succession plan to be developed following the appointment of a UK CEO.	Plan developed and delivery well under way.

## ANNUAL REMUNERATION REPORT (CONTINUED)

**Annual bonuses (continued)**

In converting performance against the measures assessed for 2016 set out in the previous tables, the directors' annual bonus awards are specified below:

Name of director	Salary on which award based £	Maximum potential award as %age of salary	Actual award as %age of salary	Total value of award £
John Deane	420,000	100%	98.28%	412,776
David Rimmington	250,000	90%	88.88%	222,200
Frank Hughes	212,032	80%	78.80%	167,082
<b>Total</b>				<b>802,058</b>

35% of the above awards are granted as deferred share awards that will vest at the end of a three-year deferred period.

**Long-Term Incentive Scheme awards**

The following table sets out the amounts that are due to vest on 20 May 2017 under the 2014 LTI Scheme, for which performance conditions were satisfied during the year.

Individual	Measures	Weightings	Ranges and targets			Actual outcome		
			Minimum achievement (as % of target)	Target achievement	Max achievement	Performance achieved	% of award vesting	Value of award £
David Rimmington	TSR	50%	=Median	18.84%	28.22%	19.33%	14.46%	19,943
	EcV	50%	=89.0%	£420.0m	£478.8m	£568.0m	50.0%	68,961
Frank Hughes	TSR	50%	=Median	18.84%	28.22%	19.33%	14.46%	23,113
	EcV	50%	=89.0%	£420.0m	£478.8m	£568.0m	50.0%	79,922

The estimated value of the awards vesting disclosed above have been determined using the average share price over the three month period prior to the year end (329.96p). The actual amounts upon vesting will be determined using the share price upon the vesting date.

The table below sets out potential LTI Scheme interests that have accrued during the year, and each director's interest in that scheme:

Name of executive director	Name of scheme	Date award was granted	Amount of options awarded <sup>1</sup>	Face value on the date of grant <sup>2</sup>	% of award vesting for minimum performance	Length of vesting period – 3 years Date of vesting
John Deane	2014 LTI	28 April 2016	133,017	£415,013 based on share price (312.00p)	12.5%	28 April 2019
	2014 LTI	28 April 2015	84,639	£269,998 based on share price (319.00p)	12.5%	28 April 2018
Frank Hughes	2014 LTI	28 April 2016	50,364	£157,136 based on share price (312.00p)	12.5%	28 April 2019
	2014 LTI	28 April 2015	48,399	£154,392 based on share price (319.00p)	12.5%	28 April 2018
	2014 LTI	20 May 2014	48,443	£150,294 based on share price (310.25p)	12.5%	20 May 2017
David Rimmington	2014 LTI	28 April 2016	71,259	£222,328 based on share price (312.00p)	12.5%	28 April 2019
	2014 LTI	28 April 2015	47,727	£152,249 based on share price (319.00p)	12.5%	28 April 2018
	2014 LTI	20 May 2014	41,800	£129,685 based on share price (310.25p)	12.5%	20 May 2017

#### Basis of awards and summary of performance measures and targets

**2014 LTI Scheme:** Share options awarded are based on the share price at close of business on date of award and a percentage of basic salary as follows: John Deane; 75% in 2015 and 100% in 2016. David Rimmington; 75% in 2014, 75% in 2015 and 90% in 2016. Frank Hughes; 75% in 2014, 2015 and 2016. Options have a nil exercise price.

#### Total shareholder return

50% of the award will vest subject to the TSR target being in a certain range, with the range being the ranking of the TSR of Chesnara against the TSR of the individual companies in the FTSE 350 Higher Yield Index. The award will be made on a sliding scale from nil if the Chesnara TSR is below the median to full if the Chesnara TSR is in the upper quartile.

#### EEV/EcV growth target

As explained in the remuneration policy on page 60, the LTI Scheme is transitioning to Economic Value (EcV) as an equivalent post Solvency II replacement for Embedded Value (EEV). For performance years starting before 1/1/2016 the measure will be EEV. For performance years starting on or after 1/1/2016 the measure will be EcV.

50% of the award will vest subject to the EEV/EcV outcome being within a certain range of its target. The award will be made on a sliding scale with nil being paid out if the outcome is less than or equal to 89% of target, up to a maximum pay-out if the outcome is greater than or equal to 114% of target.

**Note 1** – No awards are made if performance is below the minimum criteria.

**Note 2** – The face value is reported as the estimate of the maximum potential value on vesting.

#### Pension

The pension component in the single figure table represents employer's contributions that form part of the director's remuneration package. The employer's contribution is based on a fixed percentage of each executive's salary.

#### Payments for loss of office (audited information)

No payments were made during the year for loss of office.

# ANNUAL REMUNERATION REPORT (CONTINUED)

## Payments for ceasing to hold office (audited information)

On 31 December 2016 Frank Hughes ceased to be a director as a result of the removal of role of Business Services Director in Chesnara. The committee formed the view that the arrangements and payments set out below are in the best interests of the company and its shareholders, and in line with the company's remuneration policy and contractual arrangements with Frank. The total amount for loss of office is as follows:

*Contractual remuneration entitlements to 30 April 2017:* Frank will continue to receive normal pay and benefits under the terms of his service agreement from 30 November 2016.

*Payment in lieu of notice and awards from incentive plans:* Frank will cease to be employed by the company on 30 April 2017, and at that time he will receive a payment in lieu of his contractual remuneration entitlements for the remaining seven months of his twelve month notice period as set out in the table below. This table also shows how the Remuneration Committee ("the committee") has assessed the treatment of outstanding awards under the various incentive schemes in which Frank participated, including where any discretion has been exercised:

Description	Amount (£)	Explanation of how calculated
Pay in lieu of salary and benefits	176,697	This represents payment in lieu of: basic salary (£153,685*), pension contributions (£11,750) and other taxable / non-taxable benefits (£11,262) for the remaining 7 months of the contractual notice period. *This includes a £30,000 statutory redundancy payment.
Loss of company car	5,278	Compensation for the loss of use of a company car for the period 1 May until 30 November 2017..
2014 STI Scheme: – 15,237 shares granted in 2015 – 14,027 shares granted in 2016	55,653 <sup>1</sup> 51,233 <sup>1</sup>	This represents the value accrued under the 2014 STI Scheme. The committee has exercised its discretion to determine that the awards shall be retained in full and mature at the prescribed time, and Frank be treated as a 'good leaver'. Frank will not be eligible to participate in the STI for the year 2017
2014 LTI Scheme: – 48,443 shares granted in 2014 – 48,399 shares granted in 2015 – 50,364 shares granted in 2016	– – –	The committee determined that Frank should retain in full the share options awarded to him under the 2014 LTI Scheme in respect of the shares granted in 2014. The committee has exercised its discretion to determine that the awards granted in 2015 and 2016 will be reduced on a pro-rata basis, with two-thirds and one-third being retained respectively. It has also determined that Frank be treated as a 'good leaver'. The LTI awards will vest in accordance with the scheme rules. Frank will not be eligible to participate in the LTI for the year 2017.
<b>Total</b>	<b>288,861</b>	

<sup>1</sup>Note: The value of the share awards were calculated using the mid-market closing price of 365.25p on 31 December 2016.

The cost of Frank Hughes ceasing to hold office, as described above, will be recognised in the 2017 financial statements.

## Statement of directors' shareholding and share interests (audited information)

The remuneration policy, which was effective from the 2014 AGM, requires executive directors to build up a shareholding through the retention of shares to the value of their basic salary. When the minimum holding level has not been achieved, directors may only dispose of shares where funds are required to discharge any income tax and National Insurance liabilities arising from awards received from a Chesnara incentive plan. The Chairman and non-executive directors are encouraged to hold shares in the company but are not subject to a formal shareholding guideline.

The table below shows, in relation to each director, the total number of share interests with and without performance conditions, the total number of share options with and without performance measures, those vested but unexercised and those exercised at 31 December 2016 or the date of resignation.

No changes took place in the interests of the directors between 31 December 2016 and 30 March 2017.

Name of director	Shares held: 1 January 2016	Shares held: 31 December 2016 <sup>3</sup>	Options: With performance measures	Options: Without performance measures <sup>1</sup>	Options: Vested but unexercised	Options: Exercised during the year	Percentage of shareholding target held <sup>2</sup>
John Deane	9,677	19,677	217,656	32,873	–	–	40%
David Rimmington	8,048	8,848	160,786	35,818	–	–	56%
Frank Hughes	12,123	12,123	147,206	35,562	–	–	71%
Peter Mason	21,743	25,743	–	–	–	–	–
Peter Wright	70,000	70,000	–	–	–	–	–
Veronica Oak	2,000	3,000	–	–	–	–	–
David Brand	3,000	5,500	–	–	–	–	–
Mike Evans	6,452	7,956	–	–	–	–	–
Jane Dale	–	3,333	–	–	–	–	–
<b>Total</b>	<b>133,043</b>	<b>156,180</b>	<b>525,648</b>	<b>104,253</b>	–	–	–

### Notes:

- The 'options without performance measures' column in the table does not include the share options that will be awarded as part of the mandatory deferral rules under the 2014 STI Scheme in respect of awards made in relation to the 2016 financial year, which equate to 35% of the cash award under this scheme. The timetable for the administration of the scheme means that these will be reported in the 2017 Annual Report and Accounts.
- Calculated using the share price of 365.25p at 31 December 2016.
- On 14 December the company completed a Placing and Open Offer. This resulted in an increase in shares for all directors, except Peter Wright and Frank Hughes.



## Outstanding share options and share awards

Below are details of outstanding share options and awards for executive directors.

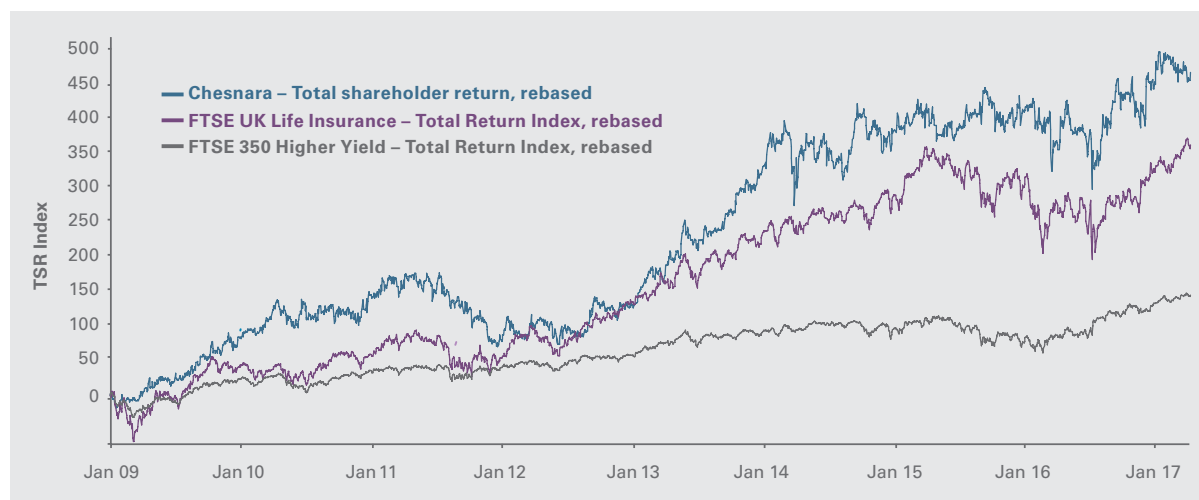
Name of executive director	Scheme	Grant date	Exercise price (p)	Number of shares under option at 1 January 2016	Number granted during year	Number of shares under option and unexercised at 31 December 2016	End of performance period	Vesting date	Performance period	Date of expiry of option
John Deane										
	2014 LTI (2016 award)	28/04/16	Nil	–	133,017	133,017	31/12/18	28/04/19	3 Years	28/04/26
	2014 LTI (2015 award)	28/04/15	Nil	84,639	–	84,639	31/12/17	28/04/18	3 Years	28/04/25
	2014 STI (2015 award)	28/04/16	Nil	–	26,575	26,575	n/a	28/04/19	n/a	28/04/25
	Share save	29/09/15	285.08	6,298	–	6,298	n/a	01/11/18	n/a	n/a
				90,937	159,592	250,529				
David Rimmington										
	2014 LTI (2016 award)	28/04/16	Nil	–	71,259	71,259	31/12/18	28/04/19	3 Years	28/04/26
	2014 LTI (2015 award)	28/04/15	Nil	47,727	–	47,727	31/12/17	28/04/18	3 Years	28/04/25
	2014 LTI (2014 award)	20/05/14	Nil	41,800	–	41,800	31/12/16	20/05/17	3 Years	20/05/24
	2014 STI (2015 award)	28/04/16	Nil	–	15,434	15,434	n/a	28/04/19	n/a	28/04/25
	2014 STI (2014 award)	27/03/15	Nil	14,086	–	14,086	n/a	27/03/18	n/a	20/05/24
	Share save	29/09/15	285.08	6,298	–	6,298	n/a	01/11/18	n/a	n/a
				109,911	86,693	196,604				
Frank Hughes*										
	2014 LTI (2016 award)	28/04/16	Nil	–	50,364	50,364	31/12/18	28/04/19	3 Years	28/04/26
	2014 LTI (2015 award)	28/04/15	Nil	48,399	–	48,399	31/12/17	28/04/18	3 Years	28/04/25
	2014 LTI (2014 award)	20/05/14	Nil	48,443	–	48,443	31/12/16	20/05/17	3 Years	20/05/24
	2014 STI (2015 award)	28/04/16	Nil	–	14,027	14,027	n/a	28/04/19	n/a	28/04/25
	2014 STI (2014 award)	27/03/15	Nil	15,237	–	15,237	n/a	27/03/18	n/a	20/05/24
	Share save	29/09/15	285.08	6,298	–	6,298	n/a	01/11/18	n/a	n/a
				118,377	64,391	182,768				

\*Note: Please refer to page 70 for detail of Frank Hughes ceasing to hold office in relation to LTI awards granted in 2015 and 2016.

# ANNUAL REMUNERATION REPORT (CONTINUED)

## Performance graph and CEO remuneration table

The graph to the right shows the company's performance compared with the performance of the FTSE 350 Higher Yield Index and the FTSE UK Life Insurance Index. The FTSE 350 Higher Yield Index has been selected since 2014 as a comparison because it is the index used by the company for the performance criterion for its LTI Scheme, and the FTSE UK Life Insurance Index has been selected due to Chesnara's inclusion within this index.



The table below sets out the details for the director undertaking the role of Group Chief Executive Officer:

Year	Individual performing CEO role	CEO single figure of total remuneration £000	Annual bonus pay-out against maximum	Long-Term Incentive vesting rates against maximum opportunity	Note
2016	John Deane	902	98.33%	–	1
2015	John Deane	596	81.96%	–	1
2014	Graham Kettleborough	712	91.30%	34.52%	2
2013	Graham Kettleborough	702	100.00%	n/a	3
2012	Graham Kettleborough	612	65.48%	100.00%	4
2011	Graham Kettleborough	384	17.39%	n/a	5
2010	Graham Kettleborough	631	100.00%	n/a	5

**Note 1** – John Deane was appointed CEO on 1 January 2015.

**Note 2** – During 2014 an LTIP that was granted to the CEO in 2012 vested. The LTIP included a condition such that the sum of the LTIPs and annual bonuses awarded in that year could not exceed 100% of the CEO's salary. The annual bonus in 2012 amounted to 65.48% of salary. When the performance measurements for the 2012 LTIP were assessed, the award was required to be restricted due to the operation of the 100% cap combined cap, such that the 2012 LTIP paid out 34.52% of the salary at the time of award.

During 2014 the annual bonus that was awarded represented 68.5% of the CEO's salary. The maximum payable was up to 75% of the CEO's salary, resulting in a 91.3% pay-out with reference to the maximum potential award.

**Note 3** – During 2013 no LTIP value was earned because the annual bonus in isolation accounted for the full 100% combined bonus cap.

**Note 4** – The vesting percentage in 2012 within the Long-Term Incentive column does not relate to a formal LTIP Scheme. It relates to a discretionary supplementary scheme established in 2009 to recognise the value added to the group from the acquisition of Movestic. The amount vesting has been classified in the LTIP column due to the fact its award was subject to certain future performance criteria being achieved. That scheme has generated the maximum potential value of £75,000 in 2012. The formal 2012 LTIP Scheme has contributed no value to the total single remuneration figure as it does not vest until performance criteria have been achieved in 2014.

**Note 5** – Prior to 2012 the LTIP Schemes were in fact better characterised as deferred annual bonus schemes. As such they are classified within the annual bonus value and any value is included in the annual bonus pay-out against maximum percentage.

## Percentage change in remuneration for the director undertaking the role of Group Chief Executive Officer

The table below shows the percentage change in remuneration for the director undertaking the role of Group Chief Executive Officer and the company's employees as a whole between the years 2016 and 2015.

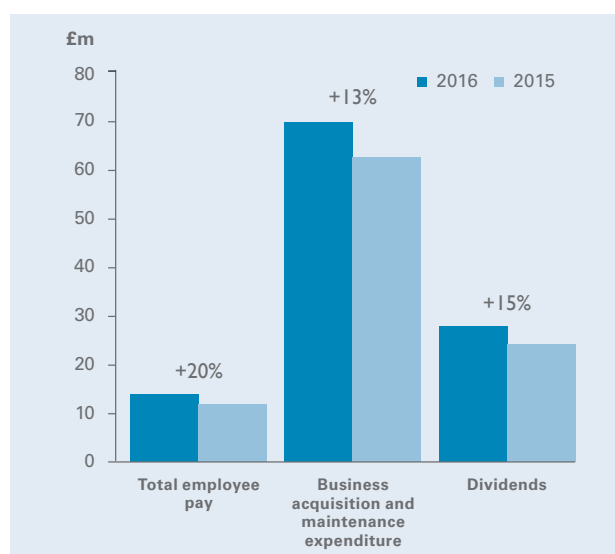
Percentage change in remuneration in 2016 compared with 2015	Percentage change in remuneration in 2016 compared with 2015	
	GCEO %	Group employees %
Salary and fees <sup>1</sup>	7.69	11.17
All taxable benefits	1.40	3.97
Annual bonuses	72.18	11.79

1. The percentage change in salary and fees above, excludes the impact of a salary reduction in 2015, in relation to John Deane's directorship appointment with Atom plc. The difference in the GCEO's salary and fees between 2015 and 2016 arises from a pay increase made in July 2015.

### Relative importance of spend on pay

The graph to the right shows the actual expenditure of the group and change between the current and previous years:

Due to Chesnara adopting a strategy of outsourcing much of its activities the level of total employee pay is relatively low in comparison to dividends. In addition, the graph shows a comparison with the group's total acquisition and maintenance expenditure. As can be seen, the total employee pay is relatively small against our overall cost base.



### Statement of Implementation of remuneration policy in the following financial year

The current remuneration policy took effect following approval at the 2014 AGM and, subject to shareholder approval, will be succeeded by the policy which is being put to shareholders at the 2017 AGM. The following states how the remuneration policy will be implemented assuming that the Policy is approved.

### Salaries and fees

Will be set in accordance with the Company's remuneration policy (see pages 58 to 64).

### 2017 award under the 2014 Short-Term Incentive (STI) Scheme

The Remuneration Committee proposes to grant awards to the executive directors under the Chesnara 2017 remuneration policy.

The table below and accompanying notes set out the performance measures, weightings and the potential outcomes for achieving minimum, on-target and maximum performance. The actual targets for each measure are deemed to be commercially sensitive and whilst they are not disclosed at this stage, will be disclosed in 2018 together with the actual performance against those targets.

Individual	Measures	Weightings	Ranges and targets			Potential outcomes in terms of % of basic salary		
			Minimum achievement (as % of target)	Target achievement (as % of target)	Max achievement (as % of target)	Minimum achievement	Target achievement	Maximum achievement
John Deane	IFRS pre-tax profit	50.0%	75.0%	100.0%	200.0%	nil	15.0%	50.0%
	EcV operating profit	30.0%	90.0%	100.0%	150.0%	nil	12.8%	30.0%
	Group strategic objectives	20.0%	75.0%	100.0%	125.0%	nil	10.0%	20.0%
David Rimmington	IFRS pre-tax profit	50.0%	75.0%	100.0%	200.0%	nil	13.5%	45.0%
	EcV operating profit	30.0%	90.0%	100.0%	150.0%	nil	11.5%	27.0%
	Group strategic objectives	20.0%	75.0%	100.0%	125.0%	nil	9.0%	18.0%

The STI Scheme will be implemented and operated by the Remuneration Committee as set out within the remuneration policy (see the Policy table on pages 59 to 61 and its accompanying notes).

### Measures

The three measures selected by the Remuneration Committee continue to ensure there is a balance between aligning executive director remuneration to shareholder returns whilst also recognising measures over which the directors can exercise more immediate and direct influence. The IFRS pre-tax profit and EcV operating profit are recognised outputs from the audited year-end Financial Statements, although it should be noted that the Remuneration Committee is able to make discretionary adjustments if deemed necessary. The objectives assigned to each executive director are relevant to their roles and include major regulatory or business development initiatives that the committee considers key to delivery of the company's business plan. Each individual development objective is assigned a 'significance weighting' influenced by factors such as business criticality, scale, complexity and level of executive director influence. Developments with a higher significance are weighted more heavily when establishing the overall performance target.

### Weightings

The weightings have been set by the Remuneration Committee. The financial measures that align most directly to shareholder benefit are generally assigned a higher weighting.

### Targets

The IFRS pre-tax profit and EcV operating profit targets are initially based on the latest budget which is produced annually as part of the group business planning process. The group business plan is subject to rigorous Chesnara board scrutiny and approval. The Remuneration Committee can make discretionary adjustments to either the targets or to the actual results for the year if it considers this to be appropriate.

### Malus and clawback

This scheme includes malus and clawback provisions covering material misstatement, assessment error and misconduct if this arises within two years of an award vesting.

## ANNUAL REMUNERATION REPORT (CONTINUED)

**2017 award made under the 2014 Long-Term Incentive (LTI) Scheme**

In 2017 the Remuneration Committee proposes to grant awards to the executive directors under the Chesnara 2014 Long-Term Incentive Scheme. The table below and accompanying notes set out the performance measures, weightings and the potential outcomes relative to achieving minimum, on-target and maximum performance. The actual EcV target is commercially sensitive and will not be disclosed until 2020 together with the actual performance against those targets.

Individual	Measures	Weightings	Ranges and targets			Potential outcomes in terms of % of basic salary		
			Minimum achievement (as % of target)	Target achievement	Max achievement (as % of target)	Minimum achievement	Target achievement	Max achievement
John Deane	TSR	50%	=Median	Median	Upper quartile	12.5%	12.5%	50.0%
	EcV	50%	=89.0%	Target	>=114.0%	nil	16.7%	50.0%
David Rimmington	TSR	50%	=Median	Median	Upper quartile	11.3%	11.3%	45.0%
	EcV	50%	=89.0%	Target	>=114.0%	nil	15.0%	45.0%

The 2017 award under the 2014 LTI Scheme will be implemented and operated by the Remuneration Committee as set out within the remuneration policy (see the remuneration policy table on pages 59 to 61, and its accompanying notes).

**Measures**

The two performance measures for the 2017 LTI award use performance against the constituents of an index and an internal target. The external measure compares the 3 year TSR of Chesnara plc with the TSR of the companies comprising the FTSE 350 Higher Yield Index with averaging over the first and last calendar months. The internal measure assesses Economic Value growth compared to board approved target projections. Both measures seek to ensure an alignment between executive director reward and shareholder value, with one assessing relative performance to other investment opportunities and the other assessing absolute performance. Both measures are based on a three-year performance period ending 31 December 2019.

**Weightings**

For the 2017 award the two measures have been assigned equal weighting.

**Targets**

TSR: The Remuneration Committee proposes that the constituents of the FTSE 350 Higher Yield Index represents

the most appropriate peer group for assessing the relative TSR performance. The award equates to 12.5% and 11.3% of salary for achieving median performance for John Deane and David Rimmington respectively, increasing on a straight line basis to 50.0% and 45.0% of salary respectively for upper quartile performance.

EcV: The Economic Value target is an output from the Chesnara business plan process. The figure is therefore subject to group board challenge and approval. The projections assume a realistic expectation for investment returns and incorporate challenging expectations for new business value from Movestic. The Remuneration Committee can make discretionary adjustments to either the target or to the actual result for the year if it considers this to be appropriate.

**Malus and Clawback**

This scheme includes malus and clawback provisions covering material misstatement, assessment error and misconduct if this arises within two years of an award vesting.

**Consideration of matters relating to directors' remuneration**

In accordance with its Terms of Reference, which can be viewed on the company's website, the Remuneration Committee considered matters relating to directors' remuneration at each of its meetings in 2016. Members of the Remuneration Committee during the course of the year were:

Committee members	Notes relating to role/tenure on the committee	Attendance	Maximum possible meetings
Veronica Oak	Committee Chairman	5	5
Peter Mason	Committee member	5	5
Mike Evans	Committee member	5	5

By invitation, the Group Chief Executive attended a number of Remuneration Committees held, but was not present when matters relating to his own remuneration were discussed.

The committee does not retain the services of external advisers.

**Statement of voting at general meeting**

The group is committed to on-going shareholder dialogue and takes an active interest in voting outcomes. Where there are substantial votes against resolutions in relation to directors' remuneration, the reasons for any such vote will be sought.

The following table sets out the voting in respect of the Directors' remuneration report at the 2016 AGM:

Report	Number of votes cast for	Percentage of votes cast for	Number of votes cast against	Percentage of votes cast against	Total votes cast	Number of votes withheld
Remuneration report	64,461,741	89.06%	7,916,194	10.94%	72,377,935	3,890,940

The following table sets out the voting in respect of the approval of the remuneration policy presented at the 2014 AGM, as included in the 2013 Annual Report and Accounts:

Report	Number of votes cast for	Percentage of votes cast for	Number of votes cast against	Percentage of votes cast against	Total votes cast	Number of votes withheld
Remuneration policy	65,816,824	95.49%	3,108,819	4.51%	68,925,643	368,719

### Composition and activities of the Remuneration Committee

There have been no changes this year to the composition of the committee. In addition to myself, the committee members are Peter Mason (Chairman of the board) and Mike Evans (Senior Independent Director).

