# ANNUAL REPORT AND ACCOUNTS

2018

Chesnara

# WELCOME TO THE

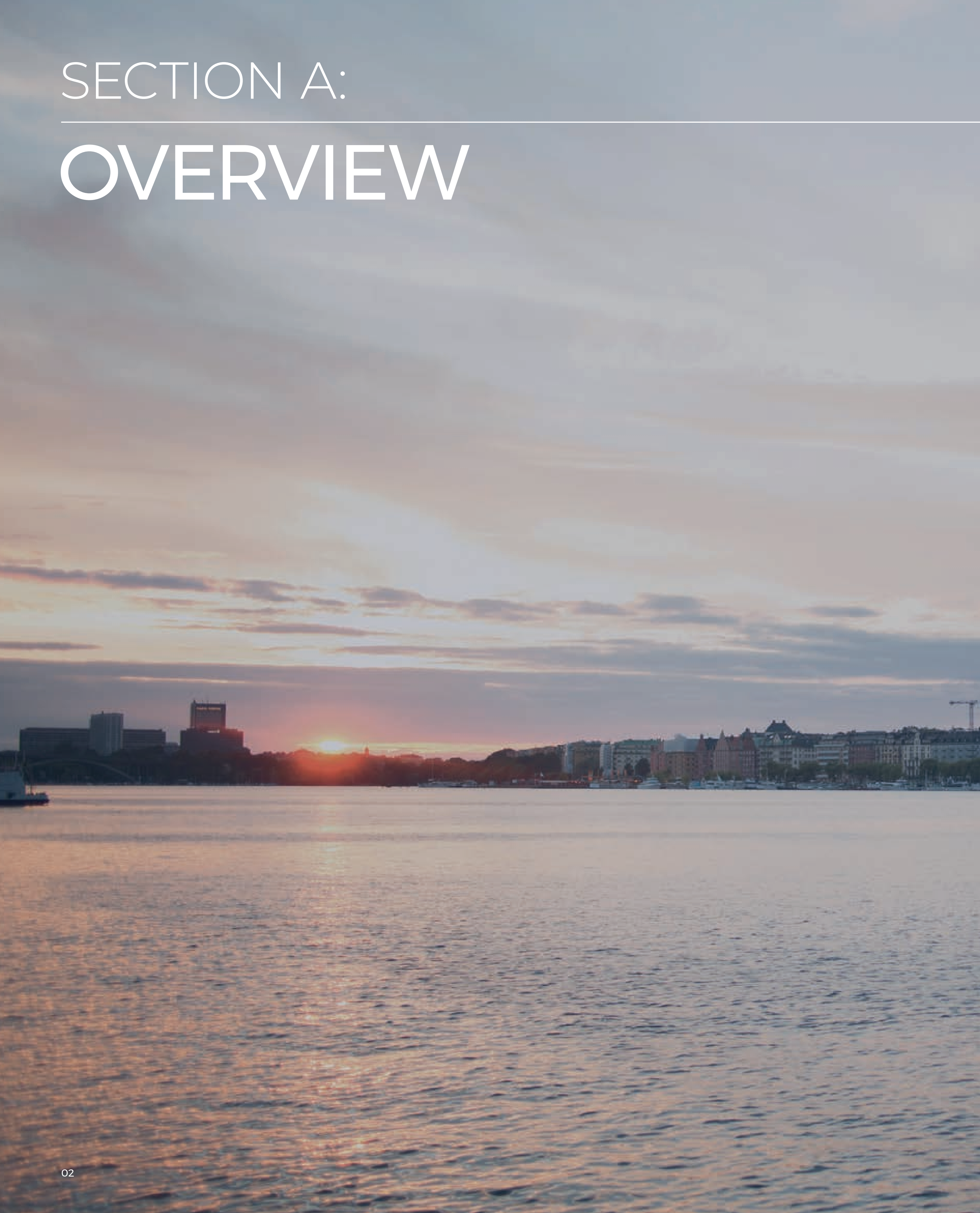
# CHESNARA ANNUAL REPORT

FOR YEAR ENDED 31 DECEMBER 2018

## CONTENTS

SECTION A:

# OVERVIEW



Stockholm Sweden

# 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 primarily focuses on the territories in which we operate, though we will consider opportunities in other European countries where there is sufficient value and strategic and cultural fit.

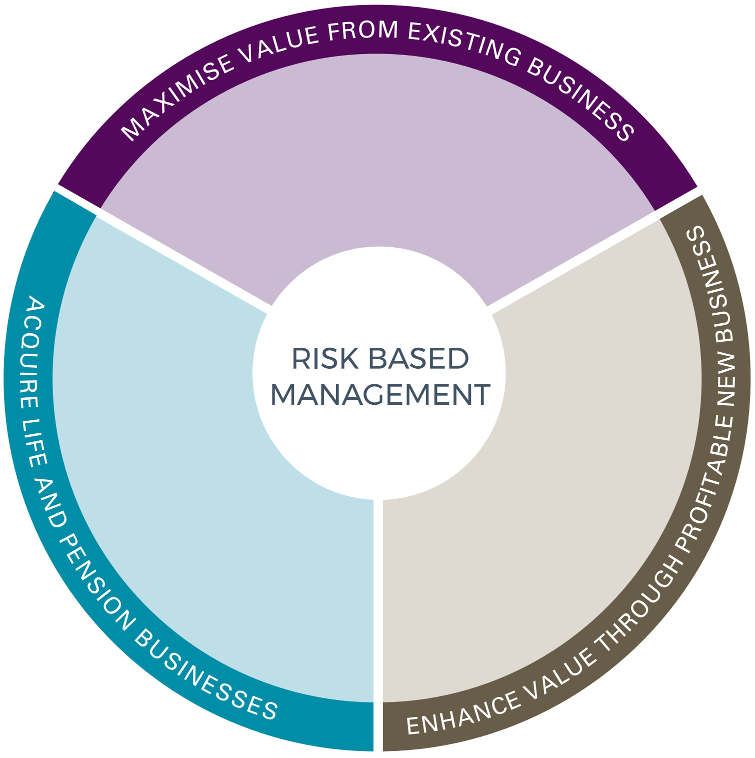
The group comprises both open-book and closed-book operations. We write new business where we are confident that conditions will ensure the sales are value adding. The new business operations will always be based on realistic market share expectations and hence the writing of new business will not detract 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 aimed to deliver fair outcomes and returns for policyholders whilst providing consistent returns for shareholders.

## 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 both a closed-book group and an open life and pensions business in the Netherlands. See page 6 for further detail on our history and businesses.

## WHAT WE DO



## HOW WE OPERATE

- Chesnara devolves management to its divisions which operate within a centrally defined governance and risk management framework.
- A central UK-based 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.

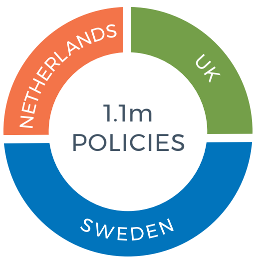
## HOW WE CREATE VALUE

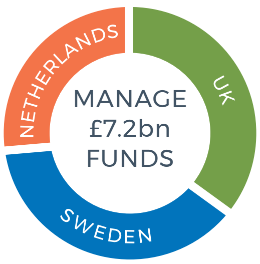
**Policyholder**

- Effective customer service operations, clear communication and competitive fund performance, with full regard to all regulatory matters, support our aim to ensure policyholders receive good returns and service in line with fair outcomes for customers.
- Provide security through strong solvency.

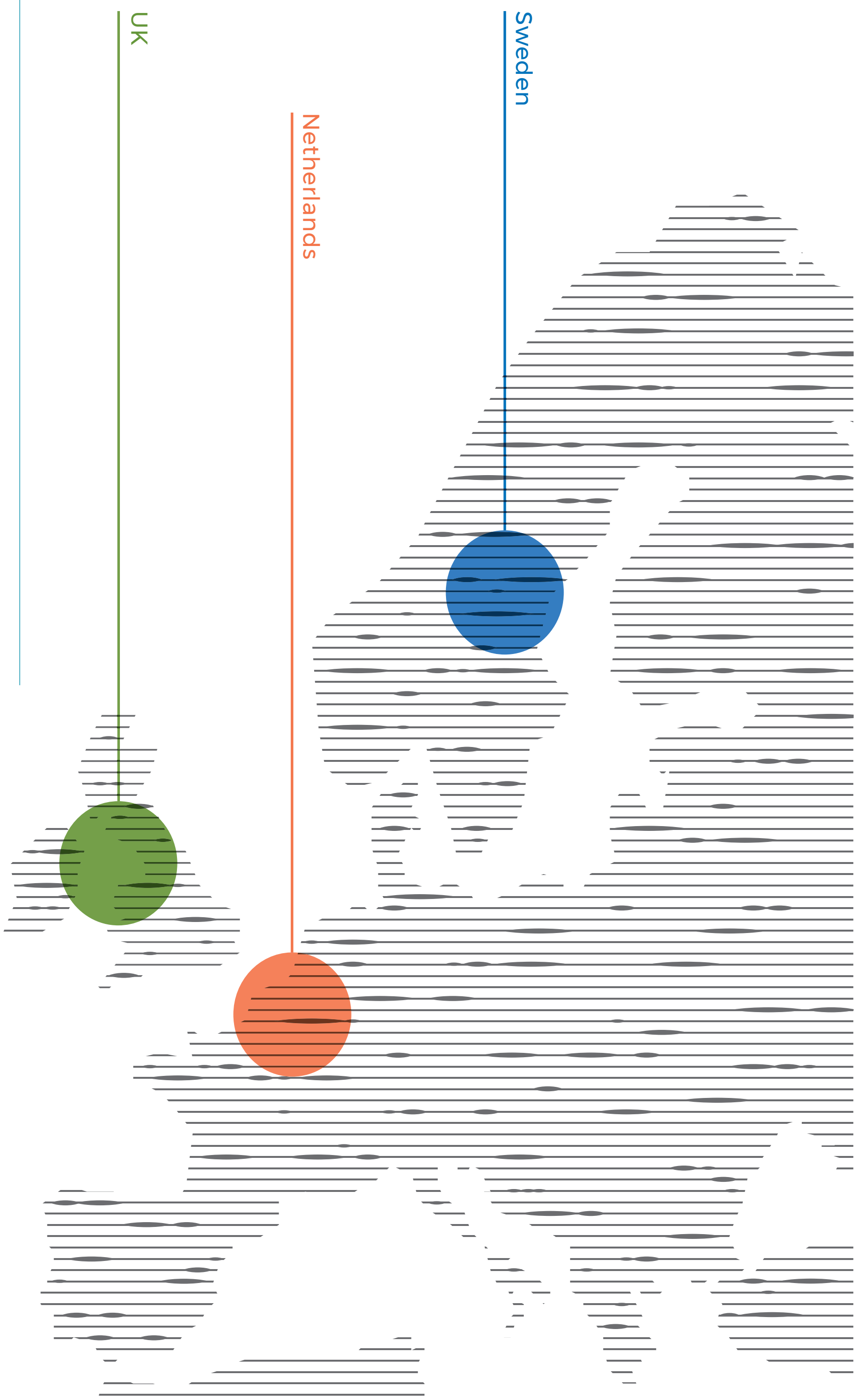
**Shareholder**

- Surpluses emerge from the in-force books of business through efficient management of the policy base and good capital management practices. These surpluses enable dividends to be paid 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 and the Netherlands has 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.

**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 (a closed-book) in the Netherlands.

**2016**

Building upon our entry to the Dutch market we announce the acquisition of Legal & General Nederland, an open business.

**2017**

Completion of Legal & General Nederland acquisition, renamed Scildon, at a 32% discount to its Economic Value of £202.5m.

## WHAT WE'VE DONE

**6** SUCCESSFUL ACQUISITIONS 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

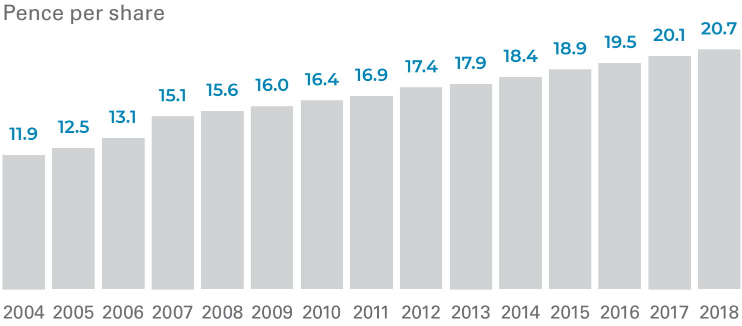
OUTCOMES

## DIVIDEND HISTORY

### 14 SUCCESSIVE YEARS OF DIVIDEND GROWTH

We recognise the importance of providing stable and attractive dividends to our shareholders. A full year 2018 dividend of 20.67p per share represents an increase of 3% on the prior year, and is Chesnara's fourteenth successive year of dividend growth.

**Dividend per share history**
Pence per share

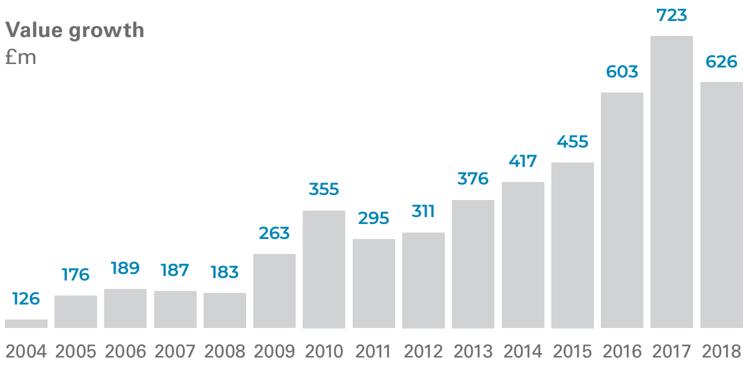



## VALUE GROWTH

### £626.1M OF ECONOMIC VALUE

Value growth* is achieved through a combination of efficient management of the existing policies, acquisitions and writing profitable new business. The growth, shown here since incorporation, includes £148m of new equity since 2004 but is net of £298m of cumulative dividend payments. The value of the group is affected by investment market conditions at any given point in time, with the closing 2018 position reflecting falls in equity and bond values that were witnessed during the year.