### Highlights 2016/2017

In 2016 the committee met five times and dealt with the following matters:

Area of focus	Matter considered
Executive director remuneration and reward	The committee discussed and set the scheme awards and performance targets for the award made in 2016 under the 2014 Short-Term Incentive Scheme (STI) and the 2014 Long-Term Incentive Scheme (LTI) for executive directors. A half-year evaluation was also undertaken.
All employee and executive remuneration	A review of remuneration trends across the group revealed that pay remains at appropriate levels and is not adversely affecting staff turnover or the ability to recruit new members of staff with the required skills and experience.
Terms of Reference	The committee's Terms of Reference were reviewed and it was concluded that they continue to be appropriate for the activities of the committee. A wider review of the Remuneration Committee Terms of Reference for the subsidiaries was also undertaken and it was agreed that the committee should have oversight of certain areas of remuneration for the UK Division.
Review of the remuneration policy	The company's remuneration policy was reviewed with a proposed Directors' remuneration policy being presented to shareholders at the 2017 AGM.
Committee evaluation	An evaluation of the committee's performance suggested that the committee continued to operate well. To ensure adequate time allocation was provided to the meetings, the committee agreed that from 2017 the timetable of meetings would be changed to hold meetings on a separate day to all other meetings.
Annual salary review	Pay is reviewed from 01 January each year. It is our normal practice to award executive directors, and indeed all employees, an annual salary increase broadly in line with inflation. For 2017 employees received an average increase of 2%. John Deane received the same increase. Frank Hughes received no increase and David Rimmington received an increase of 5.6%. The latter increase reflects the development David has made in his role since his promotion to Group Finance Director on 17/05/2013. All the executive directors receive the same pension contribution as other employees.
Directors' Remuneration Reporting	The committee reviewed the draft Directors' remuneration report for the 2016 Financial Statements and recommended their approval by the Chesnara board.
Settlement arrangements for Frank Hughes	The committee approved the final terms of settlement for the former Business Development Director, Frank Hughes. Under these terms Frank will not be awarded the 2017 STI or 2017 LTI. He has been assessed a 'Good Leaver' and will receive a pro-rata payment of his 2015 and 2016 LTI on their normal vesting dates if they have value. The payments will be subject to the standard rules including deferment. Other payments in deferment will also be subject to the normal scheme rules. More detail is set out on page 70.
Performance against strategic targets	The committee reviewed the executive directors' performance against targets set. It was the view of the committee that executives have performed well against targets set - see page 67.
Directors' Minimum Shareholding	The committee reviewed and agreed that no changes be made at present in relation to the quantum required to be held by executive directors.
2016 AGM shareholder voting on the remuneration report	The committee sought feedback from Institutional Investors in relation to the direction of voting at the 2016 AGM. As a result of this feedback the committee has committed to an action plan for future AGMs.

### Approval

This report was approved by the board of directors on 30 March 2017 and signed on its behalf by:



Veronica Oak  
Remuneration Committee Chairman

# AUDIT & RISK COMMITTEE REPORT

The Audit & Risk Committee has continued to focus on financial reporting judgements and challenged management in developing controls over managing current and future risks.



## Chairman's introduction

I am delighted to present my first report as the new Chairman of the Chesnara Audit & Risk Committee. I joined the board of Chesnara in May 2016 as the planned successor for Peter Wright, who retired at the end of the year. Peter chaired the committee during 2016 and handed over to myself in December; I am immensely grateful to Peter for his help and support during my induction and for ensuring a smooth handover.

I am a Chartered Accountant and have worked in the financial services industry for some 30 years; my final executive role until 2015 was as the Finance Director for a life insurance company, so I bring recent and relevant experience to the role. However, it is very important that the committee as a whole has broad experience and expertise in the life sector, so I am very pleased to have independent non-executive directors Veronica Oak, Mike Evans and David Brand as my fellow committee members (detailed biographies and qualifications are on pages 46 to 47). Together, I believe we have a strong blend of skills and experience to fulfil our duties.

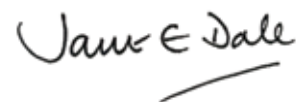
I believe that the role of the committee is ultimately to increase shareholder confidence in the published financial information and much of our work supports this goal. In addition we have a key role to play to ensure that there is a risk management framework in place which ensures that the risks across the group are properly identified, assessed, controlled and managed.

The committee had a busy agenda throughout the year and met 7 times (7 meetings were also held in 2015). As well as the annual activities around reviewing the interim and year end accounts, monitoring and reviewing internal control procedures and reviewing the outcomes from the work of Internal and External Audit, there were a number of additional areas for the committee to consider. In particular, the formal implementation of Solvency II at the start of the year, after considerable planning, meant that a number of related items were considered by the committee, including setting detailed tolerance limits for our risk appetite, delivery of the new regulatory reporting requirements and the introduction of continuous solvency monitoring. We also regularly monitored the horizon for emerging risks; the impact of the UK Referendum and currency risk were amongst the areas considered by the committee. We also had considerable work to do to oversee the due diligence appraisal and risks arising from the proposed acquisition of Legal & General Nederland.

The committee invited a number of attendees to the committee meetings during the year, to present reports and answer our questions. These included the Group Finance Director, the Group Chief Risk Officer, the Group Actuary and the Head of UK Internal Audit; the Group Chairman and the Group Chief Executive Officer were also regular attendees. Reports were received from the consulting firms who provide Internal Audit services to Movestic and the Waard Group. The external auditor, Deloitte, attended the majority of meetings. The committee also held private meetings without management present with the external auditors, Group Chief Risk Officer, the Head of Compliance and the Head of UK Internal Audit. The committee reports to the board on all its activities and makes recommendations where appropriate.

I set out opposite in greater detail the activities carried out by the committee during the year and the key issues we considered.

I look forward to my first formal year as Chairman and continuing the excellent work carried out by Peter.



Jane Dale  
Chairman of the Audit & Risk Committee  
30 March 2017

## Role of the Audit & Risk Committee

The role of the audit and 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. The full terms of reference of the audit and risk committee are available on our website [www.chesnara.co.uk](http://www.chesnara.co.uk)

### Work of the committee during the year:

In relation to the year under review the Audit & Risk Committee has formally reported to the board on how it has discharged its responsibilities. This has included the following, with non-recurring items identified in *italic* font:

#### External audit

- reviewing management’s assessment of the performance of the external auditor for the previous financial year.
- reviewing the reports issued by the Financial Reporting Council in relation to the external auditor.
- reviewing the re-appointment of the external auditor for the current financial year.
- reviewing and approving audit and non-audit fees.
- reviewing and challenging the external auditor’s plan for the audit of the group’s financial statements which included an assessment of key risks and confirmation of auditor independence.
- reviewing reports produced by the external auditor regarding matters arising from the external audit process.
- 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.
- reviewing the group’s policies and procedures relating to fraud, whistle-blowing and employment of ex-employees of the external auditor.

#### Risk

- reviewing group and divisional risk registers and risk reporting.
- ***oversight of the development of the risk management framework.***
- reviewing and challenging quarterly reports by executive management on the identification, evaluation and management of principal risks across the group.
- 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 the activity calendar of the risk function.
- discussing the emerging risks of the group.
- ***oversight over the acquisition process of Legal & General Nederland, focusing on due diligence and shareholder reporting.***
- ***consideration of the risks arising from the referendum outcome. This included reviewing management’s risk assessment in both the run up to the referendum and the impact on the business post the referendum outcome.***

#### Financial reporting

- reviewing the group’s draft financial statements prior to board approval in respect of the half year ended 30 June 2016 and the year ended 31 December 2016.
- reviewing the appropriateness of the group’s accounting policies.
- providing guidance with respect to the annual report and accounts being fair, balanced and understandable.
- reviewing the periodic reports relating to the continuing appropriateness of preparing the group IFRS financial statements on a going concern basis, having due regard for the integrity of the underlying assumptions and appropriateness of the different stress scenarios which test these assumptions.
- reviewing the disclosures in the report and accounts, and underlying supporting work, relating to the longer-term viability statement.
- reviewing and challenging the Solvency II, Economic Value (EcV) and IFRS actuarial reserving assumptions underpinning the year end 2016 reporting.
- reviewing and challenging periodic reports produced by executive management that provide further analysis and context supporting the external financial reporting of the group.
- ***reviewing the updated approach to the reporting of cash generation following the implementation of Solvency II during the year.***
- ***contributing to the decision to no longer report European Embedded Value (EEV), and reviewing the development of its replacement, Economic Value (EcV).***

#### Internal audit

- reviewing and approving internal audit plans for the internal audit of the group’s internal controls, embracing operating, financial and business controls.
- reviewing regular reports from the internal audit functions across the group.
- meeting the Head of UK Internal Audit without an executive director or a member of the company’s senior management being present.

#### Other

- reviewing the terms of reference of the committee and the committee’s compliance therewith.
- performing an evaluation of the performance of the committee during the year.



## **Significant issues considered by the committee in relation to the financial statements:**

The following issues have arisen, which have required careful consideration and exercise of judgement by the committee during the year:

### **Replacement of EEV reporting**

The decision to replace European Embedded Value (EEV) reporting as the principal valuation measure of the Chesnara group with Economic Value (EcV) reporting was given specific consideration by the committee during the year. In considering the decision the committee was presented with analysis prepared by management which supported the pros and cons of the decision and presented the basis of future EcV reporting.

### **Capital reporting in the financial statements**

In May 2016 the memo of understanding between the ASB, the Association of British Insurers and major UK life assurers agreeing to apply the accounting standard 'FRS 27 Life Assurance' was withdrawn. As a consequence these financial statements no longer seek to meet its disclosure requirements. These requirements included providing information on the solvency capital position of the group. To ensure that the financial statements continue to include the relevant facts regarding both the qualitative and quantitative aspects of how the group manages its capital, replacement disclosures have been provided to meet the more general capital reporting requirements of 'IAS 1 Presentation of financial statements'. The committee has given specific attention to this change in disclosure in the financial statements.

### **Accounting for the Waard Group mortgage investment**

During 2016 the Dutch division invested in a portfolio of mortgage assets which has a carrying value of £55m at 31 December 2016. This class of asset is new to the group and consequently the committee considered the accounting policy and associated presentation of this book of assets for IFRS reporting purposes. Management prepared a paper articulating the pros and cons of the different measurement basis available, which was reviewed by the committee, and concluded to record the assets at 'amortised cost'.

### **LGN acquisition accounting and disclosure**

During the year the company announced the proposed acquisition of LGN, which is due to complete in 2017. As part of this process the committee considered the required accounting and disclosure, the processes required to ensure compliance with relevant accounting standards, and the associated reporting implications for both the 2016 and 2017 group financial statements. Due to the acquisition not completing at the time of signing these financial statements, the majority of the disclosure requirements will be reflected in the 2017 financial statements.

### **Review of the methodology and inputs used in determining the costs for the products in S&P containing guarantees**

During the year the methodology and key inputs used for modelling the cost of products in the S&P book that contain guaranteed returns was reviewed. A paper summarising the findings from the review was prepared by management and reviewed by the Audit & Risk Committee. The key findings arising from the review were implemented, notably a requirement to update the annuity pricing that was assumed within the model.

### **Consideration of audit approach**

As part of delivering its responsibilities the committee has spent time considering and challenging the audit approach taken by the external auditor. This has included challenging the overall audit plan, including the scope of the audit work and the key risks of material misstatement identified by the external auditor. In addition to the significant issues outlined above the key risks identified by the auditor include:

- Valuation of Protection Life value-in-force business intangible asset; and
- Credit adjustment to the valuation rate of interest.

The committee can confirm it has considered the above items in the context of the preparation of the financial statements.



## External Auditor

### Effectiveness of the audit process

The committee has assessed the effectiveness of the external audit process. This assessment has had regard to the following factors:

- The quality of the background papers and verbal presentations to the committee on the audit planning process, interim and final audit findings and compliance with independence criteria. The current audit engagement partner, Stephen Williams, was appointed during the year, having replaced Andrew Holland;
- The rationale put forward for the materiality limits established and the explanation given of the impact these have had on the work performed;
- The views of the executive on the way in which the audit has been conducted, which are collated by means of a formal questionnaire approved by the committee;
- The report produced by the Financial Reporting Council dated May 2016 entitled 'Deloitte UK LLP Audit Quality Inspection'. The report was discussed with the auditor although the Chesnara plc audit was not in the population of those inspected; and
- The audit fees charged and the change in fees from the previous year. Changes in annual fees do, of course, need to reflect change in the nature of the company's business which has expanded over time.

It was concluded that the audit process was effective. In view of the tenure of the current auditor, which was appointed in 2009 following a tendering process, it is recommended that the auditor be re-appointed. The company is committed to putting its audit out to tender at least every ten years, resulting in an audit tendering process taking place at the latest during 2019, following the 2018 audit. In the past there have been no contractual restrictions on which firms may be invited to tender but the nature of the company's business (life assurance) and its geographical scope do, in practice, limit the choice of firm to those with substantial life actuarial expertise and some international reach.

### Provision of non-audit services and independence

The committee has in place a policy on the engagement of the audit firm for non-audit services. Automatic approval is granted where the service is clearly related to the process of audit services, including regulatory returns. In other cases the approval of the committee is required, where generally the engagement would result from a tendering process where the audit firm was considered to be clearly superior to any of the other firms invited to tender. Exceptionally, however, in an acquisition process time pressures may make a tendering process impractical and/or conflicts of interest may preclude other suitable firms from being engaged. In these special circumstances the committee (or its Chairman alone where time pressures are very great) may approve the engagement of the auditor.


The committee regularly monitors the level of fees paid for non-audit services to ensure, over a period of years, that these represent a low proportion of total fees paid. Reports from the auditor on independence are also reviewed annually and discussed with the auditor. It should be noted that total fees paid by the company are not material in the context of the overall business of the auditor.

Details of the fees paid to the external auditor, and its associates, for both audit and non-audit services during the year have been provided below, with associated commentary for significant non-audit services.

Audit fees	2016 £000	% proportion	2015 £000	% proportion
Audit services	587	32	562	55
Assurance services	719	39	407	40
Non-audit services	532	29	45	5
<b>Total</b>	<b>1,838</b>		<b>1,014</b>	

#### Non-audit services

Non-audit services in 2016 relate to fees associated with the proposed acquisition of L&G Nederland. We do not believe that the level of non-audit service fees compromised the objectivity or independence of the auditors. In 2015, non-audit fees relate to non-financial consultancy work performed on behalf of Movestic Livförsäkring.



Jane Dale  
Chairman of the Audit & Risk Committee  
30 March 2017

# DIRECTORS' REPORT

Chesnara plc -  
Company No. 4947166

The directors present their Annual Report and the audited consolidated financial statements of Chesnara plc ('Chesnara') for the year ended 31 December 2016. The Corporate Governance Report on pages 49 to 53 forms part of the Directors' Report.

The following information, that has been included by way of a cross reference to other areas of the Annual Report and Accounts, is required by the Companies Act to be included within the Directors' Report:

## Requirements/reference

### *Financial risk management objectives and policies*

The 'Financial management' section on pages 36 to 37 and the 'Risk management' section on pages 38 to 41.

### *Exposure to price risk, credit risk, liquidity risk and cash flow risk*

Note 6 'Management of financial risk' to the IFRS Financial Statements.

### *Likely future developments*

The 'Business review' section on pages 22 to 27.

### *Greenhouse gas reporting*

The 'Corporate and social responsibility' section on pages 42 to 43.

### *Environmental, employee and social community matters*

The 'Corporate and social responsibility' section on pages 42 to 43.

## Directors

Full information of the directors who served in 2016 is detailed in the Corporate Governance Report on pages 49 to 53. Detail of the non-executive directors who served as Chairmen and members of the board committees of the board are set out in the Corporate Governance Report on pages 49 to 53. 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 58 to 75, which also includes details of directors' interests in shares and share options. The Chairman and all the non-executive directors will retire at the Annual General Meeting and, being eligible, offer themselves for re-election. All the executive directors have service contracts with the company of no more than one year's duration and will offer themselves for re-election at least every three-years.

The service contracts of all the directors are retained at the company's office, and will be available for inspection for 15 minutes prior to the Annual General Meeting. 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 2015 and 31 December 2016 and the period to 30 March 2017.

## Share capital

Details of the issued share capital, together with details of movements in the issued share capital of Chesnara plc during the year are shown in note 37 to the IFRS Financial Statements which is incorporated by reference and deemed to be part of this report.

The company has one class of ordinary share which carries no right to fixed income. Each share carries the right to one vote at general meetings of the company. The ordinary shares are listed on the Official List and traded on the London Stock Exchange. As at 31 December 2016, the company had 149,885,761 ordinary shares in issue, of which 147,535 were held as treasury shares.

In order to retain maximum flexibility, the company proposes to renew the authority granted by ordinary shareholders at the Annual General Meeting in 2017, to repurchase up to just under 10% of its issued share capital. Further details are provided in the Notice of this year's Annual General Meeting.

At the Annual General Meeting in 2016, shareholders approved resolutions to allot shares up to an aggregate nominal value of £4,213,496 and to allot shares for cash other than pro rata to existing shareholders. Resolutions will be proposed at this year's Annual General Meeting to renew these authorities.

No person has any special rights of control over the company's share capital and all issued shares are fully paid. There are no specific restrictions on the size of holding nor on the transfer of shares which are both governed by the general provisions of the Articles of Association and prevailing legislation. The directors are not aware of any agreements between holders of the company's shares that may result in restrictions on the transfer of securities or voting rights. The directors have no current plans to issue shares.

## Director appointments

With regard to the appointment and replacement of directors, the company follows the UK Corporate Governance Code and is governed by its Articles of Association, the Companies Act 2006 and related legislation. The Articles of Association may be amended by special resolution.

## Results and dividends

The consolidated statement of comprehensive income for the year ended 31 December 2016, prepared in accordance with International Financial Reporting Standards adopted by the EU and set out on page 91 shows:

	2016 £000	2015 £000
Profit for year attributable to shareholders	35,280	39,788

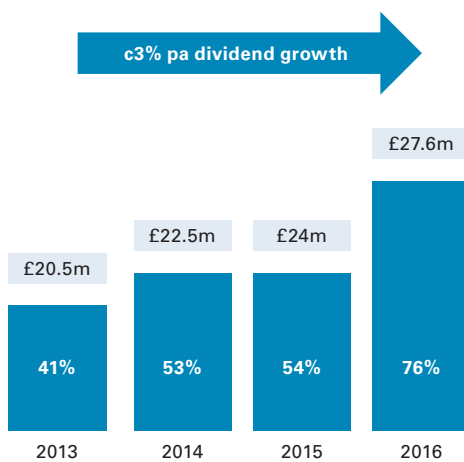
An interim dividend of 6.80p per ordinary share was paid by Chesnara on 14 October 2016. The board recommends payment of a final dividend of 12.69p per ordinary share on 24 May 2017 to shareholders on the register at the close of business on 18 April 2017.

The Chesnara dividend policy is directly influenced by two key factors. We recognise that our shares are predominantly held as a source of predictable and sustainable income. Our primary aim is therefore to provide an attractive yield with steady growth where possible.

Our aim to satisfy investor expectations cannot and will not be delivered at the expense of financial security and solvency. As such, dividend capacity is assessed giving full regard to our Group Capital Management policy which currently prohibits dividends to be declared that would result in Chesnara having a solvency ratio below 110%.

The following table summarises our dividend policy considerations together with the outcomes in terms of recent historic dividends:

### Total dividend as a ratio of cash generated



Over the past 4 years £95m of dividends have been paid at an average annual yield of 6% (based on average annual share prices) representing 55% of the cash generated over the period.

### Considerations

<b>Cash generation</b>	Historic and projected cash generation levels need to support any dividend payment although there is no explicit requirement for the current year's cash generation to cover the dividend.
<b>Solvency</b>	Dividends will not be paid if they were to result in a breach in our Capital Management policy which currently sets a minimum dividend paying solvency constraint of 110%.
<b>Acquisition strategy</b>	The Chesnara business model is based upon making future acquisitions and any dividend payments consider the financial requirements to continue to deliver our acquisition strategy.
<b>Investor expectations</b>	In addition to an attractive dividend yield our investors value predictability and sustainability of earnings. As such, under normal circumstances, 'special dividends' are unlikely.

The board makes dividend decisions with reference to a range of Management Information, Reports and policies including the group ORSA, group business plan, solvency analysis including sensitivities, analysis of historic financial results and the Group Capital Management policy.

## Substantial shareholdings

Information provided to the company by major shareholders pursuant to the FCA's Disclosure and Transparency Rules (DTR), are published via a Regulatory Information Service and is available on the company's website. The company had been notified under Rule 5 of the DTR of the following interests in voting rights in its shares as at 31 December and 21 March 2017:

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at 31 December 2016
Threadneedle Asset Management Limited	15,181,378	12.01%
Aberdeen Asset Managers Limited	6,402,102	5.06%
Barclayshare Nominees Limited	5,185,550	3.15%

Subsequent to 31 December 2016 there have been changes to this position and the holdings as at 21 March 2017 are 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 21 March 2017
Threadneedle Asset Management Limited	15,181,378	12.01%
Aberdeen Asset Managers Limited	6,402,102	5.06%
Prudential plc group of companies	6,692,370	4.46%
Barclayshare Nominees Limited	5,185,550	3.15%

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

Charitable donations made by group companies during the year ended 31 December 2016 were £nil (2015: £nil). No political contributions were made during the year ended 31 December 2016 (2015: £nil).

## Employees

The average number of employees during the year was 201 (2015: 186).

## Employee involvement

The group believes that employee communication and consultation is important in enhancing the company culture and connectivity, and in motivating and retaining employees. An open communications programme enables all employees to understand key strategies and other matters of interest and importance, quickly and efficiently. The communication includes face-to-face briefings, open discussion forums with senior management and email.

## 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 to the IFRS Financial Statements. Detailed analysis of relevant risks and other factors is included within the Risk Management section on pages 38 to 41, within the Financial Management section on pages 36 to 37 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 or she ought to have taken as a director to make himself or herself 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 30 March 2016 and signed on its behalf by:



David Rimmington  
Group Finance Director

# DIRECTORS' RESPONSIBILITIES STATEMENT

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

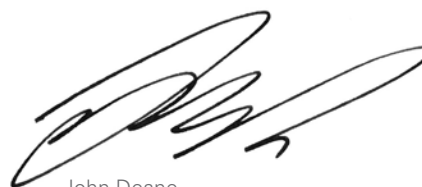
We confirm that to the best of our knowledge:

- 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;
- the strategic 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; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's performance, business model and strategy.



Peter Mason  
Chairman

30 March 2017



John Deane  
Group Chief Executive Officer

30 March 2017

# SECTION D: IFRS FINANCIAL STATEMENTS

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# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHESNARA PLC

## Opinion on financial statements of Chesnara plc

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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 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (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 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.

The financial statements that we have audited comprise:

- the consolidated statement of comprehensive income;
- the consolidated and company balance sheets;
- the consolidated and company cash flow statements;
- the consolidated and company statements of changes in equity; and
- the related notes 1 to 49.

The financial reporting framework that has been applied in their preparation is applicable law and 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.

## Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the group

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As required by the Listing Rules we have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within note 2 (c) to the financial statements and the directors' statement on the longer-term viability of the group contained on page 33.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the directors' confirmation on page 52 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 38-41 that describe those risks and explain how they are being managed or mitigated;
- the directors' statement in note 2 (c) to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and
- the directors' explanation on page 37 as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to add or draw attention to in respect of these matters.

We agree with the directors' adoption of the going concern basis of accounting and we have not identified any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's ability to continue as a going concern.

## Independence

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We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the group and we have fulfilled our other ethical responsibilities in accordance with those standards.

We confirm that we are independent of the group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

## Our assessment of risks of material misstatement

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The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

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## Accuracy of Save and Prosper cost of guarantees

<b>Risk description</b>	<p>The assessment of the cost of guarantee reserves for policies written by Save and Prosper is complex and material, including the use of a stochastic model based on a variety of possible economic scenarios. Historically, the residual cost to shareholders arising from the cost of guarantees has fluctuated significantly as a result of movements in bond yields and equity markets with a value of £35.7m at 31 December 2016 (31 December 2015: £37.2m). The value is determined by a third party actuarial consultant and the directors compare this valuation against an in-house derived estimate using an approximation model to validate its reasonableness.</p> <p>See note 3 (f) for management's consideration of critical accounting judgment and key sources of estimation and uncertainty, note 28 (c) for disclosure of the calculation methodology and the charge to income for the current and prior year and the Audit &amp; Risk Committee discussion on page 78.</p>
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<b>How the scope of our audit responded to the risk</b>	<p>We assessed the competence of the actuarial consultant. Such an assessment includes a direct challenge of the actuarial consultant's working papers and a challenge of the historical accuracy of modelling when compared with actual experience. We used actuarial specialists within our audit team to challenge the appropriateness of assumptions input into the model and benchmark against external actuarial data. Sensitivity analysis was also performed to assess potential management bias. We developed an independent expectation of how the assumptions impact the model and challenged management's explanation and analysis to support any variations.</p> <p>We assessed the design and implementation of the internal controls in place to monitor and manage the risks associated with the cost of guarantee reserve.</p>
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<b>Key observations</b>	<p>Based on the audit procedures performed, we found that the assumptions underpinning the stochastic modelling were reasonable and had been applied appropriately.</p>
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## Valuation of the Protection Life acquired value in-force ('PtL AVIF') business intangible

<b>Risk description</b>	<p>At 31 December 2016 the group carried an intangible asset for the PtL AVIF of £11.6m (31 December 2015: £15.0m).</p> <p>Following a review of the PtL AVIF business intangible in the prior year, we continued to focus on the valuation of this asset as it is the AVIF intangible which is most sensitive to changes in key assumptions used.</p> <p>Assessing the recoverable value of the acquired in-force business intangible asset requires significant judgment in the estimation of the net present value of cash flows expected to arise from the pre-acquisition policies acquired in past business combinations. The key assumptions are persistency rates, discount rates and economic assumptions.</p> <p>See note 3 (b) for management's consideration of significant accounting judgment. The accounting policy adopted by the group is documented within note 2 (o) to the financial statements and the acquired in-force business intangible is disclosed in note 19.</p>
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<b>How the scope of our audit responded to the risk</b>	<p>We evaluated the carrying value of the PtL AVIF intangible asset by reviewing and challenging:</p> <ul style="list-style-type: none"><li>– the mechanical accuracy of the net present value calculation;</li><li>– the future cash flows within the model to assess whether these were the latest available and were those used consistently throughout the business;</li><li>– the level of headroom this calculation generated by reference to the post amortisation carrying value of the asset; and</li><li>– the appropriateness of the key assumptions used within the model by reference to actual experience and performance of sensitivity analysis where appropriate.</li></ul> <p>We assessed the design and implementation of the controls over the impairment test performed by management to evaluate the suitability of the carrying value of the intangible asset.</p>
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<b>Key observations</b>	<p>We found that the assumptions underpinning the impairment test were appropriate and applied consistently. We found that the carrying value of the intangible asset remains appropriate.</p>
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# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHESNARA PLC (CONTINUED)

## Credit adjustment to the valuation rate of interest

**Risk description** Actuarial liabilities are calculated using an appropriate discount rate to take account of the time value of future expected payments. The discount rate used to determine the UK actuarial liabilities includes an adjustment to reflect the credit risk of those future cash flows. The determination of the credit risk adjustment which is applied to non-government bond yields is a source of significant judgment and is material to the balance sheet.

The accounting policy adopted by the group is documented within note 2 (h) with further detail of the calculation of actuarial liabilities disclosed within note 28.

**How the scope of our audit responded to the risk** We evaluated the appropriateness of the principal assumptions relating to the credit risk element of the valuation interest rates assumption for discounting the technical provisions. This involved benchmarking the credit risk assumptions used against those obtained from external data, including a comparison with those adopted by industry peers, where available.

We substantively agreed a sample of non-government bonds used within the calculation of the valuation rate of interest to the value of those bonds on the balance sheet to check whether they were consistent.

We evaluated the design and implementation of the internal controls around the determination and application of the credit element of the valuation rate of interest applied in discounting actuarial liabilities.

**Key observations** We found that the methodology for credit risk adjustments applied to the valuation interest rate is appropriate and applied consistently.

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

## Our application of materiality

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

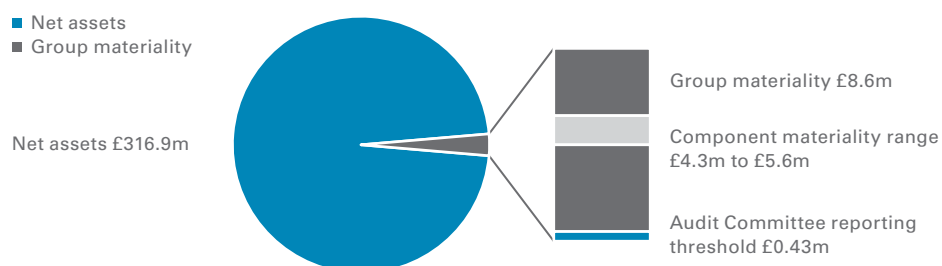
Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

**Materiality** £8.6m (2015: £7.7m)

**Basis for determining materiality** Below 3% (2015: 3%) of adjusted net assets.

The net asset amount used within the determination of materiality has been adjusted downwards by 10% (2015: 10%) to capture any volatility in the benchmark arising from volatility in bond yields and equity prices on non-linked policies held by the group. The approach is consistent with that adopted in the prior year.

**Rationale for the benchmark applied** The net asset amount is considered an appropriate basis given the predominantly closed book nature of the business and management's focus on delivering value to shareholders through dividend streams arising from cash generation.



The component materiality levels set by the group auditor range from £4.3m to £5.6m (2015: £3.9m to £5.8m). The movement in range in the year arises due to foreign exchange movements impacting the re-translated group balance sheet.

We agreed with the Audit & Risk Committee that we would report to the committee all audit differences in excess of £427,000 (2015: £154,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. The change in the reporting threshold has been made following our reassessment of what matters require communicating. We also report to the Audit & Risk Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

## An overview of the scope of our audit

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Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. Based on that assessment, we focused our group audit scope primarily on the audit work at five (2015: five) geographic locations where the group's policies are administered and of which three (2015: three) relate to Countrywide Assured plc, and the remaining two (2015: two) locations relate to Waard Leven, Hollands Welvaren Leven and Waard Schade and Movestic Livförsäkring AB. All five components were subject to a full scope audit, and this is consistent with the prior year.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The group audit team performed the audit work directly at three of the five locations. The remaining two locations involved the use of overseas Deloitte audit teams and followed a programme of planned visits that has been designed so that the senior statutory auditor and a senior member of the group audit team visited each of the locations at least once a year. This approach is consistent with the prior year.

## Opinion on other matters prescribed by the Companies Act 2006

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

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

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

## Matters on which we are required to report by exception

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### *Adequacy of explanations received and accounting records*

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

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

*We have nothing to report in respect of these matters.*

### *Directors' remuneration*

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.

*We have nothing to report arising from these matters.*

### *Corporate Governance Statement*

Under the Listing Rules we are also required to review part of the Corporate Governance Statement relating to the group's compliance with certain provisions of the UK Corporate Governance Code.

*We have nothing to report arising from our review.*

### *Our duty to read other information in the annual report*

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or
- otherwise misleading.

*We confirm that we have not identified any such inconsistencies or misleading statements.*

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the Audit & Risk Committee which we consider should have been disclosed.

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

## Respective responsibilities of directors and auditor

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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). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the group'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 group'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 group and the group's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Scope of the audit of the financial statements

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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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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Stephen Williams FCA (Senior statutory auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
Edinburgh, United Kingdom  
30 March 2017

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December			
	Note	2016 £000	2015 £000
Insurance premium revenue		109,450	114,749
Insurance premium ceded to reinsurers		(44,900)	(46,811)
<b>Net insurance premium revenue</b>		<b>64,550</b>	<b>67,938</b>
Fee and commission income	8	72,932	66,249
Net investment return	9	515,681	148,514
<b>Total revenue net of reinsurance payable</b>		<b>653,163</b>	<b>282,701</b>
Other operating income	10	17,614	18,586
<b>Total income net of investment return</b>		<b>670,777</b>	<b>301,287</b>
Insurance contract claims and benefits incurred			
Claims and benefits paid to insurance contract holders	11	(346,117)	(318,721)
Net decrease in insurance contract provisions	11	11,392	191,850
Reinsurers' share of claims and benefits	11	62,364	32,004
Net insurance contract claims and benefits		(272,361)	(94,867)
Change in investment contract liabilities	12	(274,724)	(100,469)
Reinsurers' share of investment contract liabilities	12	5,617	733
Net change in investment contract liabilities		(269,107)	(99,736)
Fees, commission and other acquisition costs	13	(23,838)	(20,875)
Administrative expenses	14	(46,615)	(41,301)
Other operating expenses			
Charge for amortisation of acquired value of in-force business	15	(10,419)	(9,274)
Charge for amortisation of acquired value of customer relationships	15	(236)	(222)
Other	15	(4,394)	(5,866)
<b>Total expenses net of change in insurance contract provisions and investment contract liabilities</b>		<b>(626,970)</b>	<b>(272,141)</b>
<b>Total income less expenses</b>		<b>43,807</b>	<b>29,146</b>
Share of profit of associate	21	150	455
Profit recognised on business combination		–	16,644
Financing costs	16	(3,272)	(3,457)
<b>Profit before income taxes</b>	7	<b>40,685</b>	<b>42,788</b>
Income tax expense	17	(5,405)	(3,000)
<b>Profit for the year</b>	7	<b>35,280</b>	<b>39,788</b>
Foreign exchange translation differences arising on the revaluation of foreign operations	4	20,114	(173)
<b>Total comprehensive income for the year</b>		<b>55,394</b>	<b>39,615</b>
Basic earnings per share (based on profit for the year)	43	27.67p	31.48p
Diluted earnings per share (based on profit for the year)	43	27.56p	31.41p

The notes and information on pages 97 to 159 form part of these financial statements.

# CONSOLIDATED BALANCE SHEET

31 December	Note	2016 £000	2015 £000
<b>Assets</b>			
Intangible assets			
Deferred acquisition costs	18	48,318	36,061
Acquired value of in-force business	19	62,943	68,341
Acquired value of customer relationships		736	875
Software assets	20	6,560	4,720
Property and equipment		519	537
Investment in associates	21	5,433	4,707
Investment properties		245	245
Reinsurers' share of insurance contract provisions	28	254,859	282,628
Amounts deposited with reinsurers	29	37,437	33,941
Financial assets			
Equity securities at fair value through income	22	485,165	486,243
Holdings in collective investment schemes at fair value through income	22	4,104,602	3,499,355
Debt securities at fair value through income	22	474,091	423,754
Policyholders' funds held by the group	22	229,397	189,919
Mortgage loan portfolio	22/23	54,756	–
Insurance and other receivables	22/24	39,646	43,674
Prepayments	22	5,271	6,565
Derivative financial instruments	22/25	2,773	2,721
Total financial assets		5,395,701	4,652,231
Reinsurers' share of accrued policyholder claims	34	19,307	19,042
Income taxes		3,352	3,611
Cash and cash equivalents	26	260,353	260,863
<b>Total assets</b>		<b>6,095,763</b>	<b>5,367,802</b>
<b>Liabilities</b>			
Insurance contract provisions	28	2,242,446	2,232,083
Other provisions		823	1,905
Financial liabilities			
Investment contracts at fair value through income	29	3,028,269	2,457,521
Liabilities relating to policyholders' funds held by the group	30	229,397	189,919
Borrowings	31	86,843	79,025
Derivative financial instruments	25	1,348	444
Total financial liabilities		3,345,857	2,726,909
Deferred tax liabilities	32	5,420	7,906
Reinsurance payables	33	6,899	9,660
Payables related to direct insurance and investment contracts	34	61,416	62,284
Deferred income	35	5,438	6,212
Income taxes		8,624	6,328
Other payables	36	23,657	18,401
Bank overdrafts	26	1,622	952
<b>Total liabilities</b>		<b>5,702,202</b>	<b>5,072,640</b>
<b>Net assets</b>	<b>7</b>	<b>393,561</b>	<b>295,162</b>
<b>Shareholders' equity</b>			
Share capital	37	43,766	42,600
Share premium	37	142,058	76,516
Treasury shares	38	(161)	(161)
Other reserves	39	19,300	(814)
Retained earnings	40	188,598	177,021
<b>Total shareholders' equity</b>		<b>393,561</b>	<b>295,162</b>

The notes and information on pages 97 to 159 form part of these financial statements.

Approved by the board of directors and authorised for issue on 30 March 2017 and signed on its behalf by:



Peter Mason  
Chairman

John Deane  
Chief Executive Officer

Company Number: 04947166

# COMPANY BALANCE SHEET

31 December	Note	2016 £000	2015 £000
<b>Assets</b>			
<b>Non-current assets</b>			
Financial assets			
Investments in subsidiaries	22	249,234	249,234
<b>Current assets</b>			
Financial assets			
Holdings in collective investment schemes at fair value through income	22	72,939	5,012
Receivables and prepayments		3,007	3,702
Deferred tax asset		202	73
Income taxes		2,279	1,815
Cash and cash equivalents	26	44,183	43,298
<b>Total current assets</b>		<b>122,610</b>	<b>53,900</b>
<b>Total assets</b>		<b>371,844</b>	<b>303,134</b>
<b>Current liabilities</b>			
Borrowings			
Other payables	36	4,785	1,566
<b>Total current liabilities</b>		<b>57,482</b>	<b>13,532</b>
<b>Non-current liabilities</b>			
Borrowings			
	31	–	40,556
<b>Total non-current liabilities</b>		<b>–</b>	<b>40,556</b>
<b>Total liabilities</b>		<b>57,482</b>	<b>54,088</b>
<b>Net assets</b>		<b>314,362</b>	<b>249,046</b>
<b>Shareholders' equity</b>			
Share capital			
	37	7,494	6,328
Share premium			
	37	142,058	76,516
Treasury shares			
	38	(161)	(161)
Other reserves			
	39	50	50
Retained earnings			
	40	164,921	166,313
<b>Total shareholders' equity</b>		<b>314,362</b>	<b>249,046</b>

The notes and information on pages 97 to 159 form part of these financial statements.

The financial statements of Chesnara plc (registered number 4947166) were approved by the board of directors and authorised for issue on 30 March 2017 and signed on its behalf by:


  
 Peter Mason                      John Deane  
 Chairman                              Chief Executive Officer

# CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December			
	Note	2016 £000	2015 £000
<b>Profit for the year</b>		<b>35,280</b>	<b>39,788</b>
Adjustments for:			
Depreciation of property and equipment		173	203
Amortisation of deferred acquisition costs		12,162	9,251
Amortisation of acquired value of in-force business		6,797	9,274
Amortisation of acquired value of customer relationships		172	222
Amortisation of software assets	20	794	1,346
Share based payment		623	212
Tax paid		5,405	2,999
Interest receivable		(20,882)	(24,693)
Dividends receivable		(30,209)	(31,501)
Interest expense		3,272	3,457
Change in fair value of investment properties		–	(4,277)
Fair value gains on financial assets		(205,870)	(87,934)
Profit arising on business combination		–	(16,644)
Share of profit of associate		(150)	(455)
Increase in intangible assets related to insurance and investment contracts		(16,448)	(14,759)
Interest received		20,281	24,458
Dividends received		29,446	31,532
Changes in operating assets and liabilities:			
(Increase)/decrease in financial assets		(280,333)	62,365
Decrease in reinsurers' share of insurance contract provisions		34,177	54,253
(Increase)/decrease in amounts deposited with reinsurers		(3,496)	1,557
Decrease in insurance and other receivables		10,294	1,754
Decrease/(increase) in prepayments		1,795	(1,710)
Decrease in insurance contract provisions		(16,530)	(201,453)
Increase in investment contract liabilities		362,641	149,011
Decrease in provisions		(1,306)	(1,893)
(Decrease)/increase in reinsurance payables		(3,660)	(578)
(Decrease)/increase in payables related to direct insurance and investment contracts		(2,114)	1,708
Increase/(decrease) in other payables		2,808	(1,630)
<b>Net cash generated from operations</b>		<b>(54,878)</b>	<b>5,863</b>
Income tax paid		(4,709)	(4,248)
<b>Net cash (utilised by)/generated from operating activities</b>		<b>(59,587)</b>	<b>1,615</b>
<b>Cash flows from investing activities</b>			
Acquisition of subsidiary, net of cash acquired		–	54,258
Development of software		(3,502)	(2,418)
Disposal/(purchases) of property and equipment		948	(265)
<b>Net cash generated from/(utilised by) investing activities</b>		<b>(2,554)</b>	<b>51,575</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of share capital		66,708	–
Proceeds from borrowings		4,268	–
Repayment of borrowings		–	(7,815)
Dividends paid		(24,181)	(23,498)
Interest paid		(3,095)	(3,382)
<b>Net cash generated/(utilised by) from financing activities</b>		<b>43,700</b>	<b>(34,695)</b>
<b>Net (decrease)/increase in net cash and cash equivalents</b>		<b>(18,441)</b>	<b>18,495</b>
Net cash and cash equivalents at beginning of year		259,911	240,510
Effect of exchange rate changes on net cash and cash equivalents		17,261	906
<b>Net cash and cash equivalents at end of the year (note 25)</b>		<b>258,731</b>	<b>259,911</b>

Note: Net cash and cash equivalents includes overdrafts.

The notes and information on pages 97 to 159 form part of these financial statements.



# COMPANY STATEMENT OF CASH FLOWS

Year ended 31 December	2016 £000	2015 £000
<b>Profit for the year</b>	<b>22,311</b>	<b>56,468</b>
Adjustments for:		
Tax recovery	(1,498)	(980)
Interest receivable	1,641	2,116
Share based payment	478	212
Dividends receivable	(30,500)	(65,000)
Increase in financial assets	(67,927)	(4,004)
Changes in operating assets and liabilities:		
Decrease/(increase) in loans and receivables	621	(3,253)
(Increase)/decrease in prepayments	(55)	2
Increase/(decrease) in other payables	3,351	(503)
<b>Net cash utilised by operating activities</b>	<b>(71,578)</b>	<b>(14,942)</b>
Income tax received	900	800
<b>Net cash utilised by operating activities</b>	<b>(70,678)</b>	<b>(14,142)</b>
<b>Cash flows from investing activities</b>		
Acquisition of subsidiary company	–	(50,123)
Dividends received from subsidiary company	30,500	65,000
<b>Net cash generated from investing activities</b>	<b>30,500</b>	<b>14,877</b>
<b>Cash flows from financing activities</b>		
Net proceeds from the issue of share capital	66,708	–
Net repayment of borrowings	–	(12,000)
Dividends paid	(24,181)	(23,498)
Interest paid	(1,464)	(2,041)
<b>Net cash generated/(utilised by) from financing activities</b>	<b>41,063</b>	<b>(37,539)</b>
<b>Net increase/(decreases) in net cash and cash equivalents</b>	<b>885</b>	<b>(36,804)</b>
Net cash and cash equivalents at beginning of year	43,298	80,102
<b>Net cash and cash equivalents at end of the year (note 25)</b>	<b>44,183</b>	<b>43,298</b>

**Note:** Net cash and cash equivalents includes overdrafts.

The notes and information on pages 97 to 159 form part of these financial statements.

# STATEMENT OF CHANGES IN EQUITY

## CONSOLIDATED

Year ended 31 December 2016						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2016</b>	<b>42,600</b>	<b>76,516</b>	<b>(814)</b>	<b>(161)</b>	<b>177,021</b>	<b>295,162</b>
Profit for the year	–	–	–	–	35,280	35,280
Dividends paid	–	–	–	–	(24,181)	(24,181)
Foreign exchange translation differences (note 4)	–	–	20,114	–	–	20,114
Share based payment	–	–	–	–	478	478
Issue of new shares	1,166	65,542	–	–	–	66,708
<b>Equity shareholders' funds at 31 December 2016</b>	<b>43,766</b>	<b>142,058</b>	<b>19,300</b>	<b>(161)</b>	<b>188,598</b>	<b>393,561</b>

Year ended 31 December 2015						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2015</b>	<b>42,600</b>	<b>76,523</b>	<b>(641)</b>	<b>(168)</b>	<b>160,519</b>	<b>278,833</b>
Profit for the year	–	–	–	–	39,788	39,788
Dividends paid	–	–	–	–	(23,498)	(23,498)
Foreign exchange translation differences (note 4)	–	–	(173)	–	–	(173)
Share based payment	–	–	–	–	212	212
Sale of treasury shares	–	(7)	–	7	–	–
<b>Equity shareholders' funds at 31 December 2015</b>	<b>42,600</b>	<b>76,516</b>	<b>(814)</b>	<b>(161)</b>	<b>177,021</b>	<b>295,162</b>

The notes and information on pages 97 to 159 form part of these financial statements.

## COMPANY

Year ended 31 December 2016						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2016</b>	<b>6,328</b>	<b>76,516</b>	<b>50</b>	<b>(161)</b>	<b>166,313</b>	<b>249,046</b>
Profit for the year	–	–	–	–	22,311	22,311
Dividends paid	–	–	–	–	(24,181)	(24,181)
Share based payment	–	–	–	–	478	478
Issue of new shares	1,166	65,542	–	–	–	66,708
<b>Equity shareholders' funds at 31 December 2016</b>	<b>7,494</b>	<b>142,058</b>	<b>50</b>	<b>(161)</b>	<b>164,921</b>	<b>314,362</b>

Year ended 31 December 2015						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2015</b>	<b>6,328</b>	<b>76,523</b>	<b>50</b>	<b>(168)</b>	<b>133,131</b>	<b>215,864</b>
Profit for the year	–	–	–	–	56,468	56,468
Dividends paid	–	–	–	–	(23,498)	(23,498)
Share based payment	–	–	–	–	212	212
Sale of treasury shares	–	(7)	–	7	–	–
<b>Equity shareholders' funds at 31 December 2015</b>	<b>6,328</b>	<b>76,516</b>	<b>50</b>	<b>(161)</b>	<b>166,313</b>	<b>249,046</b>

The notes and information on pages 97 to 159 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 in the United Kingdom and registered in England and Wales. The company has a primary listing on the London Stock Exchange. The address of the registered office is 2nd Floor, Building 4, West Strand Business Park, West Strand Road, Preston, England, PR1 8UY, UK.

The company and its subsidiaries, together forming the group, comprise UK, Swedish and Dutch life and pensions businesses.

The UK business, which comprise of the CA and S&P segments described in note 7, 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.

The Swedish business, which comprises the Movestic segment, described in note 7, 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.

The Dutch business, which comprises the Waard Group segment is described in note 7. This represents the group's Dutch life and general insurance business and encompasses the three insurance companies Waard Leven N.V., Hollands Welvaren Leven N.V. and Waard Schade N.V., and a servicing company, Tadas Verzekering. The Waard Group's policy base is predominantly made up of term life policies, although also includes unit-linked policies and some non-life policies, covering risks such as occupational disability and unemployment.

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 30 March 2017.

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

### (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.

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
Amendments to IAS 40 (Dec 2016)	Transfers of investment property
IFRIC 22	Foreign currency transactions and advance consideration
Amendments to IFRS 4 (Sept 2016)	Applying IFRS 9 financial instruments with IFRS 4 insurance contracts (expected to be IFRS 17)
Amendments to IFRS 2 (Jun 2016)	Classification and measurement of share-based payment transactions
Clarifications to IFRS 15 (Apr 2016)	Clarifications to IFRS 15 revenue from contracts with customers
Amendments to IAS 7 (Jan 2016)	Disclosure initiative
Amendments to IAS 12 (Jan 2016)	Recognition of deferred tax assets for unrealised losses
Amendments to IFRS 10, IFRS 12 and IAS 28 (Dec 2014)	Investment entities: applying the consolidation exception
Amendments to IAS 1 (Dec 2014)	Disclosure initiative
Annual Improvements to IFRSs: 2012-2014 cycle	Annual improvements to IFRSs: 2012-2014 cycle
Amendments to IFRS 10 and IAS 28 (Sept 2014)	Sale or contribution of assets between an investor and its associate or joint venture
Amendments to IAS 27 (Aug 2014)	Equity method in separate financial statements
Amendments to IAS 16 and IAS 38 (May 2014)	Clarification of acceptable methods of depreciation and amortisation
Amendments to IFRS 11 (May 2014)	Accounting for acquisitions of interests in joint operations
IFRS 16	Leases
IFRS 9	Financial instruments
IFRS 15	Revenue from contracts with customers
IFRS 14	Regulatory deferral accounts

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 9 will impact both the measurement and disclosures of financial instruments. An exemption has been granted to life insurers, to delay the implementation of IFRS 9 until the earlier of the introduction of IFRS 17 (insurance contracts) and 2021; and
- IFRS 15 does not apply to insurance contracts. However, the new standard may impact how revenue is measured and disclosed within the financial statements for investment contracts.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 2 Significant accounting policies (continued)

### (a) Statement of compliance (continued)

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 40.

### (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 or 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 judgments, 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 judgments 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. Judgments 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.

In accordance with IFRS 4 Insurance Contracts, on adoption of IFRS the group applied existing accounting practices for insurance and participating investment contracts, modified as appropriate to comply with the IFRS framework and applicable standards, introducing changes only where they provide more reliable and relevant information.

### (d) Business combinations

The group uses the purchase method of accounting 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 the Consolidated Statement of Comprehensive Income 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.

### (e) 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.

#### (f) 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 the Consolidated Statement of Comprehensive Income in the year 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 year, 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 year 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.

#### (g) 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 business, 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 ReAssure Limited (ReAssure – previously Guardian Assurance plc), 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; or
- (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.

#### (h) Insurance contracts

There are fundamental differences between the nature of the insurance contracts subsisting in the UK, Swedish and Dutch businesses, including inter alia contract longevity: the related product characteristics are set out for the separate UK, Swedish and Dutch 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:

##### (i) Premiums

Across all three businesses, 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.

In Sweden 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) Claims and benefits

Claims are accounted for in the accounting year in which they are due or notified. Surrenders are accounted for in the accounting year 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.

Swedish non-life 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.

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 28.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 2 Significant accounting policies (continued)

### (h) Insurance contracts (continued)

#### (iii) Acquisition costs

In the UK and for Swedish life and non-life business, 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.

In the Dutch business acquisition costs comprise all direct costs arising from the conclusion of insurance contracts and are expensed when incurred.

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

In the UK and Dutch businesses, 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 basis in order to comply with the reporting requirements of the Prudential Sourcebook for Insurers and the Dutch Central Bank respectively. 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 or mortality improvement 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 ReAssure. 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.

In Sweden, 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.

#### **(i) 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. This is not applicable to the Dutch business.

In respect of the UK business 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 contract.

#### **(j) 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.

#### **(k) 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)

## 2 Significant accounting policies (continued)

### (l) 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 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 Consolidated Statement of Comprehensive Income on a straight-line basis over the term of each lease. Lease incentives are recognised in the Consolidated Statement of Comprehensive Income as an integral part of the total lease income.

### (m) 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 Consolidated Statement of Comprehensive Income 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.

### (n) Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax and is recognised in the Consolidated Statement of Comprehensive Income. 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 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.

### (o) 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. The 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 Consolidated Statement of Comprehensive Income and the carrying amount is reduced to its recoverable amount.

### (p) 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.



**(q) 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.

**(r) Property and equipment**

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

Depreciation is charged to the Consolidated Statement of Comprehensive Income 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.

**(s) 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 Consolidated Statement of Comprehensive Income. Rental income from investment property is accounted for as described in accounting policy (l).

**(t) 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 four different categories of financial assets are used: 'financial assets at fair value through income', 'mortgage loan portfolio', 'prepayments' 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 the Waard Group mortgage loan portfolio and 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 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 insurance and other 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.

The mortgage loan portfolio held by the Waard Group is stated at amortised cost less impairment losses and incorporates the effective interest rate calculation method.