**Value growth**
£m



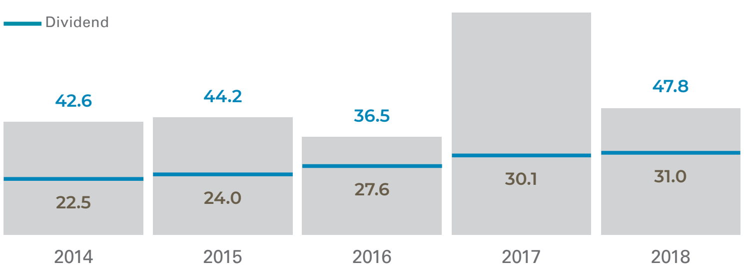

*Value is based on Embedded Value principles up until 2015, thereafter it is based on Economic Value (see page 39 for further information). The transition from Embedded Value to Economic Value resulted in only a modest change in valuation.

## CASH GENERATION

### CASH GENERATION CONTINUES TO SUPPORT DIVIDENDS

Ultimately the group needs to generate cash to service its dividends. We define cash generation as the movement in the group's surplus own funds above the group's internally required capital. Cumulative cash generation over the last 5 years represents c190% of the total dividends over the same period.

**Business as usual cash generation***




*The chart illustrates how business as usual cash generation compares to the total shareholder dividend. For this purpose the cash figure is based on divisional cash generation plus non-exceptional group items. To include exceptional items would mislead in terms of illustrating the effectiveness of the core business in funding the dividend.

## 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 deliver good customer service levels across the group.

# 2018 HIGHLIGHTS

## FINANCIAL

### IFRS

**£27.0M**

**IFRS PRE-TAX PROFIT**
2017 £89.6M

The 2017 result includes a £20.3m gain on acquisition of Legal & General Nederland.

**£23.7M**

**IFRS TOTAL COMPREHENSIVE INCOME**
2017 £86.9M

The 2018 result includes a foreign exchange loss of £0.8m (2017: gain of £8.3m). The 2017 result includes a £20.3m gain on acquisition of Legal & General Nederland.

Financial review **p36**

### SOLVENCY

**158%**

**GROUP SOLVENCY**
2017 146%

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

Capital management **p31**

### ECONOMIC VALUE

**£626.1M**

**ECONOMIC VALUE**
2017 £723.1M

Movement in the year includes dividend distributions of £30.4m and includes a foreign exchange retranslation loss of £5.8m.

Financial review **p39**

### ECONOMIC VALUE EARNINGS

**£(60.9)M**

**ECONOMIC VALUE EARNINGS**
2017 £139.5M

The loss includes £49.7m relating directly to economic market conditions. The 2017 result includes a non-recurring £65.4m gain arising on the acquisition of Legal & General Nederland.

Financial review **p38**

**£10.6M**

**NEW BUSINESS PROFIT**
2017 £12.4M

Business review **p26 to 29**

### CASH GENERATION

**£47.8M**

**GROUP CASH GENERATION**
2017 £28.6M

The 2018 result benefits from a £26.8m release of surplus previously constrained within the UK with-profits funds. The 2017 comparitive includes a £55.3m adverse effect of completing the acquisition of Legal & General Nederland.

Financial review **p37**

**£63.9M**

**DIVISIONAL CASH GENERATION**
2017 £86.7M

The 2018 cash result benefits from a £26.8m release of previously constrained surplus within the UK with-profits funds.

Financial review **p37**

These financial highlights include the use of Alternative Performance Measures (APMs) that are not required to be reported under International Financial Reporting Standards. The definition for each of these items has been included in page 10 and in further detail within the Financial Review section on pages 34 to 39.

# OPERATIONAL & STRATEGIC

## DIVIDEND

### FULL YEAR DIVIDEND INCREASE

Total dividends for the year increased by 3% to 20.67p per share (7.21p interim and 13.46p proposed final). This compares with 20.07p in 2017 (7.00p interim and 13.07p final).

## ECONOMIC BACKDROP

### BREXIT UNCERTAINTY, FALLING EQUITY MARKETS AND WIDENING BOND SPREADS

The uncertainty over Brexit was an unwelcome background to the economic backdrop for the year. 2018 saw volatility in equity markets, with many leading equity indices closing more than 10% lower than at the start of the year. In addition to this we have seen pricing pressures in corporate and some government bonds.

## 17 IFRS 17

### GROUP-WIDE IFRS 17 PROGRAMME IS PROGRESSING TO PLAN

The group's IFRS 17 programme has progressed well during the year. The initial impact assessment phase has been completed and an implementation plan has been drawn up which is now being progressed.

## SYMBOL GUIDE

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

- IFRS
- Cash generation
- Economic Value
- Economic Value Earnings
- Solvency
- Dividend/Total Shareholder Return
- Part VII
- Operational performance
- Compliance
- New business market share
- Acquisitions
- Risk appetite
- 17 IFRS 17

# MEASURING OUR PERFORMANCE

## HOW WE MEASURE PERFORMANCE WITHIN THESE REPORT AND ACCOUNTS

Throughout our Report and Accounts, we use measures to assess and report how well we have performed. The range of measures is broad and includes many measures that are not based on IFRS. The financial analysis of a life and pensions business also needs to recognise the importance of Solvency II figures, the basis of regulatory solvency. In addition the measures aim to assess performance from the perspective of all stakeholders.

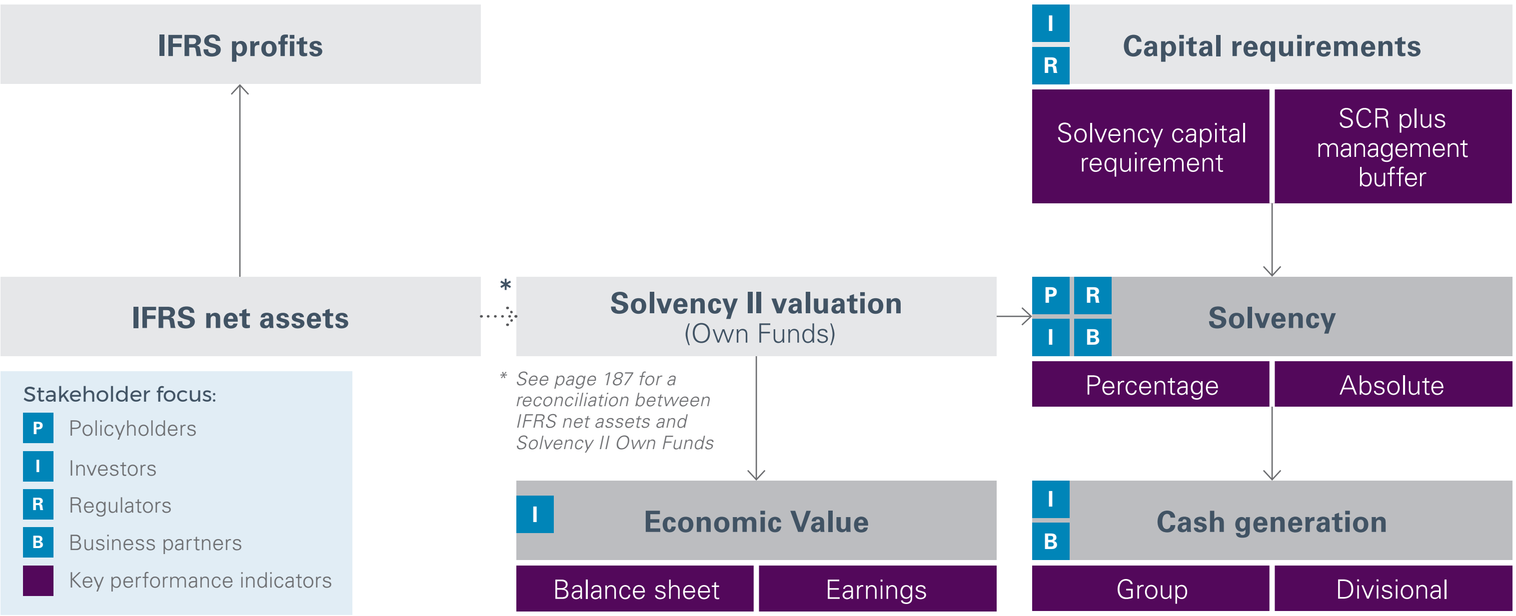
### FINANCIAL ANALYSIS OF A LIFE AND PENSION BUSINESS

Whilst the IFRS results form the core of the Report and Accounts and hence retain prominence as a key financial performance metric, there is a general acceptance that the IFRS results in isolation do not adequately recognise the wider financial performance of a typical life and pensions business.

In light of the limitations of IFRS reporting, these Report and Accounts adopt several Alternative Performance Measures (APMs) to present a more meaningful view of the financial position and performance. The non-IFRS APMs have at their heart the Solvency II valuation known as Own Funds and as such, all major financial APMs are derived from a defined rules-based regime. The diagram below shows the core financial metrics that sit alongside the IFRS results, together with their associated KPIs and interested parties.

FINANCIAL STATEMENTS

ADDITIONAL METRICS




### SOLVENCY

Solvency is a fundamental financial measure which is of paramount importance to investors and policyholders. It represents the relationship between the value of the business as measured on a Solvency II basis and the capital the business is required to hold - the Solvency Capital Requirement (SCR). Solvency can be reported as an absolute surplus value or as a ratio.

Solvency gives policyholders comfort regarding the security of their provider. This is also the case for investors together with giving them a sense of the level of potential surplus available to invest in the business or distribute as dividends (subject to other considerations and approvals).

Further details on p31 to 33

### ECONOMIC VALUE

Economic Value (EcV) is deemed to be a more meaningful measure of the long-term value of the group and it generally approximates to Embedded Value reporting, which was used before the introduction of SII. In essence, the IFRS balance sheet is not generally deemed to represent a fair commercial value of our business as it does not fully recognise the impact of future profit expectations of long-term policies.

EcV is derived from Solvency II Own Funds and recognises the impact of future profit expectations from existing business.

Further details on p38 to 39

### CASH GENERATION

Cash generation is used by the group as a measure of assessing how much dividend potential has been generated, subject to ensuring other constraints are managed.

Group cash generation is calculated as the movement in the group's surplus own funds above the group's internally required capital, as determined by applying the group's capital management policy, which has Solvency II rules at its heart.

Divisional cash generation represents the movement in surplus own funds above local capital management policies within the three operating divisions of Chesnara. Divisional cash generation is used as a measure of how much dividend potential a division has generated, subject to ensuring other constraints are managed.

Further details on p37

## OPERATIONAL AND OTHER PERFORMANCE MEASURES

In addition to the financial performance measures, our Report and Accounts includes measures that consider and assess the performance of all of our key stakeholder groups. The diagram below summarises the performance measures adopted throughout the Report and Accounts.

### KEY STAKEHOLDERS

| Measure | Policyholder | Investor | Regulators | Business partner* | What is it and why is it important? | Page |
|---|---|---|---|---|---|---|
| Customer service levels | ■ | □ | ■ | □ | How well we service our customers is of paramount importance and so through various means we aim to assess customer service levels. The business reviews within the Report and Accounts refer to a number of indicators of customer service levels. | 24-29 |
| Broker satisfaction | ■ | □ | □ | ■ | Broker satisfaction is important because they sell new policies, provide ongoing service to their customers and influence book persistency. We include several measures within the Report and Accounts, including direct broker assessment ratings for Movestic and general assessment of how our brands fare in industry performance awards in the Netherlands. | 26-29 |
| Policy investment performance | ■ | □ | ■ | □ | This is a measure of how the assets are performing that underpin policyholder returns. It is important as it indicates to the customer the returns that their contributions are generating. | 24-29 |
| Industry performance assessments | ■ | □ | □ | □ | This is a comparative measure of how well our investments are performing against the rest of the industry, which provides valuable context to our performance. | 24-29 |
| Funds under management | □ | ■ | □ | □ | This shows the value of the investments that the business manages. This is important because scale influences operational sustainability in run-off books and operational efficiency in growing books. Funds under management are also a strong indicator of fee income. | 26-27 |
| Policy count | □ | □ | □ | □ | Policy count is the number of policies that the group manages on behalf of customers. This is important to show the scale of the business, particularly to provide context to the rate at which the closed-book business is maturing. In our open businesses, the policy count shows the net impact of new business versus policy attrition. | 5 |
| Total shareholder returns | | ■ | □ | | This includes dividend growth and yield and shows the return that an investor is generating on the shares that they hold. It is highly important as it shows the success of the business in translating its operations into a return for shareholders. | 40 |
| New business profitability | | ■ | | | This shows our ability to write profitable new business which increases the value of the group. This is an important indicator given one of our core objectives is to 'enhance value through profitable new business'. | 26-29 |
| New business market share | | □ | | | This shows our success at writing new business relative to the rest of the market and is important context for considering our success at writing new business against our target market shares. | 26-29 |
| Gearing ratio | | ■ | □ | | The gearing is a ratio of debt to IFRS net assets and shows the extent to which the business is funded by external debt versus internal resources. The appropriate use of debt is an efficient source of funding but in general Chesnara seeks to avoid becoming overly dependent on permanent debt on the balance sheet. | 40 |
| Knowledge, skills and experience of the Board of Directors | □ | ■ | ■ | □ | This is a key measure given our view that the quality, balance and effectiveness of the Board of Directors has a direct bearing on delivering positive outcomes to all stakeholders. | 50-51 |

* For the purposes of this key performance indicator assessment business partners refers to major suppliers and outsource partners.

**Key:**

■ Primary interest

□ Secondary interest

# CHAIRMAN'S STATEMENT

I'm pleased to report a further 3% growth in the proposed annual dividend.

It is pleasing to report that in 2018 we continued to generate cash in excess of our dividend costs and we ended the year with a strong solvency ratio of 158% (2017: 146%). This was achieved against a backdrop of adverse economic conditions, especially during the last quarter of the year. Economic Value has been impacted by the market conditions in line with our sensitivities.

The adverse economic conditions, primarily reduced equity and bond values and the strengthening of sterling against the Swedish krona, contributed to a reduction in total Economic Value from £723.1m at the start of the year to a closing value of £626.1m. The closing value recognises the payment of £30.4m of dividends during the year.

Good progress on operational performance developments during the year has resulted in improvements in business resilience and higher new business volumes compared to 2017.

The FCA investigation into the fair treatment of longstanding customers in the UK was closed without further action.

In the early part of 2019 markets have recovered somewhat but uncertainty remains as a result of political, economic and business conditions. For Chesnara with our structure of separate subsidiary companies in each European territory, debt capacity and management capability we remain open to the opportunities this uncertainty could bring to us as a disciplined buyer with a focus on cash generation and long term value.

PETER MASON
CHAIRMAN

Against a backdrop of continuing political uncertainty, economic volatility with a net adverse outcome, and during a period of significant operational development, the Chesnara business model has held up well.

Adverse economic conditions have an immediate, but potentially temporary impact, on Economic Value. Solvency and cash generation are less affected in the short term and hence our ability to continue our dividend track record has not been impacted.

At the heart of Chesnara's proposition as a reliable income stock, the UK business has continued to generate sufficient cash to fund the Chesnara dividend and the recent trend of Movestic and Waard making meaningful positive cash contributions continues. In contrast Scildon has generated a negative cash result of £17.8m primarily as a result of investment valuation losses on various corporate and government bonds. This does not impact our view regarding the future cash generation potential of the business. The group cash generation provides 157% coverage of the total annual dividend.

As we have previously reported, Scildon remains in transition and this is reflected in its short term financial results. The successful launch of a new mortgage term assurance product during May has contributed to a modest improvement in new business volumes. Although the increase in new business volumes was reassuring, the fact that the new business operation only made modest profits serves to highlight the importance of successfully completing the Scildon improvement initiatives.

The financial resilience of the established business units creates a strong foundation to support the continued improvement programme in Scildon.

The headline results for 2018 are generally lower by comparison to 2017. The 2017 results were unusually strong due to a combination of non-recurring items (including the completion of the acquisition of Legal & General Nederland) and highly beneficial economic conditions. The 2018 IFRS result of £27.0m includes a loss of £15.5m from economic conditions compared to a corresponding economic profit of £30.9m in 2017. In addition, the 2017 result included a £20.3m gain on the acquisition of Legal and General Nederland. Excluding the investment market driven impacts and the one off acquisition gain, the underlying IFRS results are more consistent year on year. Whilst the IFRS results are worthy of note in my statement, it is my view that they are not the most meaningful measure for the purpose of assessing the performance of the company and hence my focus within the Chairman's Statement is on solvency, cash generation and Economic Value. The IFRS results are analysed in more detail on page 36.

In addition to funding an attractive dividend strategy, we have a long-term objective to protect the post dividend Economic Value of the group. This means that over time we aim to create value at least to the level of the annual dividend. Due to the sensitivity of the Economic Value to key investment market variables (see our sensitivity analysis on page 33), it can be particularly difficult to meet this Economic Value protection objective in periods where conditions are adverse as has been the case during 2018. The combination of a £49.7m economic loss, £22.8m of operating losses and the payment of £30.4m of dividends are the primary drivers in a reduction in total Economic Value from £723.1m at the beginning of the year to a closing value of £626.1m.

I will now report on how we have delivered against our three strategic objectives in a little more detail:

01

### MAXIMISE VALUE FROM EXISTING BUSINESS

**Divisional cash generation of £63.9m.**

See pages 24 to 29 for further information.

When assessed in terms of levels of cash generated in the year we have, with the exception of Scildon, delivered broadly in line with expectations. £29.0m of cash emerged from the UK division (excluding £5.7m which is currently restricted within the with-profits fund) during the period which, together with £26.8m of previously constrained surplus released from the with-profits fund, resulted in total cash significantly in excess of total annual dividends. Movestic has increased its level of surplus resulting in a further £18.1m of cash generation. Scildon has reported negative cash generation of £17.8m. This is primarily due to the impact of a downward valuation on its fixed interest investments. The Scildon result in the year does not impact our view regarding the future cash generation potential of the business.

Economic Value in the period has been more affected by economic conditions with total value falling by £97.0m. The majority of the loss is directly due to economic conditions. Operating losses of £22.8m including the impact of the strengthening of Scildon mortality assumptions, have also contributed to the reduction. Foreign exchange losses of £5.8m have emerged in the period, largely as a result of a weakening of Swedish krona. These factors, coupled with the payment of £30.4m of dividends have resulted in a 13.4% reduction in EcV since the start of the year.

Operational resilience is a vital factor with regards to our ability to protect and service our customers. We have therefore invested heavily on improving operational resilience across all aspects of the business and our assessment is that the operational resilience and security of the business has improved significantly during the year.

02

### ACQUIRE LIFE AND PENSIONS BUSINESSES

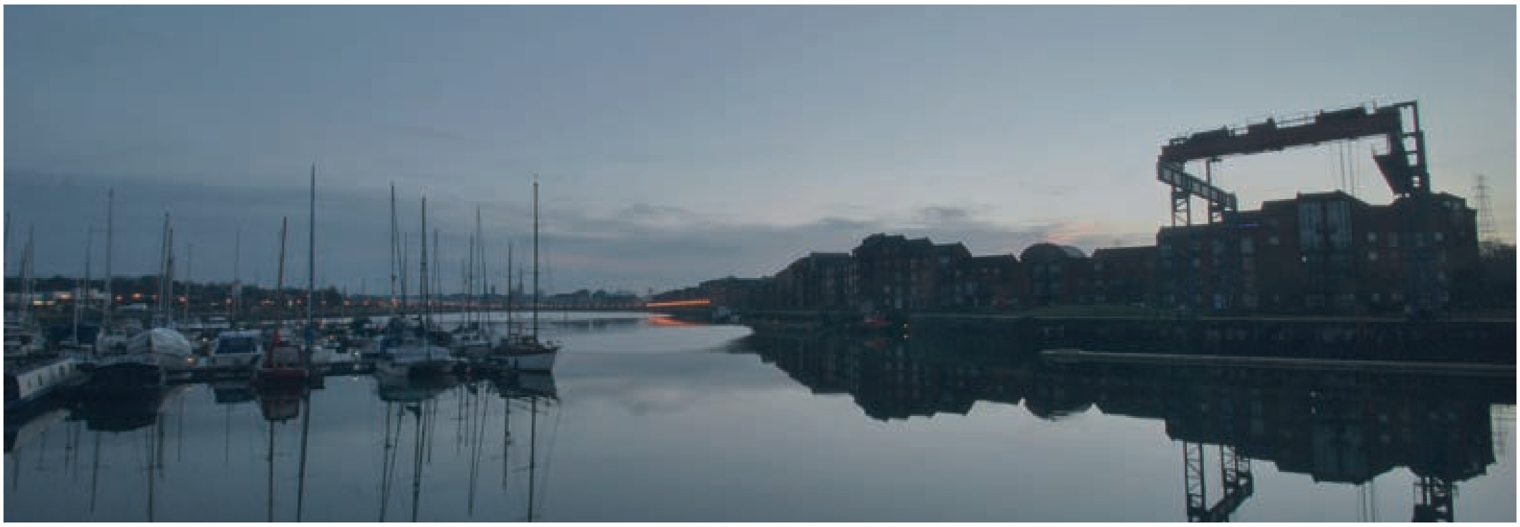
**We continue to see activity in our preferred markets and are well positioned to take advantage of any future opportunities.**

See page 30 for further information.

### THE OUTLOOK REMAINS POSITIVE. ACQUISITION ACTIVITY CONTINUES TO TAKE PLACE IN OUR TARGET MARKETS, WITH OPPORTUNITIES CONTINUING TO EMERGE.

During the year we finalised arrangements to form a broader debt syndicate and this, together with increases in solvency surplus, means we are in a strong position to fund future acquisitions where they meet our assessment criteria.

# CHAIRMAN'S STATEMENT (CONTINUED)



03

## ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

**Increase in business volumes results in total new business profits of £10.6m.**

See pages 26 to 29 for further information.

Chesnara writes new business in both Sweden and the Netherlands. The ultimate aim is to create sufficient annual profits, either through returns on the existing business, or through writing new business, to replace the proportion of Economic Value lost by way of dividend payments. Movestic continues to deliver within its target profit range with a profit for the year of £8.9m. This represents a reduction compared to 2017 mainly due to adopting a more prudent assessment of the profitability of increments to existing policies. Profits from new contracts remain broadly consistent with 2017.

Despite improved new business volumes, Scildon are not currently generating sufficient new business profits with a total profit of £1.7m. This is in line with our expectation at this stage and the need to drive profitability improvements over the coming years was factored into our acquisition price. A provision for the improvement programme has been made. During 2018 the focus has been on setting strong foundations and ensuring a clarity of direction. Whilst certain early operational enhancements have been delivered, the scale of the change to date has not been sufficient to have a marked impact on new business profits. During 2019 we intend to deliver sufficient organisational and process change to have a material impact on the cost base and to deliver a step change in how we interact with advisors.

SOLID NEW BUSINESS PROFITS HAVE EMERGED FROM MOVESTIC IN A CHALLENGING MARKET. SCILDON'S NEW BUSINESS OPERATION IS NOT GENERATING SUFFICIENT PROFIT AND THE FOCUS OVER 2019 IS TO ADDRESS THIS ISSUE.

The successful launch of a new mortgage term assurance product is a first positive step on our Scildon improvement plan although we recognise that we will only see the full potential from products when they are supported by highly efficient processes and a lower cost organisation.

### Solvency

The group continues to show a robust solvency position, with a solvency ratio of 158% at 31 December 2018 (31 December 2017: 146%). A large contributing factor to this increase is a £26.8m release of capital from the UK's with-profits funds, which positively benefitted own funds in the period. This was subject to FCA approval. The closing solvency position is stated after recognising the £20.2m cost of the proposed final dividend.

### Regulation and governance

***IFRS 17***

Our programme has progressed well in the year, with our immediate focus being on delivering an impact assessment. This deals with an initial early view on the technical application of the standard to the group and its associated financial and operational impacts. We completed our initial impact assessment in Q3 and have now transitioned to the delivery phase. We have previously provided for the cost of delivering the programme within our actuarial expense reserves. From an operational and risk management perspective, the proposed one year implementation delay is helpful but it is expected that there will be additional costs. These too have been provided for in the 2018 results.

We continue to be of the view that IFRS 17 should not have any significant bearing on the commercial assessment of Chesnara, with our expectation that capital management decision making will continue to be driven by regulatory solvency and Economic Value as opposed to our IFRS results and position.

***Regulatory compliance***

Compliance with regulation remains a priority for the group. We have continued to maintain a positive and constructive relationship with regulatory bodies across the three territories. During the period we have delivered our GDPR readiness programmes, for the new rules which were effective from 25 May 2018.

On 19 September 2018 the FCA announced that it had closed its investigation, into whether CA had failed to meet the standards expected of it regarding the fair treatment of long-standing customers. As expected, no further action has resulted from the investigation.

***Governance framework***

We continue to place great importance on ensuring our risk and governance system is fit for purpose. Work has continued to progress on ensuring that Scildon's risk and governance monitoring and reporting routines are in line with the wider group's.

## AT CHESNARA WE HAVE ALWAYS MANAGED OUR BUSINESS IN A RESPONSIBLE WAY AND HAVE A STRONG SENSE OF ACTING IN A FAIR MANNER, GIVING FULL REGARD TO THE RELATIVE INTERESTS OF ALL STAKEHOLDERS.

**Corporate purpose**
We assess our corporate purpose by considering eight aspects of our business and by looking at the business from the perspective of all stakeholders.

***1. Business model***
– Our acquisition strategy is built upon long-term commitments to any markets we operate in. Our consolidation model therefore offers a genuine solution to the challenges certain insurance markets face.

***2. The products and services we provide***
– We help protect people and their dependants through the provision of life, health and disability cover or by providing savings and pensions which help customers with their financial needs in the future. We seek to provide customers and their advisers with helpful and reliable support.

### WE HELP PROTECT PEOPLE AND THEIR DEPENDANTS THROUGH THE PROVISION OF LIFE, HEALTH AND DISABILITY COVER OR BY PROVIDING SAVINGS AND PENSIONS WHICH HELP CUSTOMERS WITH THEIR FINANCIAL NEEDS IN THE FUTURE.

***3. Sustainability***
– Driven in part by consumer demand, especially in our Swedish and Dutch operations, there is a continued positive shift towards an increased focus of sustainable fund investments.

– The nature of our business is such that in general we have a relatively low carbon footprint.

***4. Shareholder proposition***
– Investors, especially in a low interest rate environment do have a genuine need for income and hence our investor proposition, track record and responsible approach provides an investment opportunity for individuals seeking sustainable equity based income.

***5. Taxation***
– As detailed in our tax strategy, we adopt a responsible and open approach to taxation and, as a consequence, pay the appropriate taxes throughout the group.

***6. Staff***
– We provide high quality jobs with good working conditions both directly and through outsourced arrangements.