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)

## 2 Significant accounting policies (continued)

### (u) 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.

### (v) 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.

### (w) 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.

### (x) 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.

### (y) Impairment

The carrying amounts of the group's assets other than reinsurance assets (refer to (j) 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 Consolidated Statement of Comprehensive Income. 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 Consolidated Statement of Comprehensive Income 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.

### (z) 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 expenditure 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.

### (aa) Borrowings

Borrowings are recognised initially at fair value, less transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, with interest expense recognised in the Consolidated Statement of Comprehensive Income on an effective yield basis. The effective interest rate 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.

**(bb) 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 Consolidated Statement of Comprehensive Income 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 Consolidated Statement of Comprehensive Income when due.

*Dutch business*

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 Consolidated Statement of Comprehensive Income 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 Consolidated Statement of Comprehensive Income on an accruals basis.

**(cc) Share-based payments**

The value of employee share options and other equity settled share based payments is calculated at fair value at the grant date using appropriate and recognised option pricing models. Vesting conditions, which comprise service conditions and performance conditions, other than those based upon market conditions, are not taken into account when estimating the fair value of such awards but are taken into account by adjusting the number of equity instruments included in the ultimate measurement of the transaction amount. The value of the awards is recognised as an expense on a systematic basis over the period during which the employment services are provided. Where an award of options is cancelled by an employee, the full value of the award (less any value previously recognised) is recognised at the cancellation date.

**(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 judgments and key sources of estimation and uncertainty

The group makes estimates and assumptions that affect the reported amounts of assets and liabilities and also makes critical accounting judgments in applying the group's accounting policies. Such estimates and judgments 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 judgments are made, are set out below. Each item identifies the business segments, as described in note 7, to which it is relevant.

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

The group has exercised judgment in its classification of long-term business 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 judgment 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, Movestic and Waard Group)

The group applies accounting estimates and judgments 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.

The acquired value of in-force business is 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 judgment. In particular the value is sensitive to the rate at which future cash flows are discounted and to the rates of return on invested assets. Analysis shows that, based on applying a range of discount rates, which have been determined with reference to our review of the current market assessment of the true value of money and the risks specific to the asset for which the cash flows have not been adjusted. The rates used for the purpose of the impairment testing were 4%, 8%, 10% and 12%.

As at 31 December 2016, the carrying value of acquired in-force business, net of amortisation, was £16.9m in respect of CA (as at 31 December 2015: £22.4m), £4.5m in respect of S&P (31 December 2015: £5.1m), £36.0m in respect of Movestic (as at 31 December 2015: £35.4m) and £5.5m in respect of Waard Group (31 December 2015: £5.3m).

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

The group applies judgment 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. Judgment 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 2016, the carrying values of deferred acquisition costs, net of amortisation, and of deferred income, in respect of CA, were £2.9m and £5.4m respectively (as at 31 December 2015: £3.4m and £6.2m 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 2016, the carrying values of deferred acquisition costs, net of amortisation, in respect of Movestic, was £45.4m (as at 31 December 2015: £32.7m). An increase in the length of the amortisation period by one year would have increased profit before tax for the year ended 31 December 2016 by £1.6m and shareholders' equity as at 31 December 2016 by £1.2m.

### (d) 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 28.

**(e) Estimates of future maintenance expenses (CA and S&P)**

Future expense levels are a key variable that influence the value of insurance contract provisions. Under normal circumstances the nature of the cost base underpinning CA means that future expenses are relatively predictable and hence assumptions made for actuarial reserving purposes are not subject to material levels of judgment. This is because asset management and policy administration in the UK are outsourced and hence the future costs are defined in contractual arrangements. In addition, governance overheads are by their nature relatively stable and predictable.

**(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 2016, the carrying value of insurance contract liabilities which contain S&P discretionary participation features was £297.5m (31 December 2015: £302.3m).

**(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 2016, the carrying value of the insurance claim reserves, gross of reinsurance, was £81.6m (as at 31 December 2015: £66.9m). The key sensitivities in respect of insurance claim reserves are considered in note 28.

**(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 2016, such claims ceded to reinsurers and reflected on the balance sheet were £54.9m (31 December 2015: £43.6m). The application of a 10% bad debt provision on the reinsurance balance would reduce 2016 profit before tax by £5.5m and shareholders' equity by £4.3m.

**(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.

**4 Exchange rates**

The group's principal overseas operations during the year were located within Sweden and the Netherlands.

The results and cash flows of these operations have been translated into sterling at an average rate for the year of £1 = SEK 11.57 (2015: £1 = SEK 12.89) for the Swedish business and £1 = EUR 1.22 (2015: £1 = EUR 1.39) for the Dutch business.

Assets and liabilities have been translated at the year end rate of £1 = SEK 11.14 (31 December 2015: £1 = SEK 12.49) for the Swedish business and £1 = EUR 1.17 (31 December 2015: £1 = EUR 1.36) for the Dutch business.

Total foreign currency exchange rate movements for the year ended 31 December 2016 resulted in a profit recognised in the Consolidated Statement of Comprehensive Income of £20.1m (year ended 31 December 2015: loss of £0.2m).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 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, Swedish and Dutch businesses are such that insurance risk is managed separately for the separate businesses. Accordingly, the information which follows differentiates these businesses. The UK business which is substantially closed to new business, comprises 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.

### (a) UK business

#### 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

	2016		2015	
	Gross £000	Net £000	Gross £000	Net £000
Long-term unit-linked without DPF (sums assured) – CA and S&P	2,643,702	2,320,059	2,904,720	2,518,420
Long-term non-linked without DPF (sums assured) – CA and S&P	11,086,146	1,511,001	11,976,763	1,652,703
Immediate annuities (benefits per annum) – CA	5,800	5,764	5,846	5,809
Deferred annuities with DPF (benefits per annum) – S&P	1,755	1,755	1,893	1,893
Long-term with DPF (sums assured) – CA	2,862	–	19,649	–
Long-term with DPF (sums assured) – S&P	336,745	326,812	362,076	349,809

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

##### Product features

The UK business has 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 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 business, 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 73% 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; and
- (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 98.1% 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 ReAssure 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.

### **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 a fixed charge for expenses, and certain direct 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 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 98.6% 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 business, as follows:

#### *Expense risk*

The strategy of the UK business is to outsource the majority of 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 business monitors the financial soundness of third party administrators and has 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.

#### *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 business 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 business are set out in note 28 Insurance Contract Provisions.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 5 Management of insurance risk (continued)

### (b) 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	2016		2015	
	Gross £000	Net £000	Gross £000	Net £000
<b>Group</b>				
Sweden	21,005	6,011	18,425	5,208
Norway	24	5	15	3
<b>Individual</b>				
Death	3,200	1,448	2,834	1,321
Waiver of premium	3,288	961	2,894	846
Income protection	7,715	6,644	7,238	6,098
	<b>35,232</b>	<b>15,069</b>	<b>31,406</b>	<b>13,476</b>

Claims outstanding As at 31 December	2016		2015	
	Gross £000	Net £000	Gross £000	Net £000
<b>Group</b>				
Sweden	41,927	11,337	33,790	8,325
Norway	2,975	535	2,756	482
<b>Individual</b>				
Death	821	327	578	212
Waiver of premium	9,812	3,217	8,087	2,633
Income protection	26,052	13,536	21,672	11,606
	<b>81,587</b>	<b>28,952</b>	<b>66,883</b>	<b>23,258</b>

### 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 Sweden and have been sold in Norway in the past via intermediaries. 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 typically provides a maximum coverage of insured benefits up to 40 times a base amount (31 December 2016 SEK 44,300, being approximately £3,975) 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 (31 December 2016 NOK 92,576, being approximately £7,087) although most policies are between 5 to 10 times the base amount.

All contracts are for an annual period.



#### 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 and size 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 claim portfolio arising from the acquisition of the business of Aspis Liv, a small Swedish Life and Health insurer in 2010, is 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 £0.4m) and SEK 120m (approximately £10.8m).

#### 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 99.7% 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 forecasts that its maximum loss would be approximately SEK 150m (approximately £13.5m) gross of reinsurance and SEK 5m (approximately £0.4m) 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 28 Insurance Contract Provisions.

#### (c) Dutch business

##### Sums assured/benefits per annum – gross and net of reinsurance 31 December

	2016		2015	
	Gross £000	Net £000	Gross £000	Net £000
Long-term unit-linked without DPF (sums assured)	28,997	28,997	34,725	34,725
Long-term non-linked without DPF (sums assured)	2,499,291	2,260,004	2,320,156	2,046,847

#### Protection

##### Product feature

The division mainly wrote term life, sold as a single premium policy in combination with a loan or mortgage. Policy conditions allow for a surrender value at lapse. In addition, similar types of policies covering the risk of disability, unemployment and accident were written. The most significant factors that could increase risk are epidemics and changes in lifestyle and the social security environment.

##### Management of risks

The portfolio is in run-off and no significant underwriting occurs. For the existing portfolio, the division entered into an excess of loss and catastrophe (Life) and quota share (Health) reinsurance agreement to mitigate the risk in excess of risk appetite for mortality, disability and unemployment.

##### Concentration of insurance risk

The Dutch division did not write group life and health contracts and an excess of loss limit of €100,000 is applied for life risk, hence concentration risk is limited.

##### Persistency

Persistency risk concerns the risk that the policyholder cancels the contract or discontinues paying new premiums into the contract. On lapse, a surrender value is paid to the policyholder and anticipated future profits on risk premium will not be realised. Our exposure to risk on lapses is mitigated to some extent by allowing lapses for single premium policies only at each fifth policy anniversary.

##### Expense risk

The expense risk concerns the risk of incurring higher than expected expenses in the future. The expense risk is mitigated to some extent by using scalable administrative processes and tight expense management.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 5 Management of insurance risk (continued)

### (c) Dutch business (continued)

#### Unit-Linked

##### *Product features*

The division wrote unit-linked business, with policies paying out 90% of the unit-value at death of the policyholder and 100% at expiry. Early surrender triggers smaller charges for policyholders.

##### *Persistency and expense risk*

The portfolio is small and very mature. To mitigate the expense risk, management may also consider the possibility of merging the portfolio into a larger scale one, keeping cost levels appropriate. Persistency levels are moderate and largely depend on investment performance.

##### *Assumptions and sensitivities*

The assumptions and sensitivities relating to insurance contract provisions for the Dutch division are set out in note 28 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 the euro against sterling, arising from its ownership of Movestic and the Waard Group.

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 two types of investment contract: unit-linked savings and unit-linked pensions predominantly written in the UK and Sweden.

- (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 charges 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) No investment contracts exist within the Dutch business.

#### 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.

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.

<b>31 December 2016</b>	<b>Unit-linked contracts £000</b>	<b>*Insurance contracts with DPF £000</b>	<b>Annuities in payment £000</b>	<b>Other non-linked contracts £000</b>	<b>Total £000</b>
<b>Assets</b>					
Property and equipment	–	–	–	519	519
Investment in associates	–	–	–	5,433	5,433
Investment properties	245	–	–	–	245
Reinsurers' share of insurance contract provisions	63,649	40,474	–	150,736	254,859
Amounts deposited with reinsurers	37,437	–	–	–	37,437
<b>Financial assets</b>					
Equity securities at fair value through income	485,153	5	–	7	485,165
Holdings in collective investment schemes at fair value through income	3,702,355	252,194	–	150,053	4,104,602
Debt securities at fair value through income	157,600	120,193	112,479	83,819	474,091
Mortgage loan portfolio	–	–	–	54,756	54,756
Insurance and other receivables	10,331	3,024	–	26,291	39,646
Prepayments	560	229	–	4,482	5,271
Derivative financial instruments	315	33	–	2,425	2,773
<b>Total financial assets</b>	<b>4,356,314</b>	<b>375,678</b>	<b>112,479</b>	<b>321,833</b>	<b>5,166,304</b>
Reinsurers' share of accrued policyholder claims	12,789	46	–	6,472	19,307
Income taxes	–	–	–	3,352	3,352
Cash and cash equivalents	89,766	1,849	4,566	164,172	260,353
<b>Total assets</b>	<b>4,560,200</b>	<b>418,047</b>	<b>117,045</b>	<b>652,517</b>	<b>5,747,809</b>
<b>Liabilities</b>					
Insurance contract provisions	1,445,438	360,493	115,502	321,013	2,242,446
Other provisions	2	36	–	785	823
<b>Financial liabilities</b>					
Investment contracts at fair value through income	3,023,340	–	–	4,929	3,028,269
Borrowings	–	–	–	86,843	86,843
Derivative financial instruments	97	1,251	–	–	1,348
<b>Total financial liabilities</b>	<b>3,023,437</b>	<b>1,251</b>	<b>–</b>	<b>91,772</b>	<b>3,116,460</b>
Deferred tax liabilities	–	–	–	5,420	5,420
Reinsurance payables	500	8	–	6,391	6,899
Payables related to direct insurance and investment contracts	27,978	5,605	875	26,958	61,416
Income taxes	–	–	–	8,624	8,624
Other payables	9,954	390	–	13,313	23,657
Bank overdrafts	148	97	–	1,377	1,622
<b>Total liabilities</b>	<b>4,507,457</b>	<b>367,880</b>	<b>116,377</b>	<b>475,653</b>	<b>5,467,367</b>

\*Insurance contract with DPF include shareholder funds within the S&P with-profits funds.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6 Management of financial risk (continued)

31 December 2015					
	Unit-linked contracts £000	*Insurance contracts with DPF £000	Annuities in payment £000	Other non-linked contracts £000	Total £000
<b>Assets</b>					
Property and equipment	–	–	–	537	537
Investment in associates	–	–	–	4,707	4,707
Investment properties	245	–	–	–	245
Reinsurers' share of insurance contract provisions	88,514	60,807	–	133,307	282,628
Amounts deposited with reinsurers	33,941	–	–	–	33,941
Financial assets					
Equity securities at fair value through income	484,502	4	–	1,737	486,243
Holdings in collective investment schemes at fair value through income	3,152,606	269,444	–	77,305	3,499,355
Debt securities at fair value through income	138,536	92,593	107,307	85,318	423,754
Insurance and other receivables	12,022	1,714	–	29,938	43,674
Prepayments	642	444	–	5,479	6,565
Derivative financial instruments	280	16	–	2,425	2,721
Total financial assets	3,788,588	364,215	107,307	202,202	4,462,312
Reinsurers' share of accrued policyholder claims	11,521	–	–	7,521	19,042
Income taxes	–	–	–	3,611	3,611
Cash and cash equivalents	62,077	2,910	3,697	192,179	260,863
<b>Total assets</b>	<b>3,984,886</b>	<b>427,932</b>	<b>111,004</b>	<b>544,064</b>	<b>5,067,886</b>
<b>Liabilities</b>					
Insurance contract provisions	1,453,175	382,858	108,623	287,427	2,232,083
Other provisions	3	–	–	1,902	1,905
Financial liabilities					
Investment contracts at fair value through income	2,452,269	–	–	5,252	2,457,521
Borrowings	–	–	–	79,025	79,025
Derivative financial instruments	28	416	–	–	444
Total financial liabilities	2,452,297	416	–	84,277	2,536,990
Deferred tax liabilities	–	–	–	7,906	7,906
Reinsurance payables	722	9	–	8,929	9,660
Payables related to direct insurance and investment contracts	30,195	4,756	767	26,566	62,284
Income taxes	–	–	–	6,328	6,328
Other payables	3,890	681	–	13,830	18,401
Bank overdrafts	–	–	–	952	952
<b>Total liabilities</b>	<b>3,940,282</b>	<b>388,720</b>	<b>109,390</b>	<b>438,117</b>	<b>4,876,509</b>

\*Insurance contract with DPF include shareholder funds within the S&P with-profits funds.

### **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 ReAssure 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. 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.

### **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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6 Management of financial risk (continued)

### (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 serve 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 2016							
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	
<b>Insurance contract liabilities</b>							
Unit-linked	1,445,438	1,445,438	–	–	–	–	1,445,438
With DPF:							
– CA	45,317	45,317	–	–	–	–	45,317
– S&P	315,176	151,011	82,172	67,846	35,706	11,160	347,895
Annuities in payment	115,502	27,206	23,290	19,085	14,790	20,369	104,740
Other non-linked	321,013	171,288	71,767	41,985	17,732	8,262	311,034
<b>Investment contract liabilities</b>							
Unit-linked	3,023,340	3,023,340	–	–	–	–	3,023,340
Other	4,929	4,929	–	–	–	–	4,929
Other liabilities	196,653	196,653	–	–	–	–	196,653
<b>Total</b>	<b>5,467,368</b>	<b>5,065,182</b>	<b>177,229</b>	<b>128,916</b>	<b>68,228</b>	<b>39,791</b>	<b>5,479,346</b>

31 December 2015							
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	
<b>Insurance contract liabilities</b>							
Unit-linked	1,453,175	1,453,175	–	–	–	–	1,453,175
With DPF:							
– CA	65,182	65,182	–	–	–	–	65,182
– S&P	317,674	111,782	84,740	77,116	45,849	16,091	335,578
Annuities in payment	108,623	27,699	24,226	20,354	16,217	23,388	111,884
Other non-linked	287,427	165,020	62,535	44,371	19,520	9,550	300,996
<b>Investment contract liabilities</b>							
Unit-linked	2,505,419	2,505,419	–	–	–	–	2,505,419
Other	5,512	5,512	–	–	–	–	5,512
Other liabilities	133,497	133,497	–	–	–	–	133,497
<b>Total</b>	<b>4,876,509</b>	<b>4,467,286</b>	<b>171,501</b>	<b>141,841</b>	<b>81,586</b>	<b>49,029</b>	<b>4,911,243</b>

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 ReAssure 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' on page 118. 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; and
- (ii) its investment in Waard Group, the assets and liabilities of which are principally denominated in euros.

The group's currency risk through its ownership of Movestic and Waard Group is reflected in:

- (i) foreign exchange translation differences arising on the translation into sterling and consolidation of Movestic and Waard Group's financial statements; and
- (ii) the impact of adverse exchange rate movements on cash flows between Chesnara plc and its foreign subsidiaries: in the short-term these relate to cash flows from Movestic and Waard Group to Chesnara by way of dividend payments and the acquisition of LGN, the purchase consideration of which is denominated in euros. 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:

<b>31 December</b>	<b>2016</b>	<b>2015</b>
	<b>£000</b>	<b>£000</b>
<b>Swedish krona</b>		
Assets	2,700,944	2,118,412
Liabilities	(2,638,100)	(2,070,475)
<b>Net assets</b>	<b>62,844</b>	<b>47,937</b>
<b>Euro</b>		
Assets	207,940	189,696
Liabilities	(122,655)	(120,266)
<b>Net assets</b>	<b>85,285</b>	<b>69,430</b>
<b>Norwegian krone</b>		
Assets	2,473	3,596
Liabilities	(2,427)	(2,780)
<b>Net assets</b>	<b>46</b>	<b>816</b>
<b>US dollar</b>		
Assets	128	312
Liabilities	–	(313)
<b>Net assets/(liabilities)</b>	<b>128</b>	<b>(1)</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6 Management of financial risk (continued)

### (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; and
- (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	2016		2015	
	Profit before tax £m	Shareholders' equity £m	Profit before tax £m	Shareholders' equity £m
100 bp increase in market rates of interest	(3.4)	(2.7)	3.3	2.6
100 bp decrease in market rates of interest	0.3	0.3	(9.9)	(7.9)
10% increase in equity and property prices	12.7	10.1	14.0	11.1
10% decrease in equity and property prices	(13.1)	(10.5)	(14.0)	(11.1)
10% favourable movement in SEK: sterling exchange rate	1.0	7.0	0.7	5.3
10% adverse movement in SEK: sterling exchange rate	(0.8)	(5.7)	(0.6)	(4.4)
10% favourable movement in EUR: sterling exchange rate	0.6	9.4	0.1	7.6
10% adverse movement in EUR: sterling exchange rate	(0.5)	(7.7)	(0.1)	(6.3)

### (v) 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 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	2016			2015		
	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	4,015,093	89,509	4,104,602	3,484,007	15,348	3,499,355
Debt securities	142,875	331,216	474,091	124,906	298,848	423,754
Cash and cash equivalents	75,264	185,089	260,353	56,160	204,703	260,863
Derivative financial instruments	2,740	33	2,773	2,704	17	2,721
Reinsurers' share of insurance contract liabilities	–	254,859	254,859	–	282,628	282,628
Amounts deposited with reinsurers	–	37,437	37,437	–	33,941	33,941
Mortgage loan portfolio	–	54,756	54,756	–	–	–
Insurance and other receivables	22,975	16,671	39,646	28,175	15,499	43,674
Reinsurers' share of accrued policyholder claims	–	19,307	19,307	–	19,042	19,042
Income taxes	–	3,352	3,352	–	3,611	3,611
<b>Total</b>	<b>4,258,947</b>	<b>992,229</b>	<b>5,251,176</b>	<b>3,695,952</b>	<b>873,637</b>	<b>4,569,589</b>

The 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 As at 31 December 2016	AAA £000	AA £000	A £000	Below A £000	Unrated £000	Total £000
Reinsurers share of insurance contract liabilities	–	133,154	2,171	5,155	114,380	254,860
Holdings in collective investment schemes	–	–	82,789	–	6,720	89,509
Amounts deposited with reinsurers	–	–	–	–	37,437	37,437
Debt securities at fair value through income	127,786	175,745	12,190	14,469	1,026	331,216
Mortgage loan portfolio	–	–	–	–	54,756	54,756
Insurance and other receivables	1,261	9,312	76	951	5,071	16,671
Reinsurers share of accrued policyholder claims	–	5,107	967	374	12,858	19,306
Derivative financial instruments	–	–	32	–	1	33
Income taxes	2,956	–	–	–	396	3,352
Cash and cash equivalents	–	40,952	94,827	49,310	–	185,089
<b>Total</b>	<b>132,003</b>	<b>364,270</b>	<b>193,052</b>	<b>70,259</b>	<b>232,645</b>	<b>992,229</b>
<b>As at 31 December 2015</b>						
Reinsurers share of insurance contract liabilities	–	109,278	18,388	–	154,962	282,628
Holdings in collective investment schemes	–	–	15,348	–	–	15,348
Amounts deposited with reinsurers	–	–	–	–	33,941	33,941
Debt securities at fair value through income	215,914	55,699	18,957	3,533	4,745	298,848
Insurance and other receivables	1,507	11,901	–	–	2,091	15,499
Reinsurers share of accrued policyholder claims	–	6,449	1,095	–	11,498	19,042
Derivative financial instruments	–	–	17	–	–	17
Income taxes	3,611	–	–	–	–	3,611
Cash and cash equivalents	–	40,730	157,167	6,767	39	204,703
<b>Total</b>	<b>221,032</b>	<b>224,057</b>	<b>210,972</b>	<b>10,300</b>	<b>207,276</b>	<b>873,637</b>

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 £124.0m as at 31 December 2016 (31 December 2015: £169.9m) to ReAssure, which does not have a published credit rating. Of this amount £96.0m (31 December 2015: £137.0m) is in respect of currently guaranteed benefits. This counterparty exposure has been mitigated by ReAssure granting to CA a floating charge over related investment assets, which ranks that company equally with ReAssure policyholders. In order to monitor the ongoing creditworthiness of ReAssure, CA reviews the financial statements and regulatory returns submitted by ReAssure to the PRA on an annual basis.

No credit limits were exceeded during the year ended 31 December 2016 and 31 December 2015.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6 Management of financial risk (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 2016, further interim distributions totalling £19,072 (2015: £nil) 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 2016.

## 7 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 2016 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. This segment also contains the business of Protection Life, which was purchased on 28 November 2013. Following the Part VII transfer on 31 December 2014 of the long-term business of Protection Life Company Limited into Countrywide Assured plc, the business of Protection Life (PL) is now reported within the CA segment, effective from 1 January 2015. CA is responsible for conducting unit-linked and non-linked business.

**S&P:** This segment, which was acquired on 20 December 2010, comprises the historical business of Save & Prosper Insurance Limited and its then 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 pensions and savings business and providing some life and health product offerings.

**Waard Group:** This segment represents the group's Dutch life and general insurance business, which was acquired on 19 May 2015 and comprises the three insurance companies Waard Leven N.V., Hollands Welvaren Leven N.V. and Waard Schade N.V., and a servicing company, Tadas Verzekering. The Waard Group's policy base is predominantly made up of term life policies, although also includes unit-linked policies and some non-life policies, covering risks such as occupational disability and unemployment.

**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.

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 2016.

(i) Segmental income statement for the year ended 31 December 2016

	CA £000	S&P £000	UK total £000	Movestic £000	Waard Group £000	Other group activities £000	Total £000
Net insurance premium revenue	42,103	4,886	46,989	14,903	2,658	–	64,550
Fee and commission income	29,000	2,610	31,610	41,296	26	–	72,932
Net investment return	206,748	131,155	337,903	169,130	8,464	184	515,681
<b>Total revenue (net of reinsurance payable)</b>	<b>277,851</b>	<b>138,651</b>	<b>416,502</b>	<b>225,329</b>	<b>11,148</b>	<b>184</b>	<b>653,163</b>
Other operating income	2,568	10,792	13,360	3,751	503	–	17,614
<b>Segmental income</b>	<b>280,419</b>	<b>149,443</b>	<b>429,862</b>	<b>229,080</b>	<b>11,651</b>	<b>184</b>	<b>670,777</b>
Net insurance contract claims and benefits incurred	(139,748)	(123,454)	(263,202)	(7,695)	(1,464)	–	(272,361)
Net change in investment contract liabilities	(98,393)	(2,206)	(100,599)	(168,508)	–	–	(269,107)
Fees, commission and other acquisition costs	(1,641)	(23)	(1,664)	(25,089)	(330)	–	(27,083)
Administrative expenses:							
Amortisation charge on software assets	–	–	–	(1,243)	–	–	(1,243)
Depreciation charge on property and equipment	–	–	–	(197)	–	–	(197)
Other	(11,017)	(9,443)	(20,460)	(12,800)	(3,664)	(8,251)	(45,175)
Operating expenses	(1,203)	(1)	(1,204)	(3,209)	–	19	(4,394)
Financing costs	–	(2)	(2)	(1,629)	–	(1,641)	(3,272)
Share of profit from associates	–	–	–	150	–	–	150
<b>Profit before tax and consolidation adjustments</b>	<b>28,417</b>	<b>14,314</b>	<b>42,731</b>	<b>8,860</b>	<b>6,193</b>	<b>(9,689)</b>	<b>48,095</b>
Other operating expenses:							
Charge for amortisation of acquired value of in-force business	(5,643)	(604)	(6,247)	(3,554)	(618)	–	(10,419)
Charge for amortisation of acquired value of customer relationships	–	–	–	(236)	–	–	(236)
Fees, commission and other acquisition costs	–	–	–	3,245	–	–	3,245
<b>Segmental income less expenses</b>	<b>22,774</b>	<b>13,710</b>	<b>36,484</b>	<b>8,315</b>	<b>5,575</b>	<b>(9,689)</b>	<b>40,685</b>
<b>Profit before tax</b>	<b>22,774</b>	<b>13,710</b>	<b>36,484</b>	<b>8,315</b>	<b>5,575</b>	<b>(9,689)</b>	<b>40,685</b>
Income tax (expense)/credit	–	–	(6,663)	(7)	(1,721)	2,986	(5,405)
<b>Profit after tax</b>			<b>29,821</b>	<b>8,308</b>	<b>3,854</b>	<b>(6,703)</b>	<b>35,280</b>

Further analysis of the segmental profit before tax and consolidation adjustments can be found on page 32 of the Financial Review section.