***7. Suppliers and partners***
– We seek mutually respectful and sustainable relationships with our suppliers. We believe that supplier relationships only work in the long-term if the terms and conditions are mutually beneficial. Our instinct and natural preference is to maintain established long-term supplier relationships where they remain commercially competitive and operationally viable.

***8. Local community***
– In the UK our investment and continued commitment to the North West and Preston in particular creates high quality financial services roles outside of London.

– All divisions support local community initiatives to the extent deemed appropriate given our financial responsibilities as a PLC.

### OUR VIEW IS THAT CHESNARA FULFILS A POSITIVE CORPORATE PURPOSE FOR ALL KEY STAKEHOLDERS.

**Outlook and Brexit**
Chesnara is in a good position to continue its delivery against its strategic objectives, which in turn fund our well established dividend strategy. The ability to generate cash in less economically beneficial conditions, as has been the case during 2018, clearly demonstrates this.

In particular, the UK business remains a robust source of cash, with additional potential to take management actions to enhance the core cash if required. Movestic now has the scale to continue contributing to the cash position. Scildon has surplus capital and despite the negative cash emerging during the period, is also expected to be cash generative, in the absence of adverse economic conditions.

We now have sufficient scale and presence in both the UK and the Netherlands to continue our focus on acquisition activity in those territories in a disciplined manner. We also remain open to opportunities in Sweden particularly where they provide scale benefits. We would consider new territories but the benefits would need to outweigh the inherent challenge of adding another regulatory environment into our business model. Our balance sheet has further capacity for debt having completed a debt syndication process during the year, we have significant levels of surplus capital. This, together with operational capacity, means we remain well positioned to act should an opportunity arise that meets our stringent price and risk profile criteria.

Movestic has become an established profitable new business operation. They have made meaningful steps in improving the organisational effectiveness and efficiency of the business including some major automation initiatives, which have resulted in a notable reduction in the cost base. They are in a good position to deliver further digitalisation plans. We recognise that current new business profits from Scildon are not sufficient. However, the fact that we have recorded a modest profit calculated on a suitably stringent basis of assessment, means we retain our view that Scildon has the potential to create meaningful new business profits. 2019 will be a critical year regarding the delivery of material change to improve profits.

The structure of the group, with established regulated entities in several European countries, together with the fact we do not trade or share resource across territories, means I remain of the view that whatever the outcome from the Brexit negotiations, we expect it to have little direct impact on our business model.

From an investment markets perspective equity markets have generally risen since the end of the year, and spreads on bonds have narrowed. Both of these factors are positive drivers of Economic Value for the group.

In light of the above I remain confident that Chesnara is well positioned to continue to provide value to policyholders and shareholders.

Peter Mason
Chairman

28 March 2019

# SECTION B:

# STRATEGIC REPORT

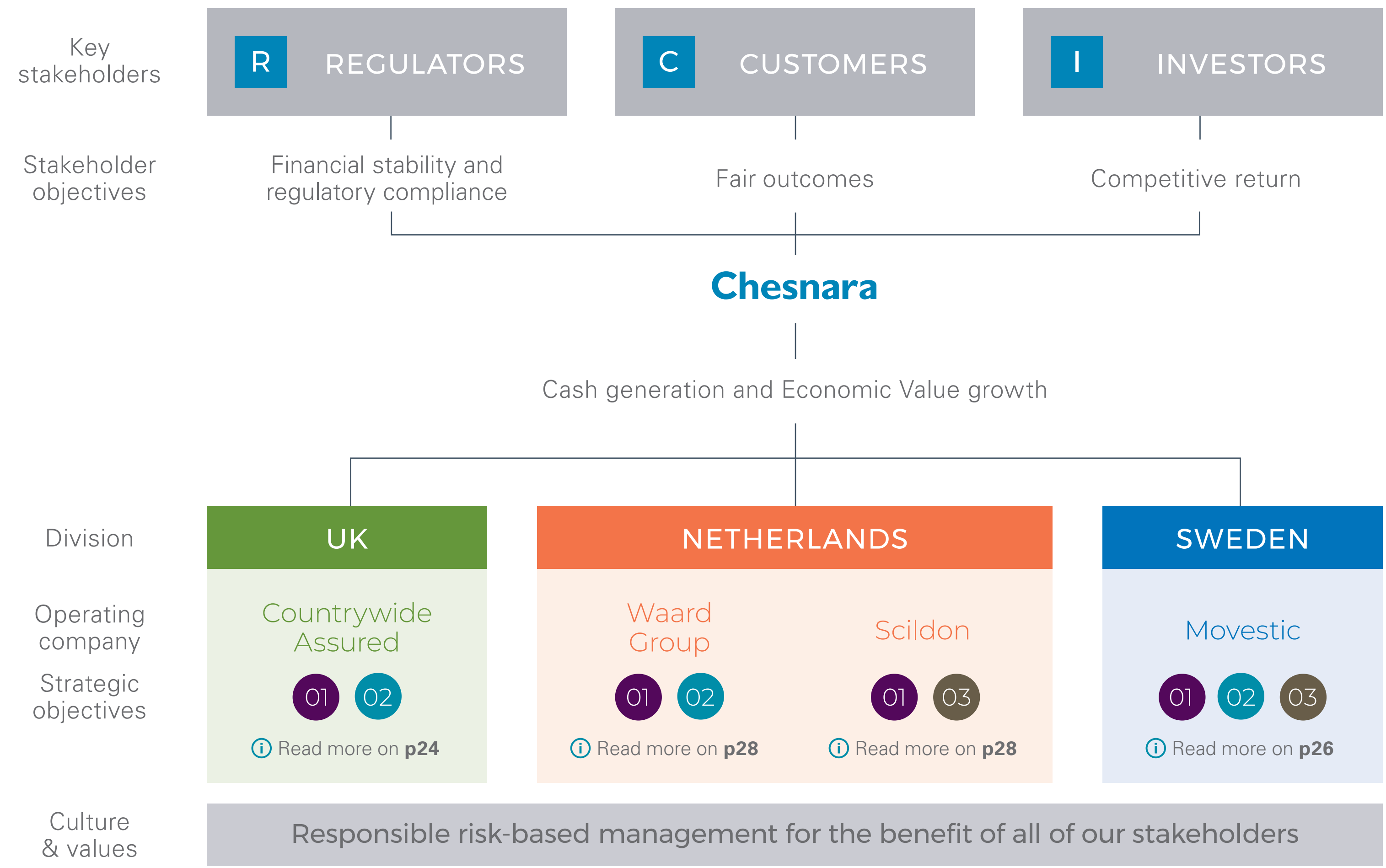


Stockholm Archipelago, Sweden

# OVERVIEW OF OUR STRATEGY, CULTURE & VALUES AND BUSINESS MODEL

Our strategy focuses on delivering value to customers 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.

## OUR BUSINESS MODEL




## OUR STRATEGIC OBJECTIVES

01

### MAXIMISE THE VALUE FROM EXISTING BUSINESS

Managing our existing customers fairly and efficiently is core to delivering our overall strategic aims.

02

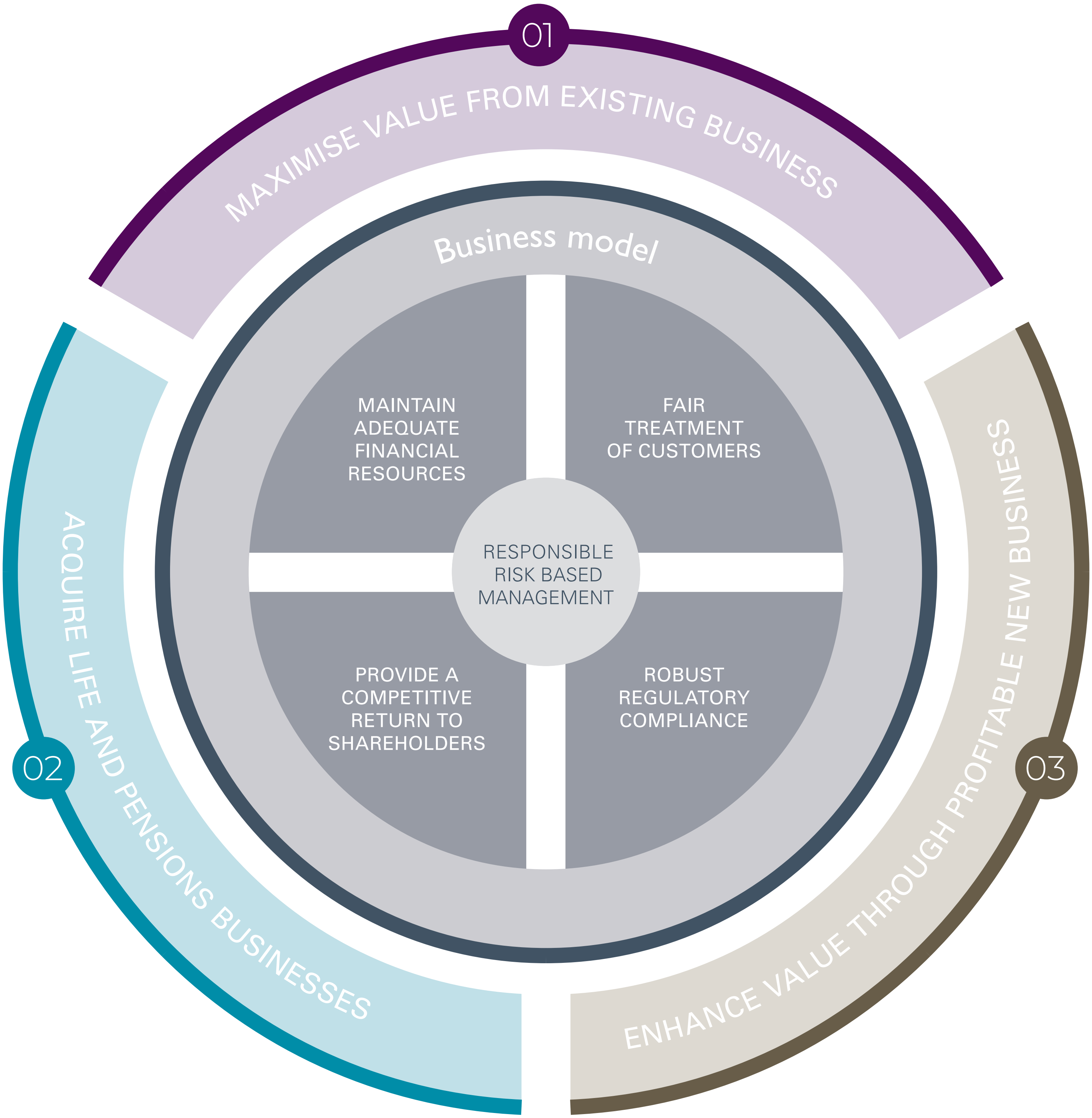
### ACQUIRE LIFE AND PENSIONS BUSINESSES

Acquiring and integrating companies into our business model is key to continuing our growth journey.

03

### 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.


01
MAXIMISE VALUE FROM EXISTING BUSINESS
Business model
MAINTAIN ADEQUATE FINANCIAL RESOURCES
FAIR TREATMENT OF CUSTOMERS
RESPONSIBLE RISK BASED MANAGEMENT
PROVIDE A COMPETITIVE RETURN TO SHAREHOLDERS
ROBUST REGULATORY COMPLIANCE
02
ACQUIRE LIFE AND PENSIONS BUSINESSES
03
ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

# OUR STRATEGY

| STRATEGIC OBJECTIVE | WHY THIS MATTERS | HOW WE DELIVER OUR BUSINESS MODEL |
|---|---|---|
| MAXIMISE VALUE FROM EXISTING BUSINESS<br>01 | The existing books of policies are the principal source of cash generation and are hence at the heart of the investment case for our shareholders. | A centralised governance oversight and corporate management team ensure robust and consistent governance across the group. Operating autonomy is delivered to the divisions to ensure we benefit from our strong divisional management teams. The UK business adopts an outsourced business model. Core operations are not outsourced in Sweden or the Netherlands because it would not suit the business models in those territories. |
| ACQUIRE LIFE & PENSIONS BUSINESSES<br>02 | Well considered and appropriately priced acquisitions maintain the effectiveness of the operating model, create a source of value enhancement and sustain the longer-term cash generation potential of the group. | – Identify potential deals through an effective network of advisers and industry associates.<br>– We assess deals applying well established criteria which consider the impact on cash generation and Economic Value under best estimate and stressed scenarios.<br>– We work cooperatively with regulators.<br>– The financial benefits are viewed in the context of the impact the deal will have on the enlarged group's risk profile.<br>– Transaction risk is minimised through stringent risk-based due diligence procedures and the senior management team's acquisition experience and positive track record.<br>– We fund deals with debt, equity or cash depending on the size and cash flows of each opportunity. |
| ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS<br>03 | The primary focus of our operations is to ensure we manage the existing policy base in an efficient and compliant manner. That said, the Chesnara financial model supports modest incremental value generation through writing new business. New business profits are an important and welcome source of regular value growth which supplements the growth delivered from our existing policy base and periodic acquisitions. | Our two operating subsidiaries that are open to new business are Movestic in Sweden and Scildon in the Netherlands. Movestic primarily focuses on unit-linked pensions and savings business, distributed largely through IFAs, and has a profitability model based upon realistic market shares. Scildon sells protection products, individual savings and group pensions contracts via a broker-led distribution model, and as with Movestic, new business operations assume realistic market shares. For both open businesses, we believe that to achieve higher volumes would require a pricing strategy that may compromise the keen focus on ensuring the business we write is profitable. |