(ii) Segmental balance sheet as at 31 December 2016

	CA £000	S&P £000	Movestic £000	Waard Group £000	Other group activities £000	Total £000
Total assets	1,829,944	1,217,546	2,718,156	207,160	122,957	6,095,763
Total liabilities	(1,728,019)	(1,155,556)	(2,638,490)	(122,655)	(57,482)	(5,702,202)
<b>Net assets</b>	<b>101,925</b>	<b>61,990</b>	<b>79,666</b>	<b>84,505</b>	<b>65,475</b>	<b>393,561</b>
Investment in associates	–	–	5,433	–	–	5,433
Additions to non-current assets	–	–	11,894	–	–	11,894

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 7 Operating segments (continued)

(iii) Segmental income statement for the year ended 31 December 2015

	CA £000	S&P £000	UK total £000	Movestic £000	Waard Group £000	Other group activities £000	Total £000
Net insurance premium revenue	47,880	5,413	53,293	13,515	1,130	–	67,938
Fee and commission income	30,216	2,513	32,729	33,502	18	–	66,249
Net investment return	24,539	37,605	62,144	87,163	(1,238)	445	148,514
<b>Total revenue (net of reinsurance payable)</b>	<b>102,635</b>	<b>45,531</b>	<b>148,166</b>	<b>134,180</b>	<b>(90)</b>	<b>445</b>	<b>282,701</b>
Other operating income	2,854	11,331	14,185	4,399	2	–	18,586
<b>Segmental income</b>	<b>105,489</b>	<b>56,862</b>	<b>162,351</b>	<b>138,579</b>	<b>(88)</b>	<b>445</b>	<b>301,287</b>
Net insurance contract claims and benefits incurred	(54,093)	(37,282)	(91,375)	(6,079)	2,587	–	(94,867)
Net change in investment contract liabilities	(13,240)	641	(12,599)	(87,137)	–	–	(99,736)
Fees, commission and other acquisition costs	(1,986)	(21)	(2,007)	(21,864)	83	–	(23,788)
Administrative expenses:							
Amortisation charge on software assets	–	–	–	(1,340)	–	–	(1,340)
Depreciation charge on property and equipment	(22)	–	(22)	(180)	–	–	(202)
Other	(10,691)	(9,628)	(20,319)	(9,884)	(1,715)	(7,841)	(39,759)
Operating expenses	(1,501)	–	(1,501)	(4,481)	–	–	(5,982)
Financing costs	–	–	–	(1,340)	–	(2,116)	(3,456)
Share of profit from associates	–	–	–	455	–	–	455
<b>Profit before tax and consolidation adjustments</b>	<b>23,956</b>	<b>10,572</b>	<b>34,528</b>	<b>6,729</b>	<b>867</b>	<b>(9,512)</b>	<b>32,612</b>
Other operating expenses:							
Charge for amortisation of acquired value of in-force business	(4,975)	(661)	(5,636)	(3,282)	(356)	–	(9,274)
Charge for amortisation of acquired customer relationships	–	–	–	(107)	–	–	(107)
Fees, commission and other acquisition costs	–	–	–	2,913	–	–	2,913
<b>Segmental income less expenses</b>	<b>18,981</b>	<b>9,911</b>	<b>28,892</b>	<b>6,253</b>	<b>511</b>	<b>(9,512)</b>	<b>26,144</b>
Share of profit from associates	–	–	–	–	–	16,644	16,644
<b>Profit before tax</b>	<b>18,981</b>	<b>9,911</b>	<b>28,892</b>	<b>6,253</b>	<b>511</b>	<b>7,132</b>	<b>42,788</b>
Income tax (expense)/credit	–	–	(4,139)	(14)	(124)	1,277	(3,000)
<b>Profit after tax</b>			<b>24,753</b>	<b>6,239</b>	<b>387</b>	<b>8,409</b>	<b>39,788</b>

(iv) Segmental balance sheet as at 31 December 2015

	CA £000	S&P £000	Movestic £000	Waard Group £000	Other group activities £000	Total £000
Total assets	1,809,494	1,181,272	2,134,143	188,993	53,900	5,367,802
Total liabilities	(1,702,363)	(1,125,113)	(2,070,860)	(120,216)	(54,088)	(5,072,640)
<b>Net assets</b>	<b>107,131</b>	<b>56,159</b>	<b>63,283</b>	<b>68,777</b>	<b>(188)</b>	<b>295,162</b>
Investment in associates	–	–	4,707	–	–	4,707
Additions to non-current assets	–	26	17,368	73	–	17,467

## 8 Fees and commission income

Year ended 31 December	2016 £000	2015 £000
<b>Fee income</b>		
Policy-based fees	13,696	12,996
Fund management-based fees	36,391	30,981
Benefit-based fees	16,226	17,351
Change in deferred income – gross	774	762
Change in deferred income – reinsurers' share	(59)	76
Total fee income	67,028	62,166
Commission income	5,904	4,083
<b>Total fee and commission income</b>	<b>72,932</b>	<b>66,249</b>

## 9 Net investment return

Year ended 31 December	2016 £000	2015 £000
Dividend income	30,444	31,501
Interest income	21,047	24,693
Rental income from investment properties	893	109
Net fair value gains and losses		
Equity securities designated as at fair value through income on initial recognition	392,726	112,246
Debt securities designated as at fair value through income on initial recognition	72,021	(23,501)
Derivative financial instruments	(1,450)	(811)
Investment properties	–	4,277
<b>Net investment return</b>	<b>515,681</b>	<b>148,514</b>

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 2015: £nil).

## 10 Other operating income

Year ended 31 December	2016 £000	2015 £000
Investment management fee rebate	13,749	13,835
Charges to policyholder funds for yield tax	3,194	4,345
Other	671	406
<b>Total other operating income</b>	<b>17,614</b>	<b>18,586</b>

All of the income streams set out in notes 8, 9 and 10 equate to revenue as defined by IAS 18.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 11 Insurance contract claims and benefits

Year ended 31 December	2016 £000	2015 £000
Claims and benefits paid to insurance contract holders	346,117	318,721
Decrease in insurance contract provisions	(11,392)	(191,850)
<b>Total insurance contract claims and benefits</b>	<b>334,725</b>	<b>126,871</b>
Reinsurer's share of claims and benefits	(62,364)	(32,004)
<b>Net insurance contract claims and benefits incurred</b>	<b>272,361</b>	<b>94,867</b>

## 12 Change in investment contract liabilities

Year ended 31 December	2016 £000	2015 £000
Changes in the fair value of investment contracts designated on initial recognition as fair value through income	261,180	94,071
Changes in the fair value of policyholders' funds held by the group designated on initial recognition as fair value through income	13,544	6,398
<b>Total increase in investment contract liabilities</b>	<b>274,724</b>	<b>100,469</b>
Reinsurers' share of investment contract liabilities	(5,617)	(733)
<b>Net increase in investment contract liabilities</b>	<b>269,107</b>	<b>99,736</b>

Investment contract benefits comprise benefits accruing to holders of investment contracts issued by the group.

## 13 Fees, commission and other acquisition costs

Year ended 31 December	2016 £000	2015 £000
<b>Directly expensed costs:</b>		
Insurance contracts		
Commission	8,592	6,818
New business and renewal costs	2,417	2,186
Deferred amount	(7,048)	(5,377)
	<b>3,961</b>	<b>3,627</b>
Investment contracts		
Commission	15,651	12,860
New business and renewal costs	5,159	4,556
Deferred amount	(13,064)	(9,382)
	<b>7,746</b>	<b>8,034</b>
<b>Amortisation of deferred acquisition costs:</b>		
Insurance contracts	7,326	5,781
Investment contracts	4,837	3,470
Investment contracts-reinsurance	(32)	(37)
<b>Total</b>	<b>23,838</b>	<b>20,875</b>

## 14 Administrative expenses

Year ended 31 December	2016 £000	2015 £000
Personnel-related costs (note 40)	17,998	14,987
Investment management fees	6,213	6,395
Amortisation charge on software assets	794	1,346
Depreciation charge on property and equipment	197	203
Costs paid to third-party administrators	11,518	9,959
Other goods and services	9,895	8,411
<b>Total</b>	<b>46,615</b>	<b>41,301</b>

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	2016 £000	2015 £000
Fees payable to the company's auditor for the audit of the company's financial statements	50	50
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	537	512
Audit-related assurance services*	719	407
Corporate finance services**	532	–
Non-audit fee***	–	45
<b>Total</b>	<b>1,838</b>	<b>1,014</b>

\*Includes the audit of regulatory returns submitted to the UK regulator in both years.

\*\*2016 relates to the fees associated with the proposed acquisition of LGN.

\*\*\*2015 relates to some non-financial consultancy work performed for Movestic Livförsäkring.

## 15 Other operating expenses

Year ended 31 December	2016 £000	2015 £000
<b>Charge for amortisation of acquired value of in-force business</b>	<b>10,419</b>	<b>9,274</b>
<b>Charge for amortisation of acquired value of customer relationships (AVCR)</b>	<b>236</b>	<b>222</b>
<b>Other</b>		
Direct operating expenses of investment properties		
Revenue-generating properties	1	(1)
Non revenue-generating properties	56	44
Recovery of cash deposit	(19)	–
Payment of yield tax relating to policyholder funds	3,194	4,345
Other	1,162	1,478
<b>Total</b>	<b>4,394</b>	<b>5,866</b>

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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 16 Financing costs

Year ended 31 December	2016 £000	2015 £000
Interest expense on bank borrowings	1,644	2,118
Interest expense on financial reinsurance	1,516	1,222
Other interest	112	117
<b>Total financing costs</b>	<b>3,272</b>	<b>3,457</b>

Interest expense on bank borrowings is calculated using the effective interest rate method and is the total interest expense for financial liabilities that are not designated at fair value through income.

## 17 Income tax

Total income tax comprises: Year ended 31 December	2016 £000	2015 £000
CA, S&P and other group activities – net expense	(3,862)	(2,862)
Movestic – net (expense)/credit (See Movestic tax)	37	(14)
Ward Group – net expense	(1,580)	(124)
<b>Total net expense</b>	<b>(5,405)</b>	<b>(3,000)</b>

### UK business

CA, S&P and other group activities Year ended 31 December	2016 £000	2015 £000
<b>Current tax</b>		
Current year	(5,155)	(4,148)
Overseas tax	(524)	(603)
Adjustment to prior years	167	130
Net expense	(5,512)	(4,621)
<b>Deferred tax</b>		
Origination and reversal of temporary differences	1,650	1,759
<b>Total income tax expense</b>	<b>(3,862)</b>	<b>(2,862)</b>

Reconciliation of effective tax rate on profit before tax Year ended 31 December	2016 £000	2015 £000
<b>Profit before tax</b>	<b>26,795</b>	<b>36,024</b>
Income tax using the domestic corporation tax rate of 20.00% (2015: 20.25%)	(5,359)	(7,295)
Non-taxable profit on acquisition of subsidiary	–	3,370
Other permanent differences	(441)	(947)
Effect of UK tax bases on insurance profits		
Offset of franked investment income	2,008	1,767
Variation in rate of tax on amortisation of acquired in-force value	80	424
Foreign tax	(426)	(481)
Effect of change in tax rate	75	90
Other	35	80
Over provided in previous years	166	130
<b>Total income tax expense</b>	<b>(3,862)</b>	<b>(2,862)</b>



*Swedish business*

<b>Movestic</b> <b>Year ended 31 December</b>	<b>2016</b> <b>£000</b>	<b>2015</b> <b>£000</b>
<b>Current tax</b>		
Current year expense*	(7)	(33)
Net credits	(7)	(33)
<b>Deferred tax</b>		
Origination and reversal of temporary differences	44	19
<b>Total income tax credit/(expense)</b>	<b>37</b>	<b>(14)</b>

\*Tax in Sweden is levied as against the value of policyholder unit-linked funds and is borne by the policyholder. This results in a small residual direct corporation tax charge.

<b>Reconciliation of effective tax rate on profit before tax</b> <b>Year ended 31 December</b>	<b>2016</b> <b>£000</b>	<b>2015</b> <b>£000</b>
<b>Profit before tax</b>	<b>8,315</b>	<b>6,253</b>
Income tax using the domestic corporation tax rate of 22%	(1,829)	(1,376)
Non-taxable income in relation to unit-linked business	2,053	1,469
Non-taxable fair value adjustment	(44)	(85)
Permanent differences	(93)	4
Unrecognised tax recoverable	(8)	5
Non-deductible expenses	(42)	–
Under provided in prior years	–	(31)
<b>Total income tax credit/(expense)</b>	<b>37</b>	<b>(14)</b>

*Dutch business*

<b>Ward Group</b> <b>Year ended 31 December</b>	<b>2016</b> <b>£000</b>	<b>2015</b> <b>£000</b>
<b>Current tax</b>		
Current year expense	(2,575)	(311)
Adjustment to prior years	(31)	(21)
Net credits	(2,606)	(332)
<b>Deferred tax</b>		
Origination and reversal of temporary differences	1,026	208
<b>Total income tax expense</b>	<b>(1,580)</b>	<b>(124)</b>

<b>Reconciliation of effective tax rate on profit before tax</b> <b>Year ended 31 December</b>	<b>2016</b> <b>£000</b>	<b>2015</b> <b>£000</b>
<b>Profit before tax</b>	<b>5,574</b>	<b>511</b>
Income tax using the domestic corporation tax rate of 25%	(1,393)	(128)
Permanent differences	(156)	26
Under provided in prior years	(31)	(22)
<b>Total income tax expense</b>	<b>(1,580)</b>	<b>(124)</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 18 Deferred acquisition costs

Year ended 31 December	2016 £000	2015 £000
<b>Balance at 1 January</b>	<b>36,061</b>	<b>31,298</b>
Additions arising from new business	20,132	14,759
Amortisation charged to income	(12,163)	(9,251)
Foreign exchange translation difference	4,288	(745)
<b>Balance at 31 December</b>	<b>48,318</b>	<b>36,061</b>
Current	5,362	3,882
Non-current	42,956	32,179
<b>Total</b>	<b>48,318</b>	<b>36,061</b>

The amortisation charged to income is recognised in fees, commission and other acquisition costs (see note 13).

## 19 Acquired value of in-force business (AVIF)

31 December	2016 £000	2015 £000
<b>Cost:</b>		
<b>Balance at 1 January</b>	<b>143,409</b>	<b>139,890</b>
Additions – acquisition of subsidiary	–	5,506
Foreign exchange translation difference	8,208	(1,987)
<b>Balance at 31 December</b>	<b>151,617</b>	<b>143,409</b>
<b>Amortisation and impairment losses:</b>		
<b>Balance at 1 January</b>	<b>75,068</b>	<b>66,421</b>
Amortisation for the year	10,408	9,274
Foreign exchange translation difference	3,198	(627)
<b>Balance at 31 December</b>	<b>88,674</b>	<b>75,068</b>
<b>Carrying amounts at 1 January</b>	<b>68,341</b>	<b>73,469</b>
<b>At 31 December</b>	<b>62,943</b>	<b>68,341</b>
Current	9,498	8,989
Non-current	53,445	59,352
<b>Total</b>	<b>62,943</b>	<b>68,341</b>

The amortisation is charged to the Consolidated Statement of Comprehensive Income and is recognised in Other Operating Expenses (see note 15).

## 20 Software assets

31 December	2016 £000	2015 £000
<b>Cost:</b>		
<b>Balance at 1 January</b>	<b>15,962</b>	<b>13,486</b>
Additions – acquisition of subsidiary	–	441
Additions	3,525	2,419
Disposals	(441)	–
Foreign exchange translation difference	2,015	(384)
<b>Balance at 31 December</b>	<b>21,061</b>	<b>15,962</b>
<b>Amortisation and impairment losses:</b>		
<b>Balance at 1 January</b>	<b>11,242</b>	<b>9,771</b>
Additions – acquisition of subsidiary	–	416
Amortisation charge for the year	794	1,346
Impairment write-down	1,039	–
Foreign exchange translation difference	1,426	(291)
<b>Balance at 31 December</b>	<b>14,501</b>	<b>11,242</b>
<b>Carrying amounts at 31 December</b>	<b>6,560</b>	<b>4,720</b>
Current	1,991	1,390
Non-current	4,569	3,330
<b>Total</b>	<b>6,560</b>	<b>4,720</b>

## 21 Investment in associate

31 December	2016 £000	2015 £000		
<b>Balance at 1 January</b>	<b>4,707</b>	<b>4,388</b>		
Share of profit	150	455		
Foreign exchange translation difference	576	(136)		
<b>Balance at 31 December</b>	<b>5,433</b>	<b>4,707</b>		
<b>Associates at 100%</b>	<b>Assets £000</b>	<b>Liabilities £000</b>	<b>Revenues £000</b>	<b>Profit £000</b>
Modernac S.A.	39,468	28,380	9,255	305
<b>Total 31 December 2016</b>	<b>39,468</b>	<b>28,380</b>	<b>9,255</b>	<b>305</b>
<b>Associates at 49%</b>		<b>Equity at 100% £000</b>	<b>Equity at 49% £000</b>	<b>49% share of profit £000</b>
Modernac S.A.		11,088	5,433	150
<b>Total 31 December 2016</b>		<b>11,088</b>	<b>5,433</b>	<b>150</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 22 Financial instruments

### Group

<b>Financial assets by measurement category</b>		
<b>31 December</b>		
	<b>2016</b>	<b>2015</b>
	<b>£000</b>	<b>£000</b>
Fair value through income		
Designated at fair-value through income on initial recognition	5,293,255	4,599,271
Derivative financial instruments	2,773	2,721
Mortgage loan portfolio	54,756	–
Insurance and other receivables	39,646	43,674
Prepayments	5,271	6,565
<b>Total</b>	<b>5,395,701</b>	<b>4,652,231</b>

Fair value is the amount for which an asset or liability 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).

<b>Fair value measurement at 31 December 2016</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Financial assets</b>				
Equities – Listed	485,165	–	–	485,165
Holdings in collective investment schemes	4,104,602	–	–	4,104,602
Debt securities – fixed rate:				
– Government bonds	322,870	29,357	–	352,227
– Listed	120,302	–	–	120,302
Debt securities – floating rate listed	1,562	–	–	1,562
Total debt securities	444,734	29,357	–	474,091
Policyholders' funds held by the group	229,397	–	–	229,397
Derivative financial instruments	–	2,773	–	2,773
<b>Total</b>	<b>5,263,898</b>	<b>32,130</b>	<b>–</b>	<b>5,296,028</b>
Current				2,749,699
Non-current				2,546,329
<b>Total</b>				<b>5,296,028</b>
<b>Financial liabilities</b>				
Investment contracts at fair value through income	–	3,028,269	–	3,028,269
Liabilities related to policyholders' funds held by the group	229,397	–	–	229,397
Derivative financial instruments	–	1,348	–	1,348
<b>Total</b>	<b>229,397</b>	<b>3,029,617</b>	<b>–</b>	<b>3,259,014</b>

**Fair value measurement at 31 December 2015**

	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
<b>Financial assets</b>				
Equities – Listed	486,243	–	–	486,243
Holdings in collective investment schemes	3,498,814	541	–	3,499,355
Debt securities – fixed rate				
– Government bonds	311,805	–	–	311,805
– Listed	86,356	–	–	86,356
Debt securities – floating rate listed	6,642	–	–	6,642
Structured notes	–	18,951	–	18,951
Total debt securities	404,803	18,951	–	423,754
Policyholders' funds held by the group	189,919	–	–	189,919
Derivative financial instruments	17	2,704	–	2,721
<b>Total</b>	<b>4,579,796</b>	<b>22,196</b>	<b>–</b>	<b>4,601,992</b>
Current				198,962
Non-current				4,403,030
<b>Total</b>				<b>4,601,992</b>
<b>Financial liabilities</b>				
Investment contracts at fair value through income	–	2,457,521	–	2,457,521
Liabilities related to policyholders' funds held by the group	189,919	–	–	189,919
Derivative financial instruments	–	444	–	444
<b>Total</b>	<b>189,919</b>	<b>2,457,965</b>	<b>–</b>	<b>2,647,884</b>

Included within Holdings in collective investment schemes are amounts held with JPMorgan Life Limited through a reinsurance arrangement, under which the group has reassured certain unit-linked liabilities. The contract does not transfer significant insurance risk and is accounted for as Holdings in collective investment schemes, representing the substance of the arrangement in place. These amounts have been classified as Level 2 in the above hierarchy table as the reinsurance contract itself is not quoted but is valued using market-observable data.

The debt securities classified as Level 2 at 31 December 2016 are traded in active markets with less depth or wider-bid ask spreads, which do not meet the classification as Level 1 inputs. The fair values of debt securities not traded in active markets are determined using broker quotes or valuation techniques with observable market inputs. Financial instruments valued using broker quotes are classified at Level 2, only where there is a sufficient range of available quotes.

The debt securities classified as Level 2 in 2015, were structured bond-type or non-standard debt products, held by our Dutch subsidiaries, for which there was no active market and were sold during 2016. These products were structured such that the principal amount invested was protected by high security assets, with the returns being linked to underlying pools of riskier, higher-return assets. At the balance sheet date, the underlying assets supporting the coupon had under performed such that no coupon was being paid, resulting in these assets all behaving like zero coupon bonds. These assets had been classified as Level 2 because the third-party valuation models included observable inputs to the valuation of these assets, including counterparty default spreads, yield curve swaps and foreign exchange swaps.

These assets were valued using counterparty or broker quotes and were periodically validated against third-party models.

Within derivative financial instruments is a financial reinsurance embedded derivative related to our Movestic operation. 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. 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 rate at the balance sheet date. It is, accordingly, determined at Level 2 in the three-level fair value determination hierarchy set out above.

The investment contract liabilities in Level 2 of the valuation hierarchy represent the fair value of linked and non-linked 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)

## 22 Financial instruments (continued)

Except as detailed in the following table, the directors consider that the carrying value amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements are approximately equal to their fair values:

31 December	Carrying amount		Fair value	
	2016 £000	2015 £000	2016 £000	2015 £000
Financial liabilities:				
Borrowings	86,843	79,025	87,196	79,679

Borrowings consist of bank loans and an amount due in relation to financial reinsurance. The fair value of the bank loans are taken as the principal outstanding at the balance sheet date. The amount due in relation to financial reinsurance is fair valued with reference to market interest rates at the balance sheet date. There were no transfers between Levels 1, 2 and 3 during the year. The group holds no Level 3 liabilities as at the balance sheet date.

### Company

Fair value measurement at 31 December 2016 using	2016 £000	2015 £000
Holdings in collective investment schemes	72,939	5,012
<b>Total</b>	<b>72,939</b>	<b>5,012</b>
Current	72,939	5,012
Non-current	–	–
<b>Total</b>	<b>72,939</b>	<b>5,012</b>

There were no Level 2 and Level 3 assets.

### Investment in subsidiaries

#### Company

Year ended 31 December	2016 £000	2015 £000
Balance at 1 January	249,234	199,111
Acquisition of Waard Group	–	50,123
<b>Balance at 31 December</b>	<b>249,234</b>	<b>249,234</b>
Current	–	–
Non-current	249,234	249,234
<b>Total</b>	<b>249,234</b>	<b>249,234</b>

A list of investments in subsidiaries held by the group is disclosed in note 48.

## 23 Mortgage loan portfolio

Year ended 31 December	2016 £000	2015 £000
<b>Cost</b>		
Balance at 1 January	–	–
Additions	58,738	–
<b>Balance at 31 December</b>	<b>58,738</b>	<b>–</b>
<b>Amortisation</b>		
Balance at 1 January	–	–
Amortisation	3,982	–
<b>Balance at 31 December</b>	<b>3,982</b>	<b>–</b>
<b>Carrying amount at 31 December</b>	<b>54,756</b>	<b>–</b>
Current	9,827	–
Non-current	44,929	–
<b>Total</b>	<b>54,756</b>	<b>–</b>

The mortgage loan portfolio was acquired in the year by the Waard Group and is stated at amortised cost.