Other than the fact that Brexit could impact the investment markets to which our results are sensitive (see sensitivities on page 33) we consider that our operating model is relatively unaffected by Brexit. We do not trade across borders nor do we share resource between our European businesses. Each division operates to autonomous local regulatory frameworks and we believe we have the flexibility to change our regulatory structure if Brexit results in an inefficient regulatory structure of the organisation.

| HOW WE MEASURE DELIVERY | | RISKS: WHAT CAN STOP US MEETING THIS OBJECTIVE | RISKS: WHAT CAN WE DO ABOUT THIS | UPDATE |
|---|---|---|---|---|
| Cash generation | Cash generated by the existing business is an important measure for how the business is performing. It 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. | – Adverse investment market conditions can result in lower assets under management and hence lower fee income from unit-linked business. For products with guarantees, this can increase the cost of fulfilling the guarantees.<br>– Increased lapses on cash generative / value enhancing products.<br>– Loss of key brokers can result in increases in the level of customers moving to competitors.<br>– Regulatory change can potentially impact the cash flows arising from the existing business.<br>– Expenditure levels could exceed those assumed.<br>– Foreign currency fluctuations can impact the sterling value emerging from overseas operations | – Where appropriate, active investment management with the aim of delivering competitive investment returns for policyholders.<br>– Outsourcer service levels that ensure strong customer service standards.<br>– Expense assumptions are deemed to be realistic and the cost base is well controlled, predictable and within direct management influence.<br>– 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. | **UK**<br>Pages 24-25<br>**Sweden**<br>Pages 26-27<br>**Netherlands**<br>Pages 28-29 |
| Value optimisation | Value generation is measured by reference to the movement in Economic Value over the period. | | | |
| Customer outcomes | This is measured through monitoring:<br>– customer service metrics;<br>– policyholder fund performance against industry and market expectations;<br>– customer complaint levels; and<br>– our compliance with regards to regulatory conduct matters. | | | |
| Cash generation | Collectively our future acquisitions must be suitably cash generative to continue to fund the Chesnara dividend strategy. | – 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.<br>– There is the risk that we make an inappropriate acquisition that adversely impacts the financial strength of the group.<br>– Our acquisition strategy includes both UK and non-UK markets. | – Operating in three territories increases our options thereby reducing the risk that no further value adding deals are done.<br>– A broader target market also increases the potential for deals that meet our strategic objectives.<br>– Flexibility over the timing of subsequent divisional dividend flows provide an element of management control over the sterling value of cash inflows.<br>– Each acquisition is supported by a financial deal assessment model which includes high quality financial analysis. This is reviewed and challenged by management and the board, mitigating the risk of a bad deal being pursued. | Page 30 |
| Value enhancement | Acquisitions are required to have a positive impact on the Economic Value per share under best estimate and certain more adverse scenarios. | | | |
| Customer outcomes | Acquisitions must ensure we protect, or ideally enhance, customer interests. | | | |
| Risk appetite | Acquisitions 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. | | | |
| Value enhancement | We measure the amount of Economic Value added through selling new contracts. The value added takes full account of all costs incurred so as to ensure the profit represents true incremental value. | – The attractiveness of products can be influenced by economic conditions, politics and the media.<br>– New business volumes are sensitive to the quality of service to intermediaries and the end customer.<br>– In Sweden, new business remains relatively concentrated towards several large IFAs.<br>– A competitive market puts pressure on new sales margins. | – In Sweden, continue to extend the breadth of IFA support.<br>– Ensure high quality of service to existing network of intermediaries.<br>– Focus on other margin drivers beyond product pricing, for example the fund management operation.<br>– In the Netherlands, enhance our business processes and product offering to be attractive to brokers and consumers. | **Sweden**<br>Pages 26-27<br>**Netherlands**<br>Pages 28-29 |

# OUR 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 customers, regulators and our investors.

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 31 to 33.

| CULTURE & VALUES | WHY IS IT IMPORTANT? |
|---|---|
| RESPONSIBLE RISK-BASED MANAGEMENT FOR THE BENEFIT OF ALL OF OUR STAKEHOLDERS | 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, distributors and regulators. When applying the terms of our customer contracts, coupled with guidance and requirements set out by our local regulators, we place a high priority on taking account of the fair treatment of our customers. |
| PROVIDE A COMPETITIVE RETURN TO OUR SHAREHOLDERS | As a public company, it is imperative that we offer an attractive investment proposition. 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 | THE OUTCOMES |
| --- | --- |
| – Further aligned the governance within Scildon with that of the wider group, including the appointment of John Deane to their Supervisory Board and the appointment of a CRO.<br>– Continued to enhance our Own Risk and Solvency Assessments (ORSAs), further supporting the group and divisions in making informed risk-based decisions.<br>– Delivered our continuous improvement regime regarding how we manage risk across the group, supported by our annual systems of governance review. | – Strengthened controls reducing risk likelihood and impact of adverse outcomes for shareholders and policyholders.<br>– Constructive dialogue with regulators across the different territories in which the group operates.<br>– Closure of the FCA Investigation into the treatment of long standing customers.<br>– Continued improvement in the understanding of the group's Solvency II balance sheet, which provides a stronger linkage between risk, capital and strategy aiding more risk-based decision-making. |
| – Across the group, we have continued to deliver a good standard of customer service.<br>– The UK division is implementing its customer strategy in support of regulatory guidelines and during 2018 delivered a new customer website and enhanced its customer communications. The UK's administrative outsource service partners have delivered within stringent service level requirements.<br>– Service standards in Sweden remain strong, as evidenced by external surveys of brokers undertaken by independent organisations.<br>– Unit-linked policy returns remain competitive based on both fund benchmarks and external unit-linked policy performance surveys.<br>– Where complaints do arise across the group, we continue to manage them in accordance with best regulatory practice.<br>– We closely monitor any regulatory developments to ensure we continue to treat our customers fairly in accordance with regulatory requirements. | – Generally low level of complaints across the group has continued.<br>– Improved customer communications, supporting better customer outcomes.<br>– Service standards and customer outcomes in Sweden mean we continue to meet our targets for market share range.<br>– In the Netherlands, Scildon has again received an award from Afdiz, the Dutch broker organisation. In 2018, the business was awarded 'Best Occupational Pension Insurer' and was also rated second for term insurance. |
| – Continued our dividend strategy of increasing our dividend each year, even during turbulent investment market conditions.<br>– Maintained a robust solvency position in all divisions and at group level which supports the continued dividend strategy. | – Dividend track record continues, with 3% dividend growth in 2018.<br>– Over the past 5 years, £134.6m of dividends have been paid. |
| – Maintenance of robust levels of solvency throughout the group and all divisions throughout the year.<br>– Continued to place a high priority on compliance and maintaining an open dialogue with our regulators.<br>– During the year the FCA announced that it had closed its investigation, without further action, into whether Countrywide Assured had failed to meet the standards expected of it regarding the fair treatment of long-standing customers.<br>– Ensured we have complied with the FCA's senior managers and certifications regime, which came into force from 10 December 2018. | – Ongoing constructive relationships with UK, Swedish and Dutch regulators.<br>– Continued adherence to internal governance policies and principles. |

# BUSINESS REVIEW • UK

The UK division is principally made up of Countrywide Assured plc, a life insurance company that is in run off. The company has 277,000 policies and its operations are predominantly outsourced, and overseen by a central governance team.

MAXIMISE VALUE FROM EXISTING BUSINESS

01

| | BACKGROUND INFORMATION | INITIATIVES & PROGRESS IN 2018 |
|---|---|---|
| CAPITAL & VALUE MANAGEMENT | – As a closed book, the division creates value through managing the following key value drivers: costs; policy attrition; investment return; and reinsurance strategy.<br>– In general, surplus regulatory capital emerges as the book runs off. The level of required capital is closely linked to the level of risk to which the division is exposed. 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.<br>– At the heart of maintaining value is ensuring that the division is governed well from a regulatory and customer perspective. | – Cash generation of £55.8m emerged during the year despite volatile equity markets, including £26.8m arising from a transfer of surplus capital from the company's with-profits funds following approval by the Financial Conduct Authority.<br>– Proposed final dividend to Chesnara of £59.0m.<br>– Looking through the impact of dividends, the EcV of the division reduced by £8m since the start of the year, largely as a result of the fall in equity markets in 2018.<br>– IFRS pre-tax profits of £28.2m have been made in the period. |
| CUSTOMER OUTCOMES | – Treating customers fairly is one of our primary responsibilities. 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 customer expectations. | – On 19 September 2018 the FCA announced that it had closed its investigation, without further action, into whether Countrywide Assured (CA) had failed to meet the standards expected of it regarding the fair treatment of long-standing customers.<br>– The division's customer strategy implementation plan has continued to be progressed during the year. Key items of delivery have included:<br>• Reviewing key event communications with customers and making sure they meet the expected standards. This work will continue into 2019.<br>• Updating the CA website to improve the accessibility of information that customers may wish to refer to. A second phase roll-out to provide more information on fund unit prices and performance, as well as enhanced information on savings and protection products, was progressed during 2018 and went live in 2019.<br>– The business has continued its programme to stay in touch with customers through its 'goneaways' programme.<br>– Good customer services standards have been maintained throughout the year. |
| GOVERNANCE | – Maintaining effective governance and a constructive relationship with regulators underpins the delivery of the division's strategic plans.<br>– Having 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. | – The division has started a programme to enhance its operational resilience following the Bank of England's paper entitled 'Building the UK financial sector's operational resilience' which was issued in July 2018.<br>– The division's IFRS 17 programme commenced, with the first phase involving an impact assessment. This work has been utilised to scope the delivery phase of the plan, which has now commenced.<br>– Positive engagement with all regulators has continued during the year.<br>– The General Data Protection Regulation (GDPR) project was completed prior to the rules coming into force on 25 May 2018. |

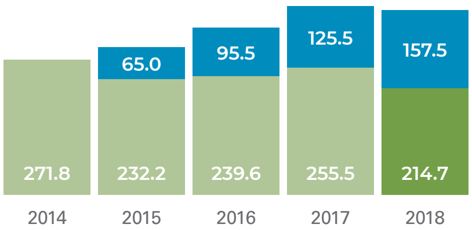
The division has continued to focus on delivering its core strategic objectives of managing the capital and value of the business effectively, focusing on customer outcomes and ensuring that the business is governed well.

## FUTURE PRIORITIES

- As a closed book operation, a key priority for the division is to continue to monitor expenses closely, especially in light of the ever-demanding regulatory environment in which the company operates.
- Continue to consider investment strategy of the division, including the mix of assets we invest in and also the operating model used to deliver investment management.
- The division will continue to support the group in delivering its acquisition strategy in the UK.

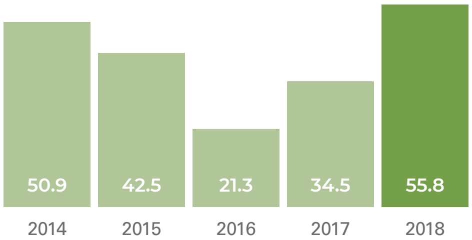
## KPIs

**Economic Value**
£m




**2018 value reduced as a result of investment market conditions towards the end of the year.**

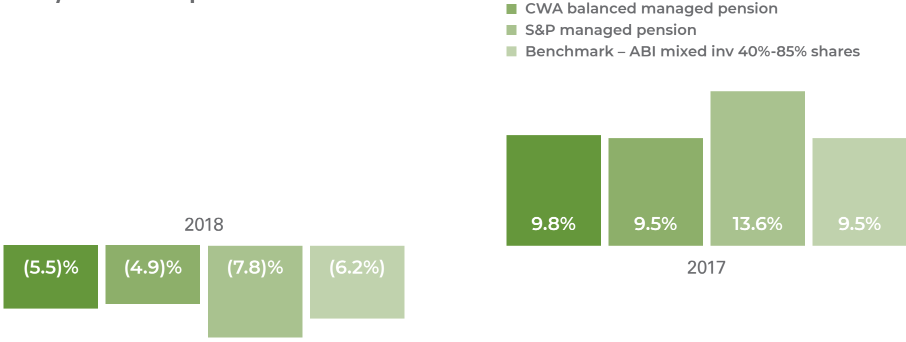
**Cash generation**
£m




**Cash generation of £55.8m, which includes a one-off surplus transfer from the with-profits funds, continues to support the group's dividend strategy.**

- The division's customer strategy implementation programme is expected to come to a close in early 2020, with the programme transferring the updated processes into a business as usual environment. Key items that are planned to be delivered in 2019 include:
  - Implementing the vast majority of the updated customer communications, most notably annual statements, retirement communications, and the remaining transfers and surrender letters.
  - Continue the cycle of seeking to make contact with customers who have not provided us with their most recent contact information. This will include writing to all customers who we believe we have traced to new addresses.

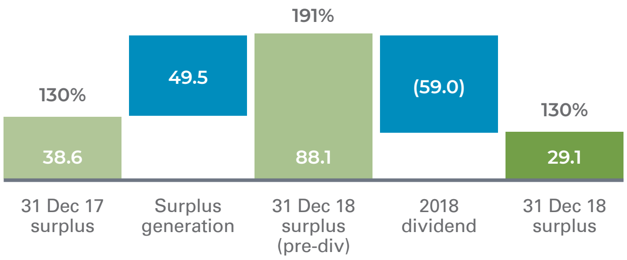
**Policyholder fund performance**




**Our main managed funds continue to generally perform well against their benchmarks although the S&P managed pension fund experienced a disappointing end to the year as a result of its higher relative exposure to equities, which fell during the year. The S&P performance over a longer-term period compares favourably to benchmark.**

- 2019 will focus on delivering the division's operational resilience plans following the Bank of England's discussion paper that was issued in 2018.
- The division will continue with its IFRS 17 implementation plan, noting that the standard is subject to further review by the IASB. At this stage these plans include producing a balance sheet valuation under IFRS 17 valuation rules.

SOLVENCY RATIO: **191%**




**Solvency remains robust. The surplus generated in the period increases the solvency position from 130% to 191%. After the dividend, due to be paid during 2019, the ratio is 130%.**

# BUSINESS REVIEW • SWEDEN

Movestic is a life and pensions business based in Sweden, and is open to 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 brokers and is well-rated within the broker community.

MAXIMISE VALUE FROM EXISTING BUSINESS

01

| | BACKGROUND INFORMATION | INITIATIVES & PROGRESS IN 2018 |
|---|---|---|
| CAPITAL & VALUE MANAGEMENT | – Movestic creates value predominantly by generating growth in the unit linked Assets under Management (AuM). 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. | – Cash of £19.4m has been generated, on constant exchange rates (£18.1m post foreign exchange retranslation).<br>– IFRS profit of £9.3m.<br>– Assets under management resilient despite investment market drop in the period, on constant exchange rates.<br>– The transfer market remains intense. Movestic reflects the market trend with transfers in at a similar level to outgoing transfers.<br>– The division has implemented an operational change programme, designed to improve efficiencies and reduce costs within the business and hence combat the impact of price pressure.<br>– The Swedish krona has weakened against sterling by 3.2% during the year, resulting in retranslation losses being reported in EcV and cash generation. During 2017 the Swedish krona strengthened by 0.6%.<br>– Equity markets developed negatively during the fourth quarter resulting in a negative investment return for the full year. |
| CUSTOMER OUTCOMES | – Movestic provides personalised long-term savings, insurance policies and occupational pensions for individuals and business owners. We believe that recurring independent financial advice increases the likelihood of a solid and well-planned financial status, hence we are offering our products and services through advisors, licenced brokers or digitally. | – Policyholder average investment return of -6.0% in the year (2017: +8.2%), ahead of the Swedish stock market return of -7.7%.<br>– Fees have been lowered in Movestic's funds to strengthen its customer proposition.<br>– Movestic was elected as one of the unit linked providers in the procurement of the collective agreement ITP, where 2 million clients have their occupational pension solution. The offering was made available on 1 October and was combined with our digital investment advisory tool MAIA. This is the first time that kind of solution was made available for this group of clients. It should be noted that this represents low margin business. |
| GOVERNANCE | – Movestic operates to exacting regulatory standards and adopts a robust approach to risk management.<br>– Maintaining strong governance is a critical platform to delivering the various value-enhancing initiatives planned by the division. | – The General Data Protection Regulation (GDPR) project was completed prior to the rules coming into force on 25 May 2018.<br>– Movestic has successfully implemented the first phase of the Insurance Distribution Directive (IDD), which applied from 1 October 2018.<br>– The IFRS 17 project has progressed well, with the initial impact assessment study delivered during Q4. |

ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

03

| | | |
|---|---|---|
| PROFITABLE NEW BUSINESS | – As an 'open' business, Movestic not only adds value from sales but as it gains scale, it 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 6.5%-10.0% of the advised occupational pension market. This focus ensures we are able to adopt a profitable pricing strategy. | – Movestic continues to operate within its target market range.<br>– Annual premium equivalent of new contracts sold increased by 3% compared with 2017, although gross margin rates have deteriorated slightly, reflecting the pricing pressures that exist in the market.<br>– Overall profits from new contracts have remained consistent with 2017 despite price pressure. A reassessment of the profitability of increments to existing policies has however driven a reduction in overall new business profit.<br>– Movestic are redesigning their organisation for a digital world to increase business efficiency and reduce cost. As part of this process outsourcing of some IT operations capability was completed in the year. |

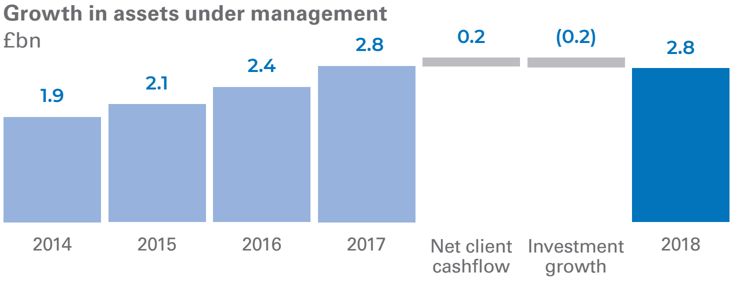
Movestic has delivered a stable set of results across key financial metrics and shows resilience in a negative investment market environment. Its new business operation continues to add value to the group and assets under management growth as a result of positive net client cash flow continues to support the division in achieving its ambitions on scale. The division will continue to focus on its IT streamlining plans, which are anticipated to bring cost efficiencies and improvements in broker and policyholder experience.

## FUTURE PRIORITIES

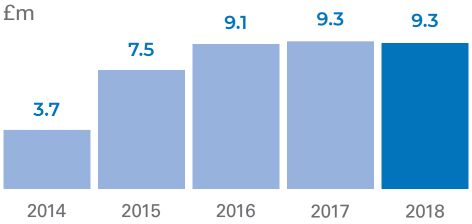
- Continue the journey of digitising and automating processes, with a view to improving both efficiency and control.
- Continue to develop more digitised and individualised customer proposition and experience.
- Provide a predictable and sustainable dividend to Chesnara.

## KPIs ALL COMPARATIVES HAVE BEEN PRESENTED USING 2018 EXCHANGE RATES

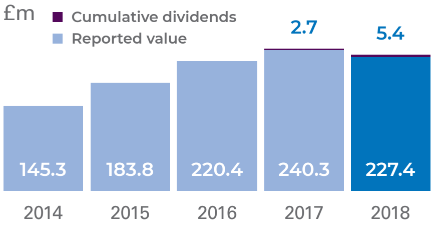
**Growth in assets under management**
£bn




**IFRS profit**
£m

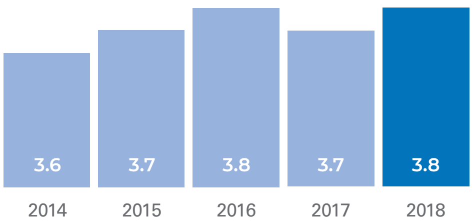



**Economic Value**
£m




- Continue to develop new solutions and tools to support the brokers' value-enhancing customer proposition.

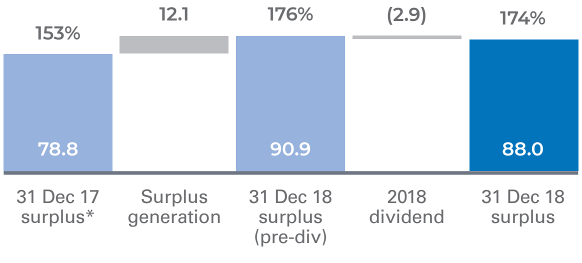
**Broker assessment rating**




POLICYHOLDER AVERAGE INVESTMENT RETURN:
**(6.0) %**
(SWEDISH STOCK MARKET (7.7)%)

- Continue to deliver compliance with the IDD. The IDD seeks to improve consumer protection and transparency within the distribution of insurance-based products.
- Deliver IFRS 17 implementation plans.

SOLVENCY RATIO: **176 %**

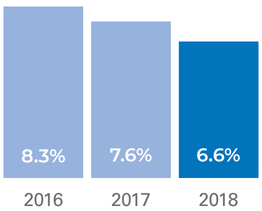



**Solvency remains strong at 176%. Solvency surplus of £12.1m has been generated in the period. After the dividend, due to be paid during 2019, the ratio is 174%.**

*As previously reported.

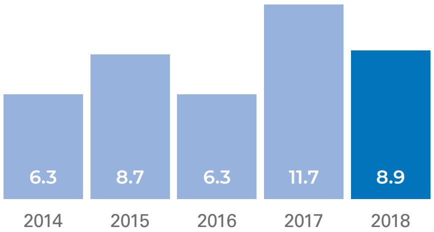
- Continue to focus on writing new business within the target range.
- Ongoing digitalisation of processes to improve customer and broker experience.
- Focus on increasing brand awareness.

**Occupational pension market share %**




**Market shares have been restated to better reflect the market excluding increments. On the restated base our target range becomes 6.5% to 10.0%.**

**New business profit**
£m



# BUSINESS REVIEW • NETHERLANDS

Our Dutch division consists of two separate businesses; Scildon and Waard. Scildon, acquired in 2017, is an open business, writing new policies focusing on three product markets via a broker network. Scildon is a well-established player in the term assurance market, the current market leader in unit-linked savings insurance and is a challenger brand in the Dutch defined contribution pension insurance market. Waard manages c100,000 policies and is in runoff, focusing on the efficient administration of its existing book of business.

## 01 MAXIMISE VALUE FROM EXISTING BUSINESS

| | BACKGROUND INFORMATION | INITIATIVES & PROGRESS IN 2018 |
|---|---|---|
| **CAPITAL & VALUE MANAGEMENT** | – Both Scildon and Waard have a common aim to make capital available to the Chesnara group to fund further acquisitions or to contribute to the dividend funding. Whilst their aims are common, the dynamics by which the businesses add value differ:<br>• Waard is in run-off and has the benefit that the capital requirements reduce in-line with the attrition of the book.<br>• As an open business, Scildon's capital position does not benefit from book run-off. It therefore adds value and creates surplus capital through writing new business and by efficient operational management and capital optimisation. | – During 2018, Waard and Scildon paid dividends to Chesnara of £12.9m and £21.7m. Further combined distributions of £8.4m are due in 2019 in respect of 2018.<br>– Including the impact of foreign exchange, Scildon has reported an EcV loss of £30.0m with Waard delivering a profit of £2.3m. The loss in Scildon is primarily driven by adverse asset valuation movements from widening credit spreads on corporate and certain government bonds together with updated mortality assumptions to reflect the latest industry data.<br>– Cash utilisation of £10.0m, representing a £7.8m gain from Waard primarily due to SCR reductions, offset by a cash loss of £17.8m from Scildon.<br>– IFRS profit of £1.7m reflects a £2.8m profit in Waard offset by a £1.1m loss in Scildon.<br>– Progressed a focused plan for Scildon to drive improvements in new business development, cost management and organisational structure.<br>– Aligned some functions between the two Dutch businesses to provide operational efficiencies. |
| **CUSTOMER OUTCOMES** | – Great importance is placed on providing customers with high quality service and positive outcomes.<br>– Whilst the ultimate priority is the end customer, Scildon also see the brokers who distribute their products as being customers and hence developing processes to best support their needs is a key focus. | – Updated the Scildon service desk to enhance the 'customer journey' for IFAs and consumers.<br>– Scildon has again received an award from Afdiz, the Dutch broker organisation. In 2018, the business was awarded 'Best Occupational Pension Insurer' and was rated second for term insurance.<br>– The annual performance research for consumers shows high scores. |
| **GOVERNANCE** | – Waard and Scildon operate in a regulated environment and comply with rules and regulations from both a prudential and financial conduct point of view. | – Scildon has aligned its governance and risk management framework to Chesnara practices.<br>– Scildon strengthened its governance framework during 2018 through changes in structure and personnel.<br>– The IFRS 17 project is underway for both companies.<br>– Implemented GDPR, in line with regulatory requirements, in both companies. |

## 03 ENHANCE VALUE THROUGH PROFITABLE NEW BUSINESS

| | | |
|---|---|---|
| **PROFITABLE NEW BUSINESS** | – Scildon primarily sells protection and individual savings contracts via a broker-led distribution model. The aim is to deliver meaningful value growth from a realistic market share. Having realistic aspirations regarding volumes means we are able to adopt a profitable pricing strategy. New business also helps the business maintain scale and hence contributes to unit cost management. | – Scildon generated new business profits of £1.7m. This is in line with expectations and shows marginal increases since acquisition but it is not currently generating sufficient new business profits and this is therefore a focus of our improvement plans.<br>– As part of those plans, Scildon successfully launched a new mortgage term product in 2018, which was well received by the market.<br>– A Scildon management team is in place which is strategically aligned with the group, including the appointment of a new Finance Director and interim Chief Operating Officer.<br>– Market share for the core protection business is within the 5.0%-10.0% target range but we have further work to do to strengthen the proposition and reduce costs.<br>– The number of policies increased by 4% over the year.<br>– Scildon updated the group pension offering to maximise value transfers and premium levels. |

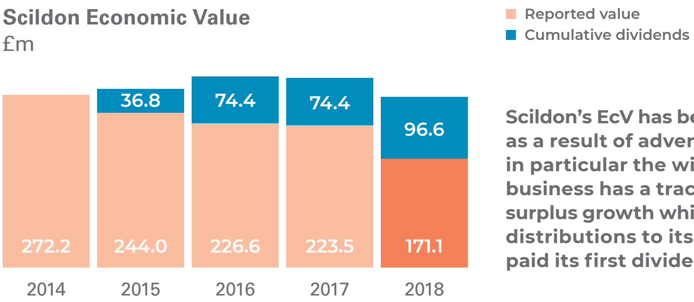
2018 has seen positives for the Dutch division, including dividend payments to Chesnara from both Scildon and Waard with further dividends to be received during 2019. Waard continues to deliver in line with expectations and the integration of Scildon into the group has continued in line with its improvement plan, with key steps taken including key organisational changes and the launch of its new mortgage term product. A senior management team is now in place which is more strategically aligned with the group. The benefits from the actions taken during 2018 have not been realised in the results thus far and as previously highlighted, there remains further work to do which is our focus for 2019. Economic conditions in 2018 have impacted results; however, these results do not have any bearing on the ongoing view of the cash and profit potential from the Scildon business.

## FUTURE PRIORITIES

– Continue dividends from both businesses to support the group dividend.
– Continuation of the Scildon improvement plan which will strengthen future cash generation and value growth. The plans include:
  - Process and value for money improvements, such as increased levels of 'straight through' processing;
  - Assessment of IT infrastructure to ensure it is able to facilitate efficient processes through a simplified approach with reduced delivery risk; and
  - Continual assessment of the business model to ensure an optimal balance between returns generated versus solvency capital requirements.

## KPIs ALL COMPARATIVES HAVE BEEN PRESENTED USING 2018 EXCHANGE RATES

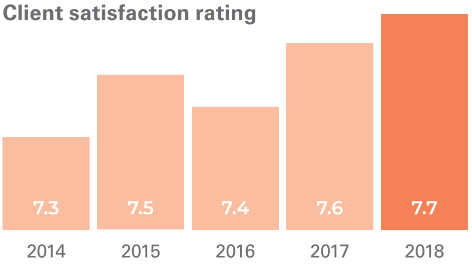
**Scildon Economic Value**
£m




**Scildon's EcV has been impacted in the year as a result of adverse market conditions, in particular the widening of spreads. The business has a track record of delivering surplus growth which has enabled dividend distributions to its parent company and paid its first dividend to Chesnara in 2018.**

– Continuing to enhance and develop Scildon's existing processes, customer experiences and the underlying infrastructure.
– Engage with brokers to support the development of our processes in conjunction with their requirements.
– Regular customer assessment, with the outcome used to improve Scildon's service quality.

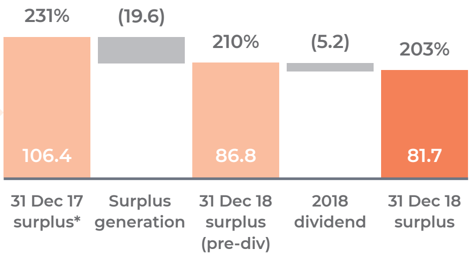
**Client satisfaction rating**




– The focus during 2019 is to further embed the governance and risk management framework.
– Deliver IFRS 17 implementation plans.

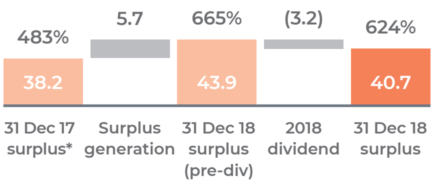
**The charts on the right show that solvency is strong in both businesses. Scildon has reported a reduction in surplus during 2018, largely due to increasing spreads reducing asset values. Waard has generated surplus capital of £5.7m. After the dividends, due to be paid during 2019, solvency ratios are 203% and 624% for Scildon and Waard respectively.**

SOLVENCY RATIO SCILDON: **210%**



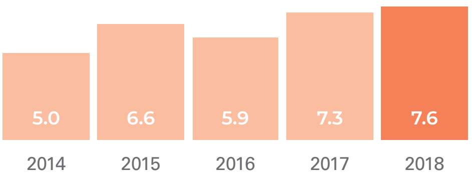

SOLVENCY RATIO WAARD: **665%**

*As previously reported.

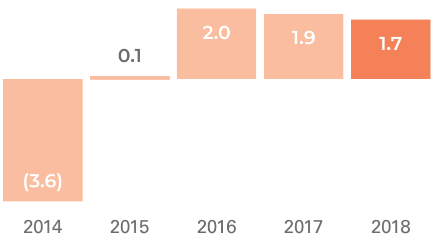



– Management actions are planned as part of the improvement plans to generate a more commercially meaningful level of new business profit.
– An objective of the improvement programme is to deliver cost reductions whilst strengthening the proposition and maintaining market share.

**Scildon term assurance market share %**




**Scildon new business profit**
£m



# 02 BUSINESS REVIEW • ACQUIRE LIFE & PENSIONS BUSINESSES

Well considered and appropriately priced acquisitions maintain the effectiveness of the operating model, create a source of value enhancement and sustain the cash generation potential of the group.

## HOW WE DELIVER OUR ACQUISITION STRATEGY

- Identify potential deals through an effective network of advisers and industry associates, utilising both group and divisional management expertise as appropriate.
- We primarily focus on acquisitions in the UK and Netherlands, although will consider other territories should the opportunity arise.
- 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 positive track record.
- We fund deals with a combination of debt, equity or cash depending on the size and cash flows of each opportunity.

## HOW WE ASSESS DEALS

| | |
|---|---|
| Cash generation | – Collectively our future acquisitions must be suitably cash generative to continue to fund the Chesnara dividend strategy. |
| Value optimisation | – Acquisitions are required to have a positive impact on the Economic Value per share under best estimate and certain more adverse scenarios. |
| Customer outcomes | – Acquisitions must ensure we protect, or ideally enhance, customer interests. |
| Risk appetite | – Acquisitions 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. |

## RISKS

- 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.
- There is the risk that we make an inappropriate acquisition that adversely impacts the financial strength of the group.
- Our acquisition strategy includes both UK and non-UK markets.

## WHAT WE CAN DO ABOUT THIS

- Operating in three territories increases our options thereby reducing the risk that no further value adding deals are done.
- A broader target market also increases the potential for deals that meet our strategic objectives.
- Flexibility over the timing of subsequent divisional dividend flows provide an element of management control over the sterling value of cash inflows.
- Each acquisition is supported by a financial deal assessment model which includes high quality financial analysis. This is reviewed and challenged by management and the board,mitigating the risk of a bad deal being pursued.

## ACQUISITION OUTLOOK

- In the UK, in recent times we have seen a gradual increase in closed book market activity which, in our view, is driven in part at a global level by regulatory developments and, at a company level, strategic developments. We expect these drivers to continue to be relevant going forward.
- Regarding the Netherlands, we have also seen a gradual increase in market activity which we are well positioned to take advantage of, given our scale and presence. Again, regulatory and strategic developments are the drivers, and we expect these themes to continue into the future.
- We continue to assess opportunities within Western Europe that are outside of Chesnara's current territories. All opportunities and territories considered are assessed on the basis that these do not compromise the well-established Chesnara acquisition assessment model, as well as ensuring that these fit within Chesnara's governance framework and that they are able to support our strategy and business model. There has been a reasonable level of market activity in Western Europe.
- The environment in which European life insurance companies operate continues to increase in complexity. For example, 'IFRS 17 Insurance Contracts' was issued in 2017, which is a fundamental overhaul of the way in which insurance contracts are accounted for. We believe this additional complexity will potentially drive further consolidation as institutions seek to remove operational complexity and potentially release capital or generate funds from capital intensive life and pension businesses.
- Chesnara is a well-established life and pensions consolidator with a proven track record. Our financial foundations are strong, we have an established and stringent acquisition assessment model, and we continue to have strong support from shareholders and lending institutions to progress our acquisition strategy. We believe our operating model has the flexibility to accommodate a wide range of potential target books. Our good network of contacts in the adviser community, who understand the Chesnara acquisition model, ensures we are aware of most viable opportunities in the UK and Western Europe. With this in mind, we are confident that we are well positioned to continue the successful acquisition track record in the future.
- In April 2018 we converted our existing debt arrangement with RBS into a syndicated facility. This will provide access to higher levels of debt financing from a wider panel of lenders, which in turn will enable us to fulfill our appetite of financing future deals up to the maximum levels of gearing set out in our debt and leverage policy, without being restricted by the lending capacity of one individual institution. This facility enables Chesnara to access an increased level of funds efficiently, which in turn supports our acquisition strategy.

# 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 Solvency II regime.
- The capital requirement is also 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 items 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 Funds 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.

**Restricted with profit surpluses**
Surpluses in the group’s with-profit funds are not recognised in Solvency II Own Funds despite their commercial value.

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, introduced as part of the long-term guarantee package when Solvency II was introduced, are available to temporarily increase Own Funds. Chesnara does not take advantage of such measures.

### HOW DO OWN FUNDS CHANGE?

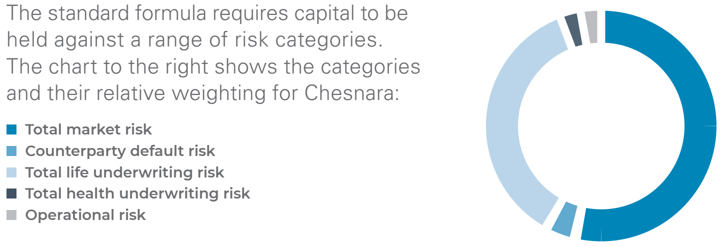
Own Funds (and EcV) are sensitive to economic conditions. In general, positive equity markets and increasing yields lead to OF growth and vice versa. Other factors that improve Own Funds include writing profitable new business, reducing the expense base and improvements to lapse rates.

## 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 chart to the right shows the categories and their relative weighting for Chesnara:




**There are three levels of capital requirement:**

**Minimum dividend paying requirement**
The board sets a minimum solvency level above the SCR which means a more prudent level is applied when making dividend decisions.

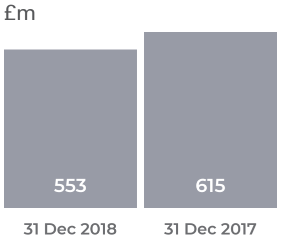
**Solvency capital requirement**
Amount of capital required to withstand a 1 in 200 event. The SCR acts as an intervention point for supervisory action including cancellation or the deferral of distributions to investors.

**Minimum capital requirement (MCR)**
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?

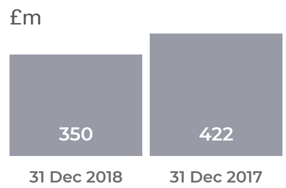
Given the largest component of Chesnara’s SCR is market risk, changes in investment mix or changes in the overall value of our assets has the greatest impact on the SCR. For example, equity assets require more capital than low risk bonds. Also, positive investment growth in general creates an increase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

## CHESNARA GROUP OWN FUNDS




| | Group solvency ratio | Group solvency surplus |
|---|---|---|
| 31 Dec 2018 | 158% | £202.4m |
| 31 Dec 2017 | 146% | £193.4m |

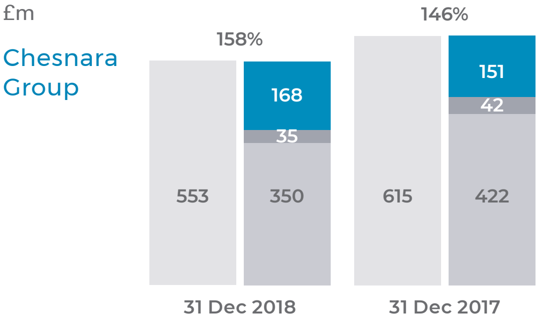
## CHESNARA GROUP SCR



# CAPITAL MANAGEMENT • SOLVENCY II (CONTINUED)

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

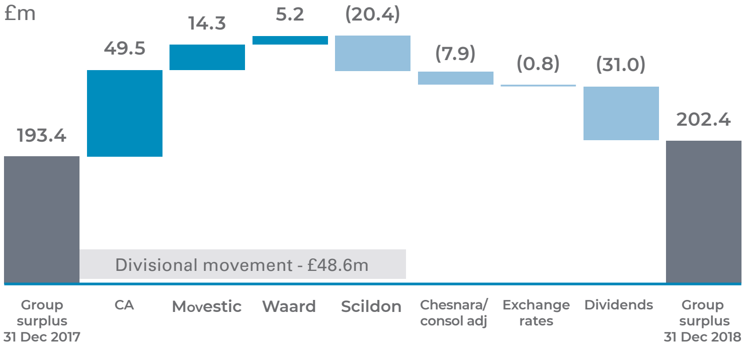
## SOLVENCY POSITION




**Surplus:** The solvency position of the group has improved, from 146% to 158%. The group now has £168.0m of surplus over and above the internal capital management policy, compared to £151.2m at the end of 2017. The growth in surplus has arisen from a reduction in capital requirements, which have fallen more than the reduction in Own Funds.

**Dividends:** The closing solvency position is stated after deducting the £20.2m proposed dividend (31 December 2017: £19.6m), and also reflects the payment of an interim dividend of £10.8m.

## SOLVENCY SURPLUS MOVEMENT

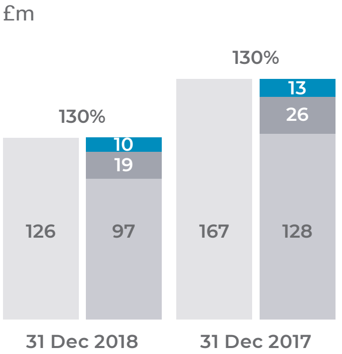



**Own Funds:** Own Funds have fallen by £62.6m. This is driven by falls in equity markets during the year, in particular during Q418, which had a significant impact on Movestic and CA. In addition, rising spreads have reduced the value of the bond holdings, which particularly affects Scildon. The depreciation of the Swedish krona has also caused a reduction in the sterling value of the Swedish business.

**SCR:** The SCR has fallen by £72.2m this year. The key movements underlying this are reductions in equity risk, spread risk, currency risk and lapse risk.

The graphs below present a divisional view of the solvency position which may differ to the position of the individual insurance company(ies) within that division. Note that prior year figures have been restated using 31 December 2018 exchange rates.

## UK



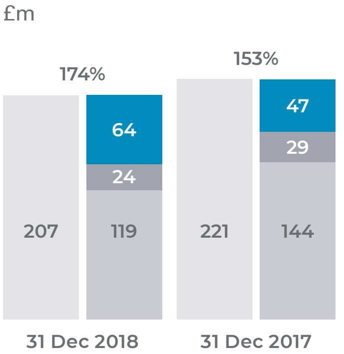

**Surplus:** £9.8m above board's capital management policy.

**Dividends:** The solvency position is stated after deducting £59.0m proposed dividend (2017: £32.0m).

**Own Funds:** Increased by £18.0m (pre-dividend) due to the transfer of £26.8m capital from WP funds, partially offset by negative economic variances.