## 24 Insurance and other receivables

### Group

Insurance and other receivables 31 December	2016 £000	2015 £000
<b>Receivables arising from insurance contracts</b>		
Policyholders	2,479	2,123
<b>Receivables arising from investment contracts</b>		
Other	10,084	10,905
<b>Other receivables</b>		
Loan to associated companies	673	573
Accrued interest income	7,942	9,852
Accrued rent	–	294
Receivables from fund management companies	5,637	12,811
Initial margin payments on derivatives	6,545	3,845
Other	6,286	3,271
<b>Total</b>	<b>39,646</b>	<b>43,674</b>
Current	38,186	42,107
Non-current	1,460	1,567
<b>Total</b>	<b>39,646</b>	<b>43,674</b>

The carrying amount is a reasonable approximation of fair value.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 25 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	2016		2015	
	Asset £000	Liability £000	Asset £000	Liability £000
Exchange-traded futures	349	(1,348)	296	(444)
Financial reinsurance embedded derivative	2,424	–	2,425	–
<b>Total</b>	<b>2,773</b>	<b>(1,348)</b>	<b>2,721</b>	<b>(444)</b>
Current	957	(1,348)	296	(444)
Non-current	1,816	–	2,425	–
<b>Total</b>	<b>2,773</b>	<b>(1,348)</b>	<b>2,721</b>	<b>(444)</b>

### 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 22.

Exchange-traded futures (by geographical investment market)				
31 December	2016		2015	
	Asset £000	Liability £000	Asset £000	Liability £000
Australia	16	–	–	–
Switzerland	3	(25)	–	(25)
Europe	28	(171)	17	(197)
UK	277	–	268	–
Hong Kong	–	(64)	–	–
Japan	10	(51)	3	(217)
USA	15	(1,034)	8	(5)
Denmark	–	(3)	–	–
<b>Total</b>	<b>349</b>	<b>(1,348)</b>	<b>296</b>	<b>(444)</b>

### Financial reinsurance embedded derivative

In respect of Movestic, the group has 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 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 22.

### 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 22.



## 26 Cash and cash equivalents

### Group

31 December	2016 £000	2015 £000
Bank and cash balances	134,055	137,641
Call deposits due within 1 month	38,851	35,057
Call deposits due after 1 month	87,447	88,165
<b>Total cash and cash equivalents</b>	<b>260,353</b>	<b>260,863</b>
Bank overdrafts	(1,622)	(952)
<b>Cash and cash equivalents in the statement of cash flows</b>	<b>258,731</b>	<b>259,911</b>

The effective interest rate on short-term bank deposits was 0.18% (2015: 0.26%), with an average maturity of 35 days (2015: 19 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 £89,776,000 (2015: £62,077,000) held in unit-linked policyholders' funds.

### Company

31 December	2016 £000	2015 £000
Bank and cash balances	6,009	314
Cash deposits due within 1 month	23,049	7,887
Cash deposits maturing between greater than 1 month and less than 1 year	15,125	35,097
<b>Total</b>	<b>44,183</b>	<b>43,298</b>

## 27 Capital management

### (a) Regulatory context:

#### *Solvency II*

The Chesnara group is required to comply with the Solvency II capital regime. Solvency II came into force on 1 January 2016 and is a piece of EU insurance legislation that aims to unify a single EU insurance market and enhance consumer protection. The Solvency II regime includes rules over the quantity and quality of capital (known as 'own funds') that insurance companies and groups need in order to meet the regime's required level of capital (known as the 'Solvency Capital Requirement'). The Chesnara group operates exclusively within the EU and as a result the Solvency II regime applies to the group and all regulated insurance companies within the group. The regulators responsible for the supervision of the group and its subsidiaries have been shown in section (c)(i).

The Solvency II regime has specific rules regarding how own funds are recognised and valued. In a number of cases the IFRS and Solvency II value of an asset and liability are the same, but in some cases there are differences. In particular, liabilities for insurance and investment contracts are valued differently, with IFRS remaining largely based on the previous Solvency I regime. In addition Solvency II has differing treatments for certain intangible assets. A high level reconciliation between the IFRS net assets and Solvency II own funds of the group and its subsidiaries has been provided in part (c)(ii) of this note.

Regarding the Solvency Capital Requirement (SCR) of the Chesnara group and its subsidiaries, the group has elected to use the 'standard formula' approach for its calculation, which means we are applying the formulas as included in the Solvency II framework. The calculations within the standard formula have been designed such that, on the basis that an insurance company holds own funds that are at least equal to its SCR it will be able to withstand a 1 in 200 year event. An alternative would have been to use an 'internal model' but this was not deemed appropriate for the size and complexity of the Chesnara group.

#### *Company law*

As well as complying with the Solvency II regime, each company within the group is required to comply with relevant company law capital and distribution rules.

### (b) Objectives, policies and processes for managing capital

#### *(i) Objectives*

To manage compliance with the externally imposed capital requirements the group and its subsidiaries have established capital management policies in place. The objectives of these policies are:

- to ensure that capital is managed in a way that is consistent with the business strategy of group and its subsidiaries, in that they:
  - promote fair customer outcomes through protecting policyholders
  - provide protection to shareholders through ensuring that the business is adequately protected against stress events; and
  - provide a framework to support the decision making process for returns to shareholders via dividends.
- to ensure that capital of the group and its subsidiaries is managed in accordance with the board's risk appetite, in particular each board's aversion for own funds to fall below the SCR.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 27 Capital management (continued)

### (b) Objectives, policies and processes for managing capital (continued)

#### (ii) Policies

In light of the objectives for the group's and its subsidiaries' capital management policies, the following quantitative limits for managing own funds are applied across the group:

Region	UK	Sweden	Netherlands	Group
Dividend paying limit: Own funds stated as % of SCR	120%	120%	200%	110%
Management actions limit: Own funds stated as % of SCR	110%	110%	175%	105%

**Dividend paying limit:** This is the point at which a dividend would cease to be paid, until at such time the solvency position was restored above this point. This limit is set by the relevant board in each division with reference to its respective risk appetite, as articulated in each divisions' capital management policy.

**Management actions limit:** This is the point at which, should own funds fall below this level, additional management actions would be taken to restore own funds back above this level. In essence this represents an internal 'ladder of intervention limit' that is set by the group and divisional boards.

To put the above table and definitions in context, and taking group as an example, this means that the group will not pay a dividend should the payment of the dividend take the group own funds to below 110% of its SCR. Should own funds fall below 105% of SCR additional management actions will be taken.

#### (iii) Process for management of capital

The following key processes and procedures are in place across the group to manage adherence to the capital management policies in place:

- **Production of various internal reports:** A number of internal reports are produced that focus on the solvency position of the group/company. These include the Own Risk & Solvency Assessment (ORSA) report, a quarterly actuarial report and a quarterly finance report. All of these are presented to, and approved by, the board.
- **Production of projections:** On at least an annual basis solvency projections are produced for the group and its subsidiaries. These projections are included in both the business plans and the ORSA report, and show how management anticipates the solvency position to develop over time. The projections process includes assessing the impact of a number of different stress scenarios to ensure that the sensitivities of the business are understood. Both the ORSA and the business plans are presented to and approved by the board.
- **Regular review of internal limits in place:** On at least an annual basis the limits described in (b)(ii) of this note are reviewed and assessed, having regard to the developments of the business and any other changes that may have affected the group's/divisions' risk appetite.
- **Recovery management protocol:** A protocol for management actions has been designed which, in effect, represents an internally set 'ladder of intervention'. The protocol includes items such as solvency monitoring frequency, what level of escalations are required and what management actions need to be considered.
- **Trigger monitoring:** On at least a monthly basis specific key risk indicators are monitored against pre-defined trigger points. The trigger points are set having regard for the sensitivity of the group to certain scenarios. Trigger points and the list of risk indicators being monitored are assessed at least annually.

#### (iv) Compliance during year

The group, and all insurance companies within the group, have held own funds above their respective Solvency Capital Requirements at all times during the year.

### (c) Quantitative analysis

#### (i) Group solvency position

The solvency position of the group and its divisions at 31 December 2016 and at 31 December 2015, which is unaudited, has been shown in the tables below. These present a view of the solvency position which may differ to the position of the individual insurance company(ies) within that division.

31 December 2016 unaudited					
Region	UK £m	Sweden £m	Netherlands £m	Other group & consolidation adjustments £m	Group £m
Own funds (pre dividends)	196.3	192.3	86.6	49.2	524.4
Proposed dividend	(30.0)*	(2.7)	–	13.7	(19.0)
<b>Own funds (post dividends)</b>	<b>166.3</b>	<b>189.6</b>	<b>86.6</b>	<b>62.9</b>	<b>505.4</b>
SCR	129.8	135.6	12.2	43.1	320.7
<b>Solvency surplus</b>	<b>36.5</b>	<b>54.0</b>	<b>74.4</b>	<b>n/a</b>	<b>184.7</b>
<b>Solvency ratio</b>	<b>128%</b>	<b>140%</b>	<b>712%</b>	<b>n/a</b>	<b>158%</b>
Dividend paying limit (% of SCR)	120%	120%	200%	n/a	110%
Dividend paying limit (£)	155.8	162.7	24.3	n/a	352.8
Surplus over dividend paying limit	10.5	26.9	62.3	n/a	152.6

\*The proposed dividend is subject to a 'no objection' process with the PRA.

**31 December 2015 unaudited**

Region	UK £m	Sweden £m	Netherlands £m	Other group & consolidation adjustments £m	Group £m
Own funds (pre dividends)	198.2	149.8	69.8	(21.0)	396.8
Proposed dividend	(30.5)	–	–	14.9	(15.6)
<b>Own funds (post dividends)</b>	<b>167.7</b>	<b>149.8</b>	<b>69.8</b>	<b>(6.1)</b>	<b>381.2</b>
SCR	123.8	97.5	11.7	27.7	260.7
<b>Solvency surplus</b>	<b>43.9</b>	<b>52.3</b>	<b>58.1</b>	<b>n/a</b>	<b>120.5</b>
<b>Solvency ratio</b>	<b>135%</b>	<b>154%</b>	<b>597%</b>	<b>n/a</b>	<b>146%</b>
Dividend paying limit (% of SCR)	120%	120%	200%	n/a	110%
Dividend paying limit (£)	148.5	117.0	23.4	n/a	286.7
Surplus over dividend paying limit	19.2	32.8	46.4	n/a	94.5

**(ii) Reconciliation between Solvency II own funds and IFRS net asset (unaudited)**

The tables below show the key differences between the Solvency II own funds reported in part (c)(i) and the group's IFRS net assets.

**31 December 2016 unaudited**

Region	UK £m	Sweden £m	Netherlands £m	Other group & consolidation adjustments £m	Group £m
<b>Solvency II own funds (post dividends)</b>	<b>166.3</b>	<b>189.6</b>	<b>86.6</b>	<b>62.9</b>	<b>505.4</b>
Add Back: Ring-fenced fund surplus restrictions	10.6	–	–	0.2	10.8
Add Back: Intangible assets	19.1	88.8	5.5	–	113.4
Add Back: Foreseeable dividends	30.0	2.7	–	(13.7)	19.0
Add Back: Difference in valuation of technical provisions	(71.3)	(199.2)	(8.6)	20.6	(258.5)
Add Back: Difference in deferred tax	8.9	(0.3)	3.3	(4.0)	7.9
Add Back: Other valuation differences	0.3	(1.9)	(2.3)	(0.5)	(4.4)
<b>IFRS Net Assets</b>	<b>163.9</b>	<b>79.7</b>	<b>84.5</b>	<b>65.5</b>	<b>393.6</b>

**31 December 2015 unaudited**

Region	UK £m	Sweden £m	Netherlands £m	Other group & consolidation adjustments £m	Group £m
<b>Solvency II own funds (post dividends)</b>	<b>167.7</b>	<b>149.8</b>	<b>69.8</b>	<b>(6.1)</b>	<b>381.1</b>
Add Back: Ring-fenced fund surplus restrictions	4.8	–	–	–	4.8
Add Back: Intangible assets	27.9	73.7	5.3	–	106.9
Add Back: Foreseeable dividends	30.5	–	–	(14.9)	15.6
Add Back: Difference in valuation of technical provisions	(75.1)	(159.9)	(9.1)	20.9	(223.2)
Add Back: Difference in deferred tax	7.3	1.7	2.8	0.3	12.0
Add Back: Other valuation differences	0.2	(2.0)	–	(0.4)	(2.2)
<b>IFRS Net Assets</b>	<b>163.3</b>	<b>63.3</b>	<b>68.8</b>	<b>(0.2)</b>	<b>295.1</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 28 Insurance contract provisions

### (a) Analysis of insurance contract provisions by operating segment

31 December	2016			2015		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
CA	941,143	188,302	752,841	979,088	225,809	753,279
S&P	1,100,618	6,463	1,094,155	1,069,806	5,864	1,063,942
Movestic	85,951	54,926	31,025	70,555	45,601	24,954
Waard Group	114,734	5,168	109,566	112,634	5,354	107,280
<b>Total insurance contract provisions</b>	<b>2,242,446</b>	<b>254,859</b>	<b>1,987,587</b>	<b>2,232,083</b>	<b>282,628</b>	<b>1,949,455</b>
Current	286,720	86,518	200,202	214,153	38,465	175,688
Non-current	1,955,726	168,341	1,787,385	2,017,930	244,163	1,773,767
<b>Total</b>	<b>2,242,446</b>	<b>254,859</b>	<b>1,987,587</b>	<b>2,232,083</b>	<b>282,628</b>	<b>1,949,455</b>

### (b) Analysis of movement in insurance contract provisions

Year ended 31 December	2016			2015		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
<b>Balance at 1 January</b>	<b>2,232,083</b>	<b>282,628</b>	<b>1,949,455</b>	<b>2,308,043</b>	<b>335,936</b>	<b>1,972,107</b>
Arising on business combination	–	–	–	125,044	5,736	119,308
Premiums received	75,126	24,523	50,603	83,375	27,896	55,479
Fees deducted	(24,226)	(1,773)	(22,453)	(24,962)	(1,880)	(23,082)
Reserves released in respect of benefits paid	(320,807)	(105,846)	(214,961)	(284,423)	(80,878)	(203,545)
Movements in provisions for contracts sold – Movestic						
– in current year	25,226	16,173	9,053	19,755	11,757	7,998
– in prior years	(18,870)	(12,127)	(6,743)	(13,026)	(7,104)	(5,922)
Investment return	197,054	9,412	187,642	40,079	2,028	38,051
Other movements	76,860	41,869	34,991	(21,802)	(10,863)	(10,939)
<b>Balance at 31 December</b>	<b>2,242,446</b>	<b>254,859</b>	<b>1,987,587</b>	<b>2,232,083</b>	<b>282,628</b>	<b>1,949,455</b>

### (c) Basis and assumptions for calculating insurance contract provisions

#### UK

##### (i) Basis:

The process used to determine the assumptions underlying the calculation of IFRS 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.

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 ReAssure. When performing the gross liability adequacy test allowance is made for expected future bonuses paid by ReAssure. This is based on the realistic liabilities of the underlying policies reinsured, as provided to CA by ReAssure.

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 certain group business within the PL component of CA, the technical provisions are assessed on an unearned premium method considered appropriate for the nature and scale of the liabilities. For the remainder of the PL business, the technical provisions are calculated on a gross premiums 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 lapse or death if earlier. The gross premiums method makes explicit allowance for future policy maintenance costs. If the net present value of future discounted cash flows is positive no asset is recognised.

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.

## (ii) Principal assumptions

### Mortality

A base mortality table is selected which is most appropriate for each type of contract taking into account rates charged 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.

### Persistency

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	2016		2015	
	SPI	SPP	SPI	SPP
<b>Assurances:</b>				
Regular premium plans	2.625%	2.625%	3.375%	2.625%
Single premium contracts	3.000%	3.375%	3.375%	3.375%
Linked TIC*	–	4.000%	–	4.000%

\*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 2016 for the material product types, these lay between 0.40% and 1.70% (31 December 2015: between 0.90% and 2.55%).

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 1.5%.

Credit rating	Aaa	Aa	A	Baa	Ba	B	Caa+
Reduction	25%	40%	45%	50%	65%	75%	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 CA funds.

### Taxation

It has been assumed that current tax legislation and tax rates will not change.

The sensitivities of technical provisions to changes in assumptions are set out below.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 28 Insurance contract provisions (continued)

### (c) Basis and assumptions for calculating insurance contract provisions (continued)

#### UK (continued)

#### (iii) Valuation of options and guarantees

##### Contracts with discretionary participation features

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.

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 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.

The cost of guaranteeing a minimum investment return on participating contracts 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.

The following sets out the cumulative charge to shareholders for the cost of guarantees on these bases:

Year ended 31 December	2016 £000	2015 £000
<b>At beginning of the year</b>	<b>37,156</b>	<b>34,593</b>
(Credit)/charge to income	(1,410)	2,563
<b>At the end of year</b>	<b>35,746</b>	<b>37,156</b>

#### 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 £644,000 as at 31 December 2016 (31 December 2015: £486,000).

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 25% and allowing for future investment returns, including presumed future equity investment return of 3.7% 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 2016 was £4.5m (31 December 2015: £4.8m). 498 policies invested in the fund (31 December 2015: 526), of which 37 (31 December 2015: 40) were paying premiums (for a total of approximately £10,000 per annum (31 December 2015: £11,000)).

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:	2.77% pa
Rate of return on cash:	0.22% pa
Discount rate:	0.20% 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 2016 was £0.3m (31 December 2015: £0.4m).

#### *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 2016 was £9.1m (31 December 2015: £10.4m).

#### *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 2016 was £0.1m (31 December 2015: £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 2016 was £0.3m (31 December 2015: £0.3m).

#### *Guaranteed annuity options*

A limited number of pension plans offer guaranteed annuity options at retirement. The cost of this option is assessed assuming a prudent assessment of the take-up of the option and of the cost. The reserve for this option as at 31 December 2016 is £0.15m (31 December 2015: £0.26m).

### **Sweden**

#### **(i) Basis:**

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 following Finansinspektionen guidelines.

#### *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 and are released to income 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 claims 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 28 Insurance contract provisions (continued)

### (ii) Principal assumptions:

*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.

### (iii) Analysis of claims development – gross

	2011 £000	2012 £000	2013 £000	2014 £000	2015 £000	2016 £000
Estimate of ultimates						
End of accident year	26,799	27,725	29,069	28,630	28,757	34,509
One year later	17,336	18,600	23,356	21,842	21,918	
Two years later	15,785	17,757	20,654	18,561		
Three years later	15,001	16,898	18,825			
Four years later	13,881	15,279				
Five years later	13,374					
Current estimate of ultimate claims	13,374	15,279	18,825	18,561	21,918	34,509
Cumulative payments	(10,709)	(11,663)	(12,598)	(8,175)	(7,832)	(8,310)
In balance sheet	2,665	3,616	6,227	10,386	14,086	26,199
Provision for prior years						18,408
Liability in balance sheet						81,587

### Analysis of claims development – net

	2011 £000	2012 £000	2013 £000	2014 £000	2015 £000	2016 £000
Estimate of ultimates						
End of accident year	11,246	10,306	11,576	13,814	11,013	11,062
One year later	5,762	5,357	7,641	7,376	5,958	
Two years later	4,340	4,832	6,833	4,694		
Three years later	3,974	4,890	4,042			
Four years later	4,174	2,797				
Five years later	2,529					
Current estimate of ultimate claims	2,529	2,797	4,042	4,694	5,958	11,062
Cumulative payments	(1,735)	(1,846)	(2,145)	(1,419)	(1,591)	(1,660)
In balance sheet	794	951	1,897	3,275	4,367	9,402
Provision for prior years						7,786
Liability in balance sheet						28,473



## Netherlands

### (i) Basis:

For protection policies insurance contract provisions comprise a technical reserve for future claims and a claim reserve for those not settled to completion at the reporting date.

For general insurance contracts an unearned premium reserve reflecting the non-expired term of contract is held plus an claims provision.

For insurance contracts where the policy value reflects the value of supporting assets (unit-linked contracts) the Insurance Contract Provision equals the value of assets held.

### (ii) Principal assumptions

The technical reserve uses assumptions for mortality, expenses and discounting that were used in the contract pricing, reflecting a book reserve approach. The continued appropriateness of these assumptions are assessed by undertaking a liability adequacy test.

Claims reserves for general insurance business in Waard Schade contain assessment of those Incurred But Not Reported (IBNR) which are regularly updated reflecting analysis of recent reporting patterns.

## (d) Sensitivity to changes in assumptions

### Impact on reported net of tax profits and equity to changes in key variables:

Change in variable	CA		S&P		Movestic		Movestic	
	Change in net of tax profits and equity		Change in net of tax profits and equity		Change in pre-tax profit		Change in shareholders' equity	
	2016	2015	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m	£m	£m
100 basis point increase in Investment return	(2.1)	(2.4)	0.1	5.3	n/a	n/a	n/a	n/a
100 basis point decrease in Investment return	0.9	(0.1)	(1.4)	(7.6)	n/a	n/a	n/a	n/a
10% increase in mortality/morbidity	1.0	0.5	n/a	n/a	n/a	n/a	n/a	n/a
10% increase in mortality alone	1.7	0.9	(0.1)	0.3	n/a	n/a	n/a	n/a
10% increase in morbidity alone	(0.7)	(0.4)	n/a	n/a	n/a	n/a	n/a	n/a
10% increase in policy maintenance expenses	(2.8)	(1.5)	(1.9)	(2.1)	n/a	n/a	n/a	n/a
5% increase in loss ratio								
Gross before reinsurance	n/a	n/a	n/a	n/a	(3.9)	(3.2)	(3.2)	(2.6)
Net after reinsurance	n/a	n/a	n/a	n/a	(1.4)	(1.1)	(1.1)	(0.9)
5% decrease in loss ratio								
Gross before reinsurance	n/a	n/a	n/a	n/a	3.9	3.2	3.2	2.6
Net after reinsurance	n/a	n/a	n/a	n/a	1.4	1.1	1.1	0.9
1% increase in discount rate								
Gross before reinsurance	n/a	n/a	n/a	n/a	–	0.6	–	0.5
Net after reinsurance	n/a	n/a	n/a	n/a	–	0.4	–	0.3
1% decrease in discount rate								
Gross before reinsurance	n/a	n/a	n/a	n/a	–	(0.3)	–	(0.2)
Net after reinsurance	n/a	n/a	n/a	n/a	–	(0.2)	–	(0.1)

## 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 above 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.

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 and subject to treating customers fairly.

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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 28 Insurance contract provisions (continued)

### 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 above.

### Dutch business (Waard Group)

The key material sensitivities within Waard Group that impact the group are mortality and expenses. The impact of +10% change in mortality is estimated to result in a change in net of tax profits and equity of negative £2.9m (2015: negative £2.4m). The impact of +10% change in expenses is estimated to result in a change in net of tax profits and equity of negative £0.6m (2015: negative £0.4m).

## 29 Investment contracts at fair value through income and amounts deposited with reinsurer

### Analysis by operating segment

31 December						
	Investment contract liability £000	2016 Amount deposited with reinsurer £000	Net £000	Investment contract liability £000	2015 Amount deposited with reinsurer £000	Net £000
CA	725,685	37,437	688,248	667,375	33,941	633,434
S&P	32,874	–	32,874	33,555	–	33,555
Movestic	2,269,710	–	2,269,710	1,756,591	–	1,756,591
<b>Total</b>	<b>3,028,269</b>	<b>37,437</b>	<b>2,990,832</b>	<b>2,457,521</b>	<b>33,941</b>	<b>2,423,580</b>
Current	108,795	372	108,423	86,110	451	85,659
Non-current	2,919,474	37,065	2,882,409	2,371,411	33,490	2,337,921
<b>Total</b>	<b>3,028,269</b>	<b>37,437</b>	<b>2,990,832</b>	<b>2,457,521</b>	<b>33,941</b>	<b>2,423,580</b>

The fair values of the groups' investment contract liabilities are have been disclosed according to a three-level valuation hierarchy in note 22.

## 30 Liabilities relating to policyholders' funds held by the group

Unit-linked		
31 December		
	2016 £000	2015 £000
<b>Balance at 1 January</b>	<b>189,919</b>	<b>164,858</b>
Deposits received	44,276	46,448
Fees deducted from account balances	(1,669)	(1,417)
Investment yield	13,544	6,398
Foreign exchange translation difference	23,621	(4,680)
Other movements	(40,294)	(21,688)
<b>Balance at 31 December</b>	<b>229,397</b>	<b>189,919</b>
Current	13,993	11,585
Non-current	215,404	178,334
<b>Total</b>	<b>229,397</b>	<b>189,919</b>

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 22.

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 22.

### 31 Borrowings

<b>Group</b> <b>31 December</b>	<b>2016</b> <b>£000</b>	<b>2015</b> <b>£000</b>
Bank loan	52,697	52,522
Amount due in relation to financial reinsurance	34,146	26,503
<b>Total</b>	<b>86,843</b>	<b>79,025</b>
Current	61,471	18,448
Non-current	25,372	60,577
<b>Total</b>	<b>86,843</b>	<b>79,025</b>

<b>Company</b> <b>31 December</b>	<b>2016</b> <b>£000</b>	<b>2015</b> <b>£000</b>
<b>Bank loan</b>	<b>52,697</b>	<b>52,522</b>
Current	52,697	11,966
Non-current	–	40,556
<b>Total</b>	<b>52,697</b>	<b>52,522</b>

The bank loan subsisting at 31 December 2016, comprises the following:

- on 7 October 2013 tranche one of a loan facility was drawn down, amounting to £30.0m. This facility 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. During the year, £6.05m was repayable, but the amount was deferred due pending arrangement of the new loan facility to part fund the LGN acquisitions.
- on 27 November 2013 tranche two of the loan facility was drawn down, amounting to £31.0m. As with tranche one, this facility 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. During the year, £6.05m was repayable, but the amount was deferred due pending arrangement of the new loan facility to part fund the LGN acquisitions.
- on 27 November 2013 a short-term loan of £12.8m was drawn down. This was originally repayable in full on 27 May 2015. During 2014, the repayment date of this loan has been extended to December 2018. The outstanding principal on the loan bears interest at a rate of 2.75 percentage points above the London Inter-Bank Offer Rate.

The fair value of the bank loan at 31 December 2016 was £52,800,000 (31 December 2015: £52,800,000).

Bank loans are presented net of unamortised arrangement fees. Arrangement fees are recognised in profit or loss using the effective interest rate method.

The fair value of amounts due in relation to financial reinsurance was £34,396,000 (31 December 2015: £26,879,000). The fair value of other borrowings is not materially different from their carrying value.

The bank loan has been classified as current as at the balance sheet date due to the timing of the LGN acquisition, which is anticipated to complete in the first half of 2017. At this point in time, the existing facility will be re-paid in full and replaced with a new facility.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 32 Deferred tax assets and liabilities

Deferred tax liabilities comprise:

31 December	2016 £000	2015 £000
Net deferred tax liabilities:		
CA, S&P and other group activities	(4,476)	(6,121)
Movestic	(387)	(385)
Waard Group	(557)	(1,400)
<b>Total</b>	<b>(5,420)</b>	<b>(7,906)</b>
Current	(916)	(1,517)
Non-current	(4,504)	(6,389)
<b>Total</b>	<b>(5,420)</b>	<b>(7,906)</b>

### CA, S&P and other group activities

#### (a) Recognised deferred tax assets and liabilities

31 December	2015 Assets/ (liabilities) £000	(Charge)/ credit in year £000	2016 Assets/ (liabilities) £000
Profit arising on transition to new tax regime	(1,507)	270	(1,237)
Deferred acquisition costs	(572)	103	(469)
Deferred income	1,052	(175)	877
Acquired value in force	(5,167)	1,318	(3,849)
Unrealised and deferred investment gains	(14,859)	(8,183)	(23,042)
Excess expenses of management	14,859	8,183	23,042
Share-based payments	73	129	202
<b>Total</b>	<b>(6,121)</b>	<b>1,645</b>	<b>(4,476)</b>
Comprising:- Net deferred tax liabilities	(6,121)	1,645	(4,476)
<b>Total</b>	<b>(6,121)</b>	<b>1,645</b>	<b>(4,476)</b>

31 December	2014 Assets/ (liabilities) £000	(Charge)/ credit in year £000	2015 Assets/ (liabilities) £000
Profit arising on transition to new tax regime	(1,833)	326	(1,507)
Deferred acquisition costs	(703)	131	(572)
Deferred income	1,285	(233)	1,052
Acquired value in force	(6,717)	1,550	(5,167)
Unrealised and deferred investment gains	(19,882)	5,023	(14,859)
Excess expenses of management	19,882	(5,023)	14,859
Share-based payments	30	43	73
Other	39	(39)	-
<b>Total</b>	<b>(7,899)</b>	<b>1,778</b>	<b>(6,121)</b>
Comprising:- Net deferred tax liabilities	(7,899)	1,778	(6,121)
<b>Total</b>	<b>(7,899)</b>	<b>1,778</b>	<b>(6,121)</b>

Note (i) The deferred tax (charge)/credit to the Consolidated Statement of Comprehensive Income for the year is classified as follows:

Year ended 31 December	2016 £000	2015 £000
Income tax credit	1,645	1,778

(b) Items for which no deferred tax asset is recognised

31 December	2016 £000	2015 £000
BLAGAB transitional amounts	2,858	3,334
Unrelieved expenses	117,517	198,413
<b>Total</b>	<b>120,375</b>	<b>201,747</b>

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. The movement in this balance reflects an increase in deferred deemed gains on Collective Investment Schemes in the period, which has decreased the unrelieved expenses at the balance sheet date.

**Movestic**

(a) Recognised deferred tax assets and liabilities

As at the balance sheet date, Movestic had a recognised deferred tax liability of £387k (31 December 2015: £385k), in respect of fair value adjustments arising upon acquisition. Unrecognised deferred tax assets of £132k existed at the balance sheet date in respect of corporation tax recoverable (31 December 2015: £693k).

**Ward Group**

(a) Recognised deferred tax assets and liabilities

31 December	2015 Assets/ (liabilities) £000	(Charge)/ credit in year £000	Foreign exchange translations difference £000	2016 Assets/ (liabilities) £000
Intangible assets				
Fair value adjustment on acquisition	(1,319)	154	(213)	(1,378)
Valuation differences	(81)	872	30	821
<b>Total</b>	<b>(1,400)</b>	<b>1,026</b>	<b>(183)</b>	<b>(557)</b>
Comprising:				
Net deferred tax liabilities	(1,400)	1,026	(183)	(557)
<b>Total</b>	<b>(1,400)</b>	<b>1,026</b>	<b>(183)</b>	<b>(557)</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 33 Reinsurance payables

<b>Payable to reinsurers</b>			
<b>31 December</b>			
		<b>2016</b>	<b>2015</b>
		<b>£000</b>	<b>£000</b>
Payables in respect of insurance contracts		6,264	9,067
Payables in respect of investment contracts		15	17
Reinsurers' share of deferred acquisition costs and claims deposits		620	576
<b>Total</b>		<b>6,899</b>	<b>9,660</b>
Current		6,179	8,505
Non-current		720	1,155
<b>Total</b>		<b>6,899</b>	<b>9,660</b>

The carrying value of payables to reinsurers is a reasonable approximation of fair value.

## 34 Payables related to direct insurance and investment contracts

<b>31 December</b>		<b>2016</b>			<b>2015</b>		
	<b>Gross</b>	<b>Reinsurance</b>	<b>Net</b>	<b>Gross</b>	<b>Reinsurance</b>	<b>Net</b>	
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	
Accrued claims	57,781	19,307	38,474	52,275	19,042	33,233	
Intermediaries' liabilities	635	–	635	1,702	–	1,702	
Policyholder premium liabilities	418	–	418	1,620	–	1,620	
Other	2,582	–	2,582	6,687	–	6,687	
<b>Total</b>	<b>61,416</b>	<b>19,307</b>	<b>42,109</b>	<b>62,284</b>	<b>19,042</b>	<b>43,242</b>	
Current	61,416	19,307	42,109	61,331	18,420	42,911	
Non-current	–	–	–	953	622	331	
<b>Total</b>	<b>61,416</b>	<b>19,307</b>	<b>42,109</b>	<b>62,284</b>	<b>19,042</b>	<b>43,242</b>	

The carrying value of payables related to the direct insurance and investment contracts is a reasonable approximation of fair value.

## 35 Deferred income

<b>31 December</b>			
		<b>2016</b>	<b>2015</b>
		<b>£000</b>	<b>£000</b>
<b>Balance at 1 January</b>		<b>6,212</b>	<b>6,974</b>
Release to income		(774)	(762)
<b>Balance at 31 December</b>		<b>5,438</b>	<b>6,212</b>
Current		694	760
Non-current		4,744	5,452
<b>Total</b>		<b>5,438</b>	<b>6,212</b>

The release to income is included in fees and commission income (see note 8).

### 36 Other payables

Group 31 December	2016 £000	2015 £000
Accrued expenses	11,931	7,816
VAT	103	109
Employee tax	824	614
Other	10,799	9,862
<b>Total</b>	<b>23,657</b>	<b>18,401</b>
Current	23,657	18,178
Non-current	–	223
<b>Total</b>	<b>23,657</b>	<b>18,401</b>

Company 31 December	2016 £000	2015 £000
Accrued expenses	3,275	1,194
Other	1,510	372
<b>Total</b>	<b>4,785</b>	<b>1,566</b>
Current	4,785	1,566
Non-current	–	–
<b>Total</b>	<b>4,785</b>	<b>1,566</b>

The carrying value of other payables is a reasonable approximation of fair value.

### 37 Share capital and share premium

Group 31 December	2016		2015	
	Number of shares issued	Share capital £000	Number of shares issued	Share capital £000
<b>Share capital</b>	<b>149,885,761</b>	<b>43,766</b>	<b>126,552,427</b>	<b>42,600</b>
		Share premium £000		Share premium £000
		<b>142,058</b>		<b>76,516</b>

The number of shares in issue at the balance sheet date included 147,535 shares held in treasury (31 December 2015: 147,535).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 37 Share capital and share premium (continued)

Share capital for the group includes the impact of 'reverse 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 £41,501,000, 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.

On 15 December 2016, 23,333,334 new shares were issued to new and existing shareholders, as part of a fund raising exercise in respect of the proposed acquisition of LGN. The gross amount of new equity raised was £70.0m. Transaction costs of £3.1m were incurred in respect of the fund raising and have been deducted from equity.

Company 31 December	2016		2015	
	Number of shares	Share capital £000	Number of shares	Share capital £000
<b>Authorised:</b>				
Ordinary shares of 5p each	201,000,000	10,050	201,000,000	10,050
<b>Issued</b>				
Ordinary shares of 5p each	149,865,761	7,494	126,552,427	6,328
		Share premium £000		Share premium £000
		142,058		76,516

The number of shares in issue at the balance sheet date included 147,535 shares held in treasury (31 December 2015: 147,535).

## 38 Treasury shares

Group and company 31 December	2016 £000	2015 £000
Balance 31 December	161	161

## 39 Other reserves

Group 31 December	2016 £000	2015 £000
Capital redemption reserve	50	50
Foreign exchange translation reserve	19,250	(864)
<b>Balance at 31 December</b>	<b>19,300</b>	<b>(814)</b>

Company 31 December	2016 £000	2015 £000
Capital redemption reserve	50	50



## 40 Retained earnings

<b>Group</b>		
<b>Year ended 31 December</b>	<b>2016</b>	<b>2015</b>
	<b>£000</b>	<b>£000</b>
Retained earnings attributable to equity holders of the parent company comprise		
<b>Balance at 1 January</b>	<b>177,021</b>	<b>160,519</b>
Profit for the year	35,280	39,788
Share based payment	478	212
Dividends		
Final approved and paid for 2014	–	(15,143)
Interim approved and paid for 2015	–	(8,355)
Final approved and paid for 2015	(15,586)	–
Interim approved and paid for 2016	(8,595)	–
<b>Balance at 31 December</b>	<b>188,598</b>	<b>177,021</b>

The interim dividend in respect of 2015, approved and paid in 2015 was paid at the rate of 6.61p per share. The final dividend in respect of 2015, approved and paid in 2016, was paid at the rate of 12.33p per share so that the total dividend paid to the equity shareholders of the parent company in respect of the year ended 31 December 2015 was made at the rate of 18.94p per share.

The interim dividend in respect of 2016, approved and paid in 2016, was paid at the rate of 6.80p per share to equity shareholders of the parent company registered at the close of business on 8 September 2016, the dividend record date.

A final dividend of 12.69p per share in respect of the year ended 31 December 2016 payable on 24 May 2017 to equity shareholders of the parent company registered at the close of business on 18 April 2017, the dividend record date, was approved by the directors after the balance sheet date. The resulting total final dividend of £19.0m 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 2016 and 31 December 2015:

<b>Year ended 31 December</b>	<b>2016</b>	<b>2015</b>
	<b>P</b>	<b>P</b>
Interim - approved and paid	6.80	6.61
Final - proposed/paid	12.69	12.33
<b>Total</b>	<b>19.49</b>	<b>18.94</b>

<b>Company</b>		
<b>Year ended 31 December</b>	<b>2016</b>	<b>2015</b>
	<b>£000</b>	<b>£000</b>
<b>Balance at 1 January</b>	<b>166,313</b>	<b>133,131</b>
Profit for the year	22,311	56,468
Share based payment	478	212
Dividends paid		
Final approved and paid for 2014	–	(15,143)
Interim approved and paid for 2015	–	(8,355)
Final approved and paid for 2015	(24,181)	–
Interim approved and paid for 2016	–	–
<b>Balance at 31 December</b>	<b>164,921</b>	<b>166,313</b>

Details of dividends, approved and paid, are set out in the 'Group' section above.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 41 Employee benefit expense, including directors

Year ended 31 December							
	CA £000	S&P £000	Movestic £000	Waard Group £000	Other group activities £000	2016 £000	2015 £000
Wages and salaries	1,412	594	7,608	1,262	1,372	12,248	10,219
Social security costs	181	76	3,112	134	176	3,679	3,079
Pension costs-defined contribution plans	116	49	1,699	94	113	2,071	1,689
<b>Total</b>	<b>1,709</b>	<b>719</b>	<b>12,419</b>	<b>1,490</b>	<b>1,661</b>	<b>17,998</b>	<b>14,987</b>
Average number of employees							
Company						29	24
Subsidiaries						172	162
<b>Total</b>						<b>201</b>	<b>186</b>

### Directors

Note 42 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.

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. Options have been granted to executive directors in the period, in relation to the share-based payment components of the new executive incentive schemes that was introduced under the 2014 Terms. Further details can be found in the Directors' Remuneration Report Section and in note 42 – Share Based Payments on page 153.

### Dutch-based employees

The Dutch-based business participates in a defined contribution scheme.

### Swedish-based employees

The Swedish business participates in a combined defined benefit and defined contribution scheme operated by Försäkringsbranschens Pensionskassa, 'FPK' (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 1971 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 1972 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 2015, totalled SEK 26,966k (£2,275,750). During 2016 further contributions of SEK 6,973k (£588,475) were made.

The employers within the Scheme are collectively responsible 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 2015.

The annual report states that the Scheme's surplus is SEK 1,311m (SEK 985m) as at 31 December 2015.

As at 31 December 2015, the fund had assets under management of SEK 13.2bn (31 December 2014: SEK 12.9bn). During 2015 there have been 129 (2014: 127) employer insurance companies participating in the Scheme and 26,000 (26,000) 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.

## 42 Share-based payments

The group issues equity-settled share based payments to the three executive directors based on the 2014 Terms. Equity settled share-based payments are measured at fair value at the date of the grant, and expensed on a straight-line over the vesting period, based on the group's estimate of shares that will eventually vest. The executive bonus scheme consists of two components:

- (a) Short-Term Incentive Scheme (STI scheme)
- (b) Long-Term Incentive Scheme (LTI scheme)

The STI scheme is based upon a 1 year performance period measured against IFRS, EEV operating profit and strategic group objectives. In relation to 2016, upon meeting the necessary performance targets, the company granted an award in the form of a right to receive a cash amount of up to 75% of the gross salary. In the event that the gross cash payment due is greater than £20,000, a mandatory 35% of the cash award was deferred into shares, which had a vesting period of three years. Therefore the award was 65% settled in cash and 35% settled by a share option award, which cannot be exercised for three years.

Under the LTI Scheme, options are granted with a vesting period of three years. These awards are subject to performance conditions tied to the company's financial performance in respect of growth in Economic Value and total shareholder return ('TSR').

For schemes with market performance criteria, the number of options expected to vest is adjusted only for expectations of leavers prior to vesting. Fair value of the options is measured by use of the Monte Carlo model at the issuing date.

The LTI Scheme also contains a target of Economic Value growth. As this is a non-market performance condition, the number of options expected to vest is recalculated at each balance sheet date based on expectations of performance against target. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in reserves.

If the options remain unexercised after a period of 10 years from the date of grant, the options expire. Furthermore, options are forfeited if the employee leaves the group before options vest and is deemed to be a 'bad' leaver.

### (a) 2016 award under the Short-Term Incentive (STI) Scheme

Details of the short-term incentive awards made in the year are as follows:

<b>2016 Short-Term Incentive Scheme Awards made in year:</b>	<b>2016 £000</b>	<b>2015 £000</b>
Amount paid as cash bonus through the income statement (65%)	521	329
Amount deferred into shares for three years and subject to forfeiture (35%)	281	177
<b>Total bonus award for the year</b>	<b>802</b>	<b>506</b>
<b>Amount of deferred expense recorded in the current year</b>	<b>128</b>	<b>42</b>

The deferred share award will be made following the end of the performance period by the Remuneration Committee. The deferred amount will be divided by the share price on the award date and the number of share awards will be awarded. The share awards will be accounted for per IFRS 2, under Equity Settled share-based payments.

### (b) 2016 award made under the Long-Term Incentive (LTI) Scheme

In April 2016, the group granted 255,000 nil priced share options with a vesting period of three years. These awards were subject to performance conditions tied to the company's financial performance in respect of growth in embedded value and total shareholder return ('TSR').

The fair value of the non-market base condition was determined to be 312.00p, which was the share price as at 28 April 2016, the grant date of the options.

Details of the share options outstanding during the year are as follows:

<b>2016 Long-Term Incentive Scheme</b>	<b>Options Number £000</b>	<b>Weighted average exercise price £</b>
Outstanding at the beginning of the year	–	–
Granted during the year	255	–
Outstanding at the end of the year	255	–
Exercisable at the end of the year	–	–

The weighted average contractual life is 10 years.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 42 Share-based payments (continued)

### (b) 2016 award made under the Long-Term Incentive (LTI) Scheme (continued)

The inputs into the Monte Carlo model are as follows:

Valuation method	Monte Carlo
Weighted average share price (pence)	312.00
Weighted average exercise price (pence)	Nil
Weighted average fair value of options granted (pence)	179.72
Expected volatility	28.07
Expected life	3 years
Risk free rate	0.86%
Expected dividend yield	0%

Expected volatility was determined by calculating the historical volatility of the company's share price over the previous 10 years.

The group recognised total expense of £128,000 related to equity-settled share based payments transactions in 2016.

### (c) 2015 award under the Short-Term Incentive (STI) Scheme

The group has recorded an expense of £40,000 with regards to the 35% element that has been deferred over the vesting period.

### (d) 2015 award made under the Long-Term Incentive (LTI) Scheme

In April 2015, the group granted 181,000 nil priced share options with a vesting period of three years. These awards were subject to performance conditions tied to the company's financial performance in respect of growth in embedded value and total shareholder return ('TSR').

The fair value of the non-market base condition was determined to be 319.00p, which was the share price as at 28 April 2015, the grant date of the options.

Details of the share options outstanding during the year are as follows:

	2016		2015	
	Options Number 000	Weighted average exercise price £	Options Number 000	Weighted average exercise price £
Outstanding at the beginning of the year	181	–	–	–
Granted during the year	–	–	181	–
Forfeited during the year	–	–	–	–
Exercised during the year	–	–	–	–
Outstanding at the end of the year	181	–	181	–
Exercisable at the end of the year	–	–	–	–

The weighted average contractual life is 10 years.

The inputs into the Monte Carlo model are as follows:

Valuation method	Monte Carlo
Weighted average share price (pence)	319.00
Weighted average exercise price (pence)	Nil
Weighted average fair value of options granted (pence)	187.62
Expected volatility	30.21
Expected life	3 years
Risk free rate	1.07%
Expected dividend yield	0%

Expected volatility was determined by calculating the historical volatility of the company's share price over the previous 10 years.

The group recognised total expense of £153,000 related to equity-settled share based payments transactions in 2016.

**(e) 2014 award under the Short-Term Incentive (STI) Scheme**

The group has recorded an expense of £21,000 with regards to the 35% element that has been deferred over the vesting period.

**(f) 2014 award made under the Long-Term Incentive (LTI) Scheme**

In May 2014, the group granted 169,000 nil priced share options with a vesting period of three years. These awards were subject to performance conditions tied to the company's financial performance in respect of growth in embedded value and total shareholder return ('TSR').

Fair value is measured by use of the Monte Carlo model of the TSR condition. The LTI Scheme also contains embedded value growth. As these are non-market performance conditions they are not included in the determination of fair value of share options at the grant date. The fair value of the non-market base condition was determined to be 310.25p, which was the share price as at 20 May 2014, the grant date of the options.

Details of the share options outstanding during the year are as follows:

2014 Long-Term Incentive Scheme	2016		2015	
	Options Number 000	Weighted average exercise price £	Options Number 000	Weighted average exercise price £
Outstanding at the beginning of the year	91	–	117	–
Granted during the year	–	–	–	–
Forfeited during the year	–	–	–	–
Exercised during the year	–	–	(26)	–
Outstanding at the end of the year	91	–	91	–
Exercisable at the end of the year	–	–	–	–

The weighted average contractual life is 10 years.

The inputs into the Monte Carlo model are as follows:

Valuation method	Monte Carlo
Weighted average share price (pence)	310.25
Weighted average exercise price (pence)	nil
Weighted average fair value of options granted (pence)	183.08
Expected volatility	32.10%
Expected life	3 years
Risk free rate	1.46%
Expected dividend yield	0%

Expected volatility was determined by calculating the historical volatility of the company's share price over the previous 10 years.

The group recognised total expense of £74,000 related to equity-settled share based payments transactions in 2016.

**43 Earnings per share**

Earnings per share are based on the following:

Year ended 31 December	2016	2015
Profit for the year attributable to shareholders (£000)	35,280	39,788
Weighted average number of ordinary shares	127,488,681	126,401,635
Basic earnings per share	27.67p	31.48p
Diluted earnings per share	27.56p	31.41p

The weighted average number of ordinary shares in respect of the years ended 31 December 2016 is based upon 149,885,761 shares in issue less 147,535 own shares held in treasury. The weighted average number of ordinary shares in respect of the years ended 31 December 2015 was based upon 126,552,427 shares in issue less 147,535 own shares held in treasury.

There were 526,000 share options outstanding at 31 December 2016 (2015: 271,000). Accordingly, there is dilution of the average number of ordinary shares in issue in respect of 2016.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 44 Operating leases

### Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

Operating lease rentals Year ended 31 December	2016			2015		
	Non- investment properties £000	Motor vehicles £000	Total £000	Non- investment properties £000	Motor vehicles £000	Total £000
Less than one year	953	196	1,149	852	236	1,088
Between one and two years	798	141	939	835	178	1,013
Between two and five years	868	129	997	1,231	158	1,389
More than five years	–	–	–	–	–	–
<b>Expenses recognised in the year in respect of operating leases</b>	<b>976</b>	<b>146</b>	<b>1,122</b>	<b>908</b>	<b>237</b>	<b>1,145</b>

### 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.

## 45 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.

## 46 Capital commitments

There were no capital commitments as at 31 December 2016 or as at 31 December 2015.

## 47 Related parties

### (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; and
- (v) transactions with persons related to key management personnel

### (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:

	2016 £000	2015 £000
Short-term employee benefits	1,849	1,713
Post-employment benefits	84	71
<b>Total</b>	<b>1,933</b>	<b>1,784</b>

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, or where regulatory contribution limits are reached, pay an equivalent amount as an addition to base salary.

The following amounts were payable to directors in respect of bonuses and incentives:

	2016 £000	2015 £000
<b>Annual bonus scheme (included in the short-term employee benefits above)</b>	<b>521</b>	<b>495</b>

These amounts have been included in Accrued Expenses as disclosed in note 36.

The amounts payable under the annual bonus scheme were payable within one year.

*(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 Consolidated Statement of Comprehensive Income of the company for the respective periods:

Year ended 31 December	2016 £000	2015 £000
<b>Recovery of expenses</b>	<b>3,470</b>	<b>3,054</b>

*(iii) Transactions with associate*

Movestic Livförsäkring AB and its associate Modernac SA

Year ended 31 December	2016 £000	2015 £000
Reinsurance premiums paid	(9,245)	(8,456)
Reinsurance recoveries received	4,983	4,200
Reinsurance commission received	1,761	1,570
	(2,501)	(2,686)
<b>Amounts outstanding as at balance sheet date</b>	<b>(3,570)</b>	<b>(5,321)</b>

Movestic Livförsäkring AB had the following amounts outstanding at the balance sheet date:

	2016		2015	
	Amounts owed by associate £000	Amounts owed to associate £000	Amounts owed by associate £000	Amounts owed to associate £000
<b>Modernac S.A.</b>	<b>-</b>	<b>3,570</b>	<b>-</b>	<b>5,321</b>

These amounts have been included in other payables as disclosed in note 36 and other receivables as disclosed in note 24.

*(iv) Transactions with persons related to key management personnel*

During the year, the company engaged the professional services of Clare Rimmington and Trisha Hughes, who are related to David Rimmington and Frank Hughes respectively.

Clare Rimmington is an on-line marketing expert with many years of experience developing and managing web based solutions in the Financial Services sector. Trisha Hughes has many years of project management experience including managing projects in the Financial Services sector. Their engagements are deemed to have been on terms that are more beneficial to Chesnara than would need to have been offered in an open consultancy market.

In the year an amount of £11,830 was paid by the company to Clare Rimmington for web-site related consultancy services. In addition, an amount of £65,610 was paid to Trisha Hughes for business consultancy services. These amounts have been included in administration expenses and disclosed in note 14.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 48 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	Ownership interest 31 December 2016	Ownership interest 31 December 2015	Functional Currency
Countrywide Assured plc	United Kingdom	100% of all share capital (1)	100% of all share capital (1)	Sterling
Countrywide Assured Life Holdings Limited	United Kingdom	100% of all share capital	100% of all share capital	Sterling
Countrywide Assured Services Limited	United Kingdom	100% of all share capital	100% of all share capital	Sterling
Countrywide Assured Trustee Company Limited	United Kingdom	100% of all share capital	100% of all share capital	Sterling
<b>Registered address</b> 2nd Floor, Building 4, West Strand Business Park West Strand Road, Preston, Lancashire PR1 8UY				
Movestic Livförsäkring AB	Sweden	100% of all share capital	100% of all share capital	Swedish krona
Movestic Kapitalförvaltning AB	Sweden	100% of all share capital (2)	100% of all share capital (2)	Swedish krona
<b>Registered address</b> Box 7853, S-103 99 Stockholm Sweden				
Modernac S.A.	Luxembourg	49% of all share capital (2)	49% of all share capital (2)	Swedish krona
<b>Registered address</b> BP 593 L-2015 Luxembourg Luxembourg				
Chesnara Holdings B.V.	Netherlands	100% of all share capital (3)	100% of all share capital (3)	Euro
Waard Leven N.V.	Netherlands	100% of all share capital (4)	100% of all share capital (4)	Euro
Waard Schade N.V.	Netherlands	100% of all share capital (4)	100% of all share capital (4)	Euro
Tadas Verzekering	Netherlands	100% of all share capital (4)	100% of all share capital (4)	Euro
Hollands Welvaren Leven N.V.	Netherlands	100% of all share capital (5)	100% of all share capital (5)	Euro
<b>Registered address</b> Geert Scholtenslaan II 1687 CL Wognum Netherlands				

(1) Held indirectly through Countrywide Assured Life Holdings Limited.

(2) Held indirectly through Movestic Livförsäkring AB.

(3) Company formed on 25 November 2014.

(4) Held indirectly through Chesnara Holdings B.V.

(5) Held indirectly through Waard Leven N.V.



#### 49 Post balance sheet event

On 24 November 2016 the company announced its proposed acquisition of Legal & General Nederland Levensverzekering Maatschappij N.V. At the time of the announcement the completion of the acquisition was subject to certain conditions being met. These included obtaining a declaration of no objection from the Dutch regulator, De Nederlandsche Bank (DNB), and completing the Works Council consultation process in the Netherlands. A declaration of no objection was received by DNB on 30 March 2017 and the consultation process with the works council of Legal & General Nederland has now been completed. The acquisition is expected to be completed by 6 April 2017 and therefore at the time of signing these financial statements the acquisition has not completed. As such full disclosures in accordance with IFRS 3 'Business Combinations' will be reported in the next set of financial statements following completion.