**SCR:** Reduced by £31.5m, driven by market risk falls. Equity risk has reduced, due to equity market falls (which also has knock-on impacts on currency and lapse risk). Spread risk also reduced due to falls in corporate bond exposure and improvements in asset data.

## SWEDEN



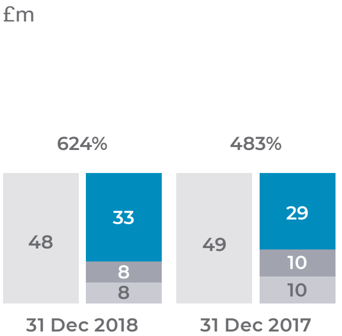

**Surplus:** £64.2m above board's capital management policy.

**Dividends:** The solvency position is stated after deducting £2.9m proposed dividend (2017: £2.8m).

**Own Funds:** Reduced by £17.8m (pre-dividend). Driven by falls in investment returns (in particular equities during Q4), strengthening of assumptions (operating expense and transfer rates) and the loss in GBP caused by the relative depreciation of the Swedish krona against sterling.

**SCR:** Capital requirements have fallen by £25.0m. Market risk has fallen, driven by the equity market falls during the year.

## NETHERLANDS – WAARD



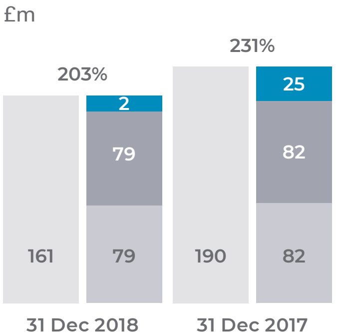

**Surplus:** £32.9m above board's capital management policy.

**Dividends:** The solvency position is stated after deducting £3.2m proposed dividend (2017: £13.0m).

**Own Funds:** Positive growth of £3.5m (pre-dividend), due to expected returns and changes in assumed mortality rates.

**SCR:** Reduced by £2.2m, due to a reduction in counterparty default risk following Chesnara dividend payment, which reduced cash holdings, and reduced underwriting risk following change in demographic assumptions.

## NETHERLANDS – SCILDON




**Surplus:** £2.5m above board's capital management policy.

**Dividends:** The solvency position is stated after deducting £5.2m proposed dividend (2017: £22.2m).

**Own Funds:** Reduction of £21.8m (pre-dividend), principally due to rising spreads and strengthening of the mortality assumptions.

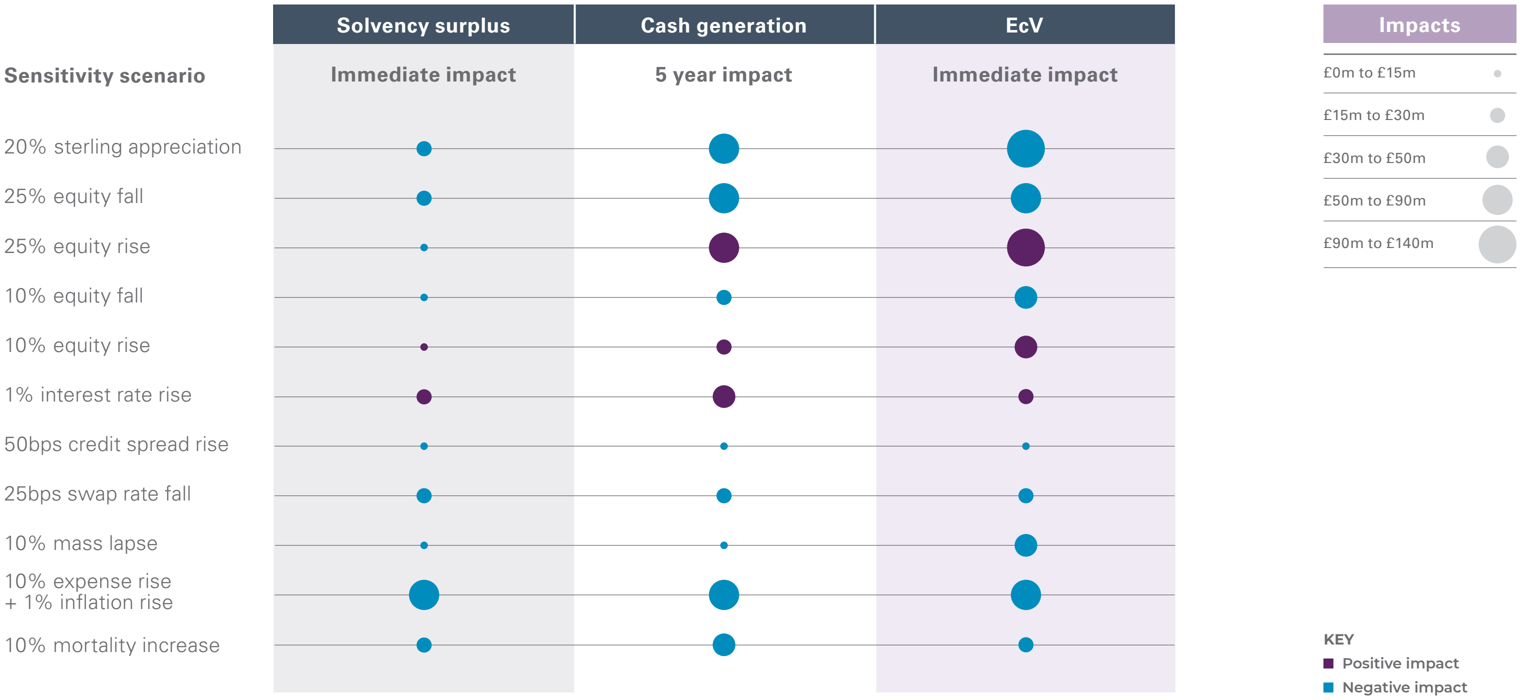
**SCR:** Decreased by £2.3m. Spread risk has fallen (due to rising spreads reducing corporate bond values) and lapse risk has reduced (due to higher mortality assumptions reducing profits). This is offset to some extent by increases in currency risk and mortality risk, in addition to changing tax rates having an adverse impact on capital requirements.

KEY Own Funds (Post Div) SCR Buffer Surplus above buffer

# CAPITAL MANAGEMENT • SENSITIVITIES

The group's solvency position can be affected by a number of factors over time. As a consequence, the group's EcV and cash generation, both of which are derived from the group's solvency calculations, are also sensitive to these factors.

The diagram below provides some insight into the immediate and longer-term impact of certain sensitivities that the group is exposed to, covering solvency, cash generation and Economic Value. As can be seen, EcV tends to take the 'full force' of adverse conditions whereas cash generation is often protected in the short-term and, to a certain extent, in the longer-term due to compensating impacts on our required capital.




## INSIGHT*

### 20% sterling appreciation
A material sterling appreciation reduces the translated value of surplus in our overseas divisions, and hence has an immediate impact on the group's solvency surplus and available cash. It also reduces the value of projected Own Funds growth in our overseas divisions and also reduces the value of overseas investments in CA.

### Equity sensitives
The equity fall sensitivities cause both the Own Funds and SCR to fall, as the value of the funds exposed to risk is lower. The reduction in SCR is smaller than Own Funds, resulting in an immediate impact on surplus. Conversely, in an equity rise, the Own Funds and SCR both rise. The extent to which the SCR increase offsets the Own Funds movement depends on the stress applied. The impacts are not symmetrical due to the use of management actions and differences in the application of tax depending on the direction of the stress. The EcV impacts are more intuitive as they are more directly linked to the Own Funds impact. CA and Movestic contribute the most due to their large amounts of unit-linked business.

### 1% interest rate rise
An interest rate rise is generally positive across the group. CA, Movestic and Scildon all contribute towards the total group cash generation impact.

### 50bps credit spread rise
A credit spread rise has an adverse impact on surplus and future cash generation, particularly in Scildon due to the corporate bond holdings that form part of the asset portfolios backing non-linked insurance liabilities. The impact on the other divisions is less severe.

### 25bps swap rate fall
This sensitivity measures the impact of a fall in the swap discount curve with no change in the value of assets. The result is that liability values increase in isolation. The most material impacts are on CA and Scildon due to the size of the non-linked book.

### 10% mass lapse
This sensitivity has a small impact on surplus as the reduction in Own Funds is largely offset by the SCR fall. However, with fewer policies on the books there is less potential for future profits. The division most affected is Movestic; the loss in future fee income following a mass lapse hits Own Funds by more than the associated reduction in SCR.

### 10% expense rise + 1% inflation rise
The expense sensitivity hits the solvency position immediately as the increase in future expenses and inflation is capitalised into the balance sheet.

### 10% mortality increase
This sensitivity has an adverse impact on surplus and cash generation, particularly for Scildon due to their term products.

### *BASIS OF PREPARATION ON REPORTING
Although it is not a precise exercise, the general aim is that the sensitivities modelled are deemed to be broadly similar (with the exception that the 10% equity movements are naturally more likely to arise) in terms of likelihood. Whilst the sensitivities provide a useful guide, in practice, how our results react to changing conditions is complex and the exact level of impact can vary due to the interactions of events and starting position.

# FINANCIAL REVIEW

The key performance indicators are a reflection of how the business has performed in delivering its three strategic objectives. The 2018 results reflect the impact of equity falls and bond price pressure that was witnessed during the year.

## IFRS PRE-TAX PROFIT

**£27.0M** 2017: £89.6M

## TOTAL COMPREHENSIVE INCOME

**£23.7M** 2017: £86.9M

Further detail on page 36

### What is it?

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?

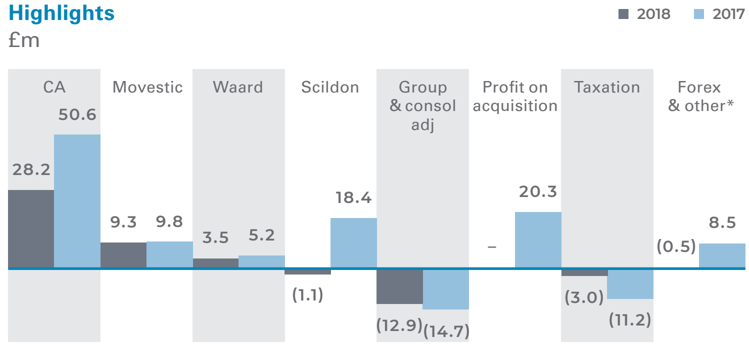
IFRS profit is a statutory measure used both internally and by our external stakeholders in assessing the performance of the business. IFRS profit is an indicator of how we are performing against our stated strategic objective of ‘maximising value from the existing business’ and can also be impacted by one-off gains arising from delivering against our stated objective of ‘acquiring life and pensions businesses’. Whilst the IFRS results form the core of reporting and hence retain prominence as a key financial performance metric, there is a general acceptance that the IFRS results in isolation do not adequately recognise the wider financial performance of a typical life and pensions business.

### Risks

The IFRS profit can be affected by a number of our principal risks and uncertainties as set out on pages 42 to 45. 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. The IFRS results of Scildon are potentially relatively volatile, in part, due to the different approach used by the division for valuing assets and liabilities, as permitted under IFRS 4.

### Highlights

£m




*includes other comprehensive income

- IFRS pre-tax profit of £27.0m is significantly lower than in the prior year, owing largely to economic losses in the closing months of 2018 and the profit on the acquisition of Scildon that was reported in 2017.
- The performance in CA is the major contributor to the group result.
- Operating profits of £42.5m are the foundation of the result, demonstrating the resilience and stability of the underlying business, offset in part by economic losses, driven by markets conditions.
- Total comprehensive income includes a small foreign exchange loss of £0.8m (2017: £8.3m gain) predominantly relating to sterling’s appreciation against the Swedish krona.

## GROUP CASH GENERATION

**£47.8M** 2017: £28.6M

## DIVISIONAL CASH GENERATION

**£63.9M** 2017: £86.7M

Further detail on page 37

### What is it?

Cash generation is calculated as being the movement in surplus own funds over the internally required capital. The internally required capital is determined with reference to the group’s capital management policies, which have Solvency II rules at their heart. Cash generation is used by the group as a measure of assessing how much dividend potential has been generated, subject to ensuring other constraints are managed.

### Why is it important?

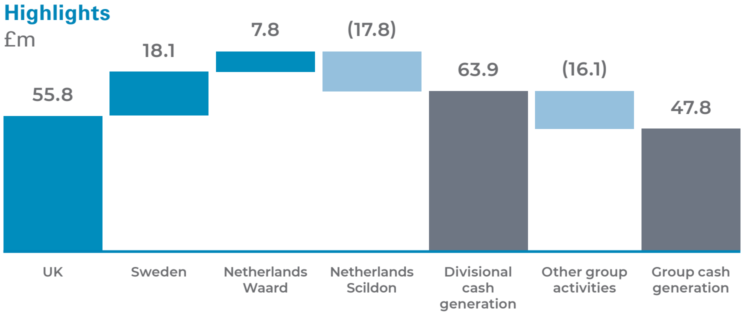
Cash generation is a key measure, because it is the net cash flows to Chesnara from its life and pensions businesses which support Chesnara’s dividend-paying capacity and acquisition strategy. Cash generation can be a strong indicator of how we are performing against our stated objective of ‘maximising 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 42 to 45. 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

£m




### Divisional cash generation

- Significant cash generation from the UK, with strong contributions again from Movestic and Waard. Adverse economic conditions were the primary basis for the reduction in Scildon’s Own Funds and subsequent negative cash result.
- The result includes the non-recurring benefit of a £26.8m capital transfer from restricted with profit funds in the UK.

### Group cash generation

- Total group cash generation includes the impact of other group activities, primarily the impact of group expenses on own funds and changes to capital requirements upon consolidation of divisions.
- Group cash generation in 2017 included the negative impact of the completion of the Legal & General Nederland acquisition (£55.3m).

These two pages provide a 'snapshot