The Prospectus and Notice of EGM that was issued on 24 November 2016 reported the following key financial metrics in relation to the proposed acquisition:

##### **Consideration:**

The headline consideration for the Acquisition is €160 million, to be paid in cash. The Acquisition consideration is proposed to be financed by a combination of a Firm Placing and Placing and Open Offer to raise in aggregate approximately £70 million (before expenses), New Debt Facilities totalling £100.2 million (£40 million and €71 million), which replace an existing debt facility of £52.8 million and raises £47.4 million of incremental debt and the balance from Chesnara's existing cash resources. In addition to the headline consideration, deferred capital related consideration will accrue from 1 October 2016 to the date of completion of the Acquisition, which is expected to occur during the first quarter of 2017. The company has calculated the maximum interest payable to be €2.3 million.

##### **Key metrics:**

Key Legal & General Nederland financial metrics at 30 June 2016 were as follows:

- €219.8 million of Solvency II own funds;
- €2.2 billion of funds under management;
- Approximately 170,600 policies;
- Solvency ratio of 219%; and
- IFRS net assets of €138.6m.

# SECTION E: ADDITIONAL INFORMATION

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# FINANCIAL CALENDAR

**31 March 2017**

Results for the year ended 31 December 2016 announced.

**13 April 2017**

Ex dividend date.

**18 April 2017**

Dividend record date.

**18 April 2017**

Published Financial Statements issued to shareholders.

**17 May 2017**

Annual General Meeting.

**24 May 2017**

Dividend payment date.

**31 August 2017**

Half year results for the 6 months ending 30 June 2017 announced.

## KEY CONTACTS

**Registered and Head Office**

2nd Floor, Building 4  
West Strand Business Park  
West Strand Road  
Preston  
Lancashire  
PR1 8UY

Tel: 01772 972050  
www.chesnara.co.uk

**Advisors**

Ashurst LLP  
Broadwalk House  
5 Appold Street  
London  
EC2A 2HA

Addleshaw Goddard LLP  
One St Peter's Square  
Manchester  
M2 3DE

**Auditor**

Deloitte LLP  
Chartered Accountants and Statutory Auditor  
Saltire Court  
20 Castle Terrace  
Edinburgh  
EH1 2DB

**Registrars**

Capita Asset Services  
The Registry  
34 Beckenham Road  
Beckenham  
Kent  
BR3 4TU

**Joint Stockbrokers**

Panmure Gordon  
One New Change  
London  
EC4M 9AF

Shore Capital Stockbrokers Limited  
Bond Street House  
14 Clifford Street  
London  
W1S 4JU

**Bankers**

National Westminster Bank plc  
135 Bishopsgate  
London  
EC2M 3UR

The Royal Bank of Scotland  
8th Floor, 135 Bishopsgate  
London  
EC2M 3UR

Lloyds Bank plc  
3rd Floor, Black Horse House  
Medway Wharf Road  
Tonbridge  
Kent  
TN9 1QS

**Public Relations Consultants**

FWD  
145 Leadenhall Street  
London  
EC3V 4QT

**Corporate Advisors**

Shore Capital Stockbrokers Limited  
Bond Street House  
14 Clifford Street  
London  
W1S 4JU

# NOTICE OF THE 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.**

**Chesnara plc has a policy of not paying to have access to governance and sustainability analysts' databases on which voting recommendations and reports are produced. We encourage early, open and timely engagement to ensure the accuracy of the information contained in any analysis and reports issued in respect of Chesnara plc.**

### Company No. 4947166

Notice is given that the 2017 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 2017 at 11am. for the business set out below. Resolutions 1 to 14 inclusive will be proposed as ordinary resolutions and resolutions 15 to 19 inclusive will be proposed as special resolutions.

1. To receive and adopt the audited accounts for the financial year ended 31 December 2016, together with the reports of the directors and auditor thereon.
2. To declare a final dividend of 12.69 pence per ordinary share for the financial year ended 31 December 2016.
3. To approve the Directors' remuneration report (other than the part of it which contains the Directors' remuneration policy) for the year ended 31 December 2016.
4. To approve the Directors' remuneration policy which forms part of the Directors' remuneration report for the year ended 31 December 2016. The policy can be found on pages 58 to 64 of the Annual Report and Accounts.
5. To re-elect John Deane as a director.
6. To elect Jane Dale as a director.
7. To re-elect Peter Mason as a director.
8. To re-elect Veronica Oak as a director.
9. To re-elect David Brand as a director.
10. To re-elect Mike Evans as a director.
11. 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.
12. To authorise the directors to determine the auditor's remuneration.
13. That, from the passing of this resolution 13 until the earlier of 14 November 2018 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 (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.
14. That the directors be and they are hereby generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 (the 'Act'), to allot shares in the company and/or to grant rights to subscribe for or to convert any security into shares in the company ('Allotment Rights'):
- (a) comprising equity securities (as defined by section 560 of the Act) up to an aggregate nominal amount of £2,495,637, such amount to be reduced by the nominal amount of any equity securities allotted pursuant to the authority in paragraph 14(b) below in connection with an offer by way of a rights issue:
    - (i) to holders of ordinary shares in proportion (as nearly as may be practicable) to their respective holdings; and
    - (ii) to holders of other equity securities as required by the rights of those securities or as the directors otherwise consider necessary,

but subject to such exclusions or other arrangements as the directors may deem necessary or expedient in relation to treasury shares, fractional entitlements, record dates, legal or practical problems in or under the laws of any territory or the requirements of any regulatory body or stock exchange; and

- (b) in any other case, up to an aggregate nominal amount of £4,991,274, such amount to be reduced by the nominal amount of any equity securities allotted pursuant to the authority in paragraph (a) above in excess of £2,495,637,

provided that this authority shall, unless renewed, varied or revoked by the company, expire at the conclusion of the 2018 Annual General Meeting (or, if earlier, at the close of business on the date which is 15 months after the date on which this resolution is passed) save that the company may, before such expiry, make offers of agreements which would or might require securities to be allotted and the directors may allot securities in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution.

# NOTICE OF THE ANNUAL GENERAL MEETING (CONTINUED)

**15.** That, subject to the passing of resolution 14 in this notice, the directors be and are hereby empowered pursuant to section 570 of the Companies Act 2006 ('the Act') to allot equity securities (as defined in section 560 of the Act) for cash, pursuant to the authority conferred on them by resolution 14 of this notice or by way of a sale of treasury shares as if section 561 of the Act did not apply to any such allotment, provided that this power is limited to:

- (a)** the allotment of equity securities in connection with any rights issue or open offer (each as referred to in the Financial Conduct 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 (other than pursuant to paragraph (a) above) with an aggregate nominal value of £374,346 and shall expire on the revocation or expiry (unless renewed) of the authority conferred on the directors by resolution 14 of this notice, 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 and the directors may allot equity securities under any such offer or agreement as if the power had not expired.

**16.** That, subject to the passing of resolution 14 of this notice and, in addition to the power contained in resolution 15 of this notice, the directors be and are hereby empowered pursuant to section 570 of the Companies Act 2006 ('the Act') to allot equity securities (as defined in section 560 of the Act) for cash, pursuant to the authority conferred on them by resolution 14 of this notice or by way of sale of treasury shares as if section 561 of the Act did not apply to any such allotment, provided that this power is:

- (a)** limited to the allotment of equity securities up to an aggregate nominal value of £374,346; and
- (b)** used only for the purposes of financing (or refinancing, if the power is to be exercised within six months after the date of the original transaction) a transaction which the directors determine to be an acquisition or other capital investment of a kind contemplated by the Statement of Principles on Disapplying Pre-emption Rights most recently published by the Pre-emption Group prior to the date of the notice of this meeting, and shall expire on the revocation or

expiry (unless renewed) of the authority conferred on the directors by resolution 14 of this notice 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 and the directors may allot equity securities under any such offer or agreement as if the power had not expired.

**17.** That the company be and is hereby generally and unconditionally authorised for the purposes of section 701 of the Companies Act 2006 ('the Act') to make one or more market purchases (as defined in section 693(4) of the 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 14,973,822;
- (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 Conduct 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 those 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 price is stipulated by the Regulatory Technical Standards pursuant to Article 5(6) of the EU Market Abuse Regulation;
- (e)** the authority hereby conferred shall expire 15 months after the passing of this resolution or, if earlier, on the date of the company's next Annual General Meeting to be held in 2018; and
- (f)** the company may enter into contracts 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.

**18.** That, the authority conferred by Article 87, Non-Executive Director Fees, of the company's Articles of Association be and is hereby increased from £350,000 to £500,000.

**19.** That a general meeting of the company (other than an Annual General Meeting) may be called on not less than 14 clear working days' notice.

By order of the board

**Zoe Kubiak**  
Company Secretary

2nd Floor, Building 4  
West Strand Business Park  
West Strand Road  
Preston  
Lancashire  
PR1 8UY  
30 March 2017

# EXPLANATORY NOTES TO THE NOTICE OF THE ANNUAL GENERAL MEETING

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 by hand only (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 Asset Services, at The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU or in accordance with the reply paid details, by 11am. on Monday 15 May 2017. Alternatively, members may appoint a proxy online by following the instructions for the electronic appointment of a proxy at [www.capitashareportal.com](http://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 Asset Services which is acting as the company's 'issuer's agent' (ID RA10) by 11am. on Monday 15 May 2017. 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 are available for inspection at the registered office of the company during normal business hours each business day. They will also be available for inspection at 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 6.00pm. on Monday 15 May 2017. 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.

# EXPLANATORY NOTES TO THE NOTICE OF THE ANNUAL GENERAL MEETING (CONTINUED)

- 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 22 March 2017 (being the last practicable date prior to the publication of this document), the company's issued share capital consisted of 149,885,761 ordinary shares, carrying one vote each. The total voting rights in the company as at 22 March 2017 (being the last practicable date prior to the publication of this document) were 149,738,226.
- 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](http://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.

The notes on the following pages give an explanation of the proposed resolutions:



## **Resolution 1:**

### **Report and accounts**

The Companies Act 2006 requires the directors of a public company to lay its annual report and accounts before the company in general meeting, giving shareholders the opportunity to ask questions on the contents. The annual report and accounts comprise the audited financial statements, the auditor's report, the directors' report, the directors' remuneration report, and the directors' strategic report. In accordance with the UK Corporate Governance Code 2014 (the 'Code'), the company proposes, as an ordinary resolution, a resolution on its annual report and accounts for the year ended 31 December 2016.

## **Resolution 2:**

### **Final dividend**

The payment of the final dividend requires the approval of shareholders in general meeting. If the 2017 Annual General Meeting approves resolution 2, the final dividend of 12.69 pence per share will be paid on 24 May 2017 to ordinary shareholders who are on the register of members at the close of business on 18 April 2017 in respect of each ordinary share.

## **Resolution 3:**

### **Approval of the Directors' remuneration report**

In accordance with the Companies Act 2006, the company proposes an ordinary resolution to approve the Directors' remuneration report for the financial year ended 31 December 2016. The Directors' remuneration report can be found on pages 58 to 75 of the 2016 report and accounts and, for the purposes of this resolution, does not include the parts of the Directors' remuneration report containing the Directors' remuneration policy report set out on pages 58 to 64.

The vote on this resolution is advisory only and the directors' entitlement to remuneration is not conditional on it being passed.

## **Resolutions 5 – 10 inclusive:**

### **Election and re-election of directors**

The company's Articles of Association require one-third of directors to retire by rotation at each Annual General Meeting. Any director who has not retired by rotation must retire at the third Annual General Meeting after his or her appointment or re-appointment. In accordance with its view of best practice, the Board of Directors has decided that, in addition, all of the Non-Executive Directors will retire at every Annual General Meeting. As a result Peter Mason, Veronica Oak, David Brand, John Deane and Mike Evans will retire and, with the exception of Jane Dale who will stand for election for the first time since her appointment by the board on 19 May 2016, are all put forward by the Board of Directors for re-election and appointment (Jane Dale) at the 2017 Annual General Meeting. Biographical details of each director can be found on pages 46 and 47 of this document. The Chairman confirms that each of the directors proposed for re-election and appointment continues to make an effective and valuable contribution and demonstrates commitment to their responsibilities. This is supported by the annual performance evaluation that was undertaken recently. The board unanimously recommend that each of these directors be re-elected and, in the case of Jane Dale, appointed, as a director of the company.

In accordance with the Code, the board has reviewed the independence of its Non-Executive Directors and has determined that they remain fully independent of management. The Code states that whilst the Chairman should, on appointment, meet the Code's independence criteria, thereafter the tests of independence are not appropriate in relation to that post. Peter Mason did meet the Code's independence criteria upon his election as Chairman.

## **Resolutions 11 and 12:**

### **Re-appointment and remuneration of auditor**

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 continue to act as the company's auditor. The Audit & Risk Committee has reviewed Deloitte LLP's effectiveness and recommends their reappointment. The resolutions authorise the company to reappoint and, following formal practice, to authorise the Audit & Risk Committee to determine their remuneration.

## **Resolution 13:**

### **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 ('the Act') 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.

# EXPLANATORY NOTES TO THE NOTICE OF THE ANNUAL GENERAL MEETING (CONTINUED)

## **Resolution 14:**

### **Power to allot shares**

The Companies Act 2006 provides that the directors may only allot shares if authorised by shareholders to do so. This resolution will, if passed, authorise the directors to allot shares up to an aggregate nominal amount of £4,991,274 which represents an amount which is approximately equal to two-thirds of the issued ordinary share capital of the company as at 22 March 2017 (being the latest practicable date prior to the publication of this document).

The Investment Association ('IA') has published guidance to the effect that IA 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. The company held 147,535 treasury shares, being approximately 0.10% of the total ordinary share capital in issue (calculated exclusive of treasury shares).

As provided in paragraph (a) of the resolution, up to half of this authority (equal to one-third of the issued share capital of the company) will enable directors to allot and issue new shares in whatever manner (subject to pre-emption rights) they see fit. Paragraph (b) of the resolution provides that the remainder of the authority (equal to a further one-third) may only be used in connection with a rights issue in favour of ordinary shareholders. As paragraph (a) imposes no restrictions on the way the authority may be exercised, it could be used in conjunction with paragraph (b) so as to enable the whole two-thirds authority to be used in connection with a rights issue. This reflects the best practice guidance issued by The Investment Association.

The authority will expire at the earlier of the date this is 15 months after the date of the passing of the resolution and the conclusion of the 2018 Annual General Meeting of the company.

Passing resolution 14 will ensure that the directors have flexibility to take advantage of any appropriate opportunities that may arise. At present the directors have no intention of exercising this authority.

## **Resolutions 15 and 16:**

### **Disapplication of statutory pre-emption rights**

The directors are currently authorised, subject to certain limitations, to issue securities of the company for cash without first offering them to existing shareholders in proportion to their existing shareholdings. That authority will expire on 13 May 2018 or, if earlier, at the conclusion of the next Annual General Meeting of the company and, in accordance with best practice, resolutions 15 and 16 (which will be proposed as special resolutions) seek to renew the directors' authority to disapply pre-emption rights as referenced below.

Other than in connection with a rights or other similar issue or where, for example, difficulties arise in offering shares to certain overseas shareholders and in relation to fractional entitlements, the authority contained in resolution 15 will be limited to an aggregate nominal value of £374,346. This aggregate nominal amount equates to approximately 5% of the issued ordinary share capital of the company as at 22 March 2017 (being the latest practicable date prior to the publication of this notice of annual general meeting). Resolution 15 follows guidance from the Pre-Emption Group's revised Statement of Principles, published on 12 March 2015, and adopts the Pre-Emption Groups template wording that was published on 5 May 2016.

In line with the revised Statement of Principles, the company is seeking authority, pursuant to resolution 16, to issue up to an additional 5% of its issued ordinary share capital for cash without pre-emption rights applying. In accordance with the revised Statement of Principles, and the Pre-Emption Groups template wording issued on 5 May 2016, the company will only allot shares with a nominal value of up to £374,346 (representing 5% of issued ordinary share capital) pursuant to resolution 16 where that allotment is in connection with an acquisition or specified capital investment (within the meaning given in the Statement of Principles) which is announced contemporaneously with the allotment, or which has taken place in the preceding six-month period and is disclosed in the announcement of the allotment. This renewed authority will remain in-force until 15 months after the passing of resolution 16 or, if earlier, at the conclusion of the next Annual General Meeting in 2018.

In accordance with the Statement of Principles (which is supported by the Association of British Insurers, the Pensions and Lifetime Savings Association (formerly National Association of Pension Funds Limited) and The Investment 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 pursuant to resolutions 15 and 16 during any rolling three-year period.

**Resolution 17:****Authority to purchase own shares**

This resolution, which will be proposed as a special resolution, seeks to renew the company's authority to purchase its own shares. It specifies the maximum number of shares which may be acquired as 10% of the company's issued ordinary share capital as at 22 March 2017, being the latest practicable date prior to the publication of this document, and specifies the minimum and maximum prices at which shares may be bought.

The directors will only use this authority if, in the light of market conditions prevailing at the time, they believe that the effect of such purchases will be (where such shares are to be purchased for cancellation) to increase earnings per share, and that taking into account other investment opportunities, purchases will be in the best interests of the shareholders generally. Any shares purchased in accordance with this authority will be cancelled or held in treasury for subsequent transfer to an employee share scheme. The directors have no present intention of exercising this authority, which will expire at the earlier of date that this is 15 months after the date of the passing of the resolution and the conclusion of the 2018 Annual General Meeting of the company.

The company has options and awards outstanding under existing share schemes over an aggregate of 629,901 ordinary 5p shares, representing 0.42% of the company's issued ordinary share capital as at 22 March 2017 (the latest practicable date prior to the publication of this document). This would represent approximately 0.47% of the company's issued share capital if the proposed authority being sought at the Annual General Meeting to buy back 14,973,822 ordinary shares was exercised in full (and all of the repurchased ordinary shares were cancelled).

**Resolution 18:**

The company's current Articles of Association (the 'Current Articles') provide for the total aggregate fees payable to all non-executive directors (excluding any payments made under any other provision in the Articles of Association) to not exceed £350,000 per annum. Resolution 18 proposes an amendment to the Current Articles that will increase the limit on the total aggregate fees payable to all non-executive directors to £500,000 per annum. The total fees payable in 2017 are estimated to be very close to this limit at £347,500. The board is proposing to increase the limit by special resolution to £500,000. This will allow the board, as and when required, to appoint non-executive directors to replace existing directors, with appropriate handover arrangements, and to add additional non-executive directors or to increase the time commitment of existing directors as required to perform the expanding regulatory duties of the board. There are no other changes proposed to the Current Articles. The new Articles of Association (the 'New Articles') showing the changes to the Current Articles are available for inspection during normal business hours, Monday to Friday (public holidays excepted).

**Resolution 19:****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 clear days' notice. Resolution 19 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 of the above 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.

# GLOSSARY

<b>AGM</b>	Annual General Meeting.	<b>London Stock Exchange</b>	London Stock Exchange plc.
<b>ALM</b>	Asset Liability Management – management of risks that arise due to mismatches between assets and liabilities.	<b>LTI</b>	Long-Term Incentive Scheme – A reward system designed to incentivise executive directors' long-term performance.
<b>APE</b>	Annual Premium Equivalent – an industry-wide measure that is used for measuring the annual equivalent of regular and single premium policies.	<b>Movestic</b>	Movestic Livförsäkring AB.
<b>CA</b>	Countrywide Assured plc.	<b>Modernac</b>	Modernac SA, an associated company which is 49% owned by Movestic.
<b>CALH</b>	Countrywide Assured Life Holdings Limited and its subsidiary companies.	<b>Official List</b>	The Official List of the Financial Conduct Authority.
<b>Cash Generation</b>	This represents the operational cash that has been generated in the period. The cash generating capacity of the group is largely a function of the movement in the solvency position of the insurance subsidiaries within the group, and takes account of the buffers that management has set to hold over and above the solvency requirements imposed by our regulators.	<b>Ordinary Shares</b>	Ordinary Shares of five pence each in the capital of the company.
<b>Directors or Board</b>	The directors of the company as at the date of this document whose names and biographies are set out on pages 46 and 47 of this document.	<b>ORSA</b>	Own Risk and Solvency Assessment.
<b>DNB</b>	De Nederlandsche Bank is the central bank of the Netherlands and is the regulator of our Dutch subsidiary.	<b>Own Funds</b>	Own Funds – in accordance with the UK's regulatory regime for insurers it is the sum of the individual capital resources for each of the regulated related undertakings less the book-value of investments by the company in those capital resources.
<b>DPF</b>	Discretionary Participation Feature – A contractual right under an insurance contract to receive, as a supplement to guaranteed benefits, additional benefits whose amount or timing is contractually at the discretion of the issuer.	<b>PRA</b>	Prudential Regulation Authority.
<b>Dutch Business</b>	Waard Group, consisting of Waard Leven N.V., Hollands Welvaren Leven N.V., Waard Schade N.V. and Tadas Verzekeringen B.V.	<b>QRT</b>	Quantitative Reporting Template.
<b>EcV</b>	Economic Value.	<b>ReAssure</b>	ReAssure Limited.
<b>FCA</b>	Financial Conduct Authority.	<b>Resolution</b>	The resolution set out in the notice of General Meeting set out in this document.
<b>FI</b>	Finansinspektionen, being the Swedish Financial Supervisory Authority.	<b>RMF</b>	Risk Management Framework.
<b>Form of Proxy</b>	The form of proxy relating to the General Meeting being sent to shareholders with this document.	<b>Shareholder(s)</b>	Holder(s) of Ordinary Shares.
<b>FSMA</b>	The Financial Services and Markets Act 2000 of England and Wales, as amended.	<b>Solvency II</b>	A fundamental review of the capital adequacy regime for the European insurance industry. Solvency II aims to establish a set of EU-wide capital requirements and risk management standards and has replaced the Solvency I requirements.
<b>Group</b>	The company and its existing subsidiary undertakings.	<b>STI</b>	Short-Term Incentive Scheme – A reward system designed to incentivise executive directors' short-term performance.
<b>Group Own Funds</b>	In accordance with the UK's regulatory regime for insurers it is the sum of the individual capital resources for each of the regulated related undertakings less the book-value of investments by the group in those capital resources.	<b>SCR</b>	In accordance with the UK's regulatory regime for insurers it is the sum of individual capital resource requirements for the insurer and each of its regulated undertakings.
<b>Group SCR</b>	In accordance with the UK's regulatory regime for insurers it is the sum of individual capital resource requirements for the insurer and each of its regulated undertakings.	<b>Swedish Business</b>	Movestic and its subsidiaries and associated companies.
<b>HCL</b>	HCL Insurance BPO Services Limited.	<b>S&amp;P</b>	Save & Prosper Insurance Limited and Save & Prosper Pensions Limited.
<b>IFRS</b>	International Financial Reporting Standards.	<b>TCF</b>	Treating Customers Fairly – a central PRA principle that aims to ensure an efficient and effective market and thereby help policyholders achieve fair outcomes.
<b>IFA</b>	Independent Financial Adviser.	<b>TSR</b>	Total shareholder return, measured with reference to both dividends and capital growth.
<b>KPI</b>	Key performance indicator.	<b>UK or United Kingdom</b>	The United Kingdom of Great Britain and Northern Ireland.
<b>LGN</b>	LGN or Legal & General Nederland refers to the legal entity Legal & General Nederland Levensverzekering Maatschappij N.V, which Chesnara announced its intention to acquire in November 2016.	<b>UK Business</b>	CA, S&P and CALH.

# NOTE ON TERMINOLOGY

As explained in note 7 to the IFRS financial statements, the principal reporting segments of the group are:

<b>CA</b>	which comprises the original business of Countrywide Assured plc, the group's original UK operating subsidiary; City of Westminster Assurance Company Limited, which was acquired by the group in 2005, the long-term business of which was transferred to Countrywide Assured plc during 2006; and Protection Life Company Limited which was acquired by the group in 2013, the long-term business of which was transferred into Countrywide Assured plc in 2014;
<b>S&amp;P</b>	which was acquired on 20 December 2010. This business was transferred from Save & Prosper Insurance Limited and Save & Prosper Pensions Limited to Countrywide Assured plc on 31 December;
<b>Movestic</b>	which was purchased on 23 July 2009 and comprises the group's Swedish business, Movestic Livförsäkring AB and its subsidiary and associated companies;
<b>The Waard Group</b>	which was acquired on 19 May 2015 and comprises three insurance companies; Waard Group Leven N.V., Hollands Welvaren Leven N.V. and Waard Schade N.V.; and a service company, Tadas Verzekering; and
<b>Other group activities</b>	which represents the functions performed by the parent company, Chesnara plc. Also included in this segment are consolidation adjustments.

## IN THIS REPORT & ACCOUNTS:

- i. The **CA** & **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. The '**Waard Group**' segment may also be referred to as the '**Dutch Business**';
- iv. '**CA plc**' refers to the legal entity Countrywide Assured plc, which includes the long term business of **CA, CWA, S&P** and **PL**;
- v. '**CWA**' refers to the long-term business of City of Westminster Assurance Company Limited, which subsidises within Countrywide Assured plc;
- vi. '**S&P**' refers collectively to the original business of Save & Prosper Insurance Limited and Save & Prosper Pensions Limited, which subsidises within Countrywide Assured plc;
- vii. '**PL**' refers to the long-term business that was, prior to the Part VII transfer into CA plc on 31 December 2014, reported within Protection Life Company Limited and was reported as a separate segment for IFRS reporting purposes;
- viii. '**PL Ltd**' refers to the legal entity Protection Life Company Limited;
- ix. '**Movestic**' may also refer to Movestic Livförsäkring AB, as the context implies;
- x. '**Acquisition of Waard Group**' refers to the purchase of the Waard Group, based in the Netherlands, on 19 May 2015; and
- xi. '**LGN**' or '**Legal & General Nederland**' refers to the legal entity Legal & General Nederland Levensverzekering Maatschappij N.V, which Chesnara announced its intention to acquire in November 2016.





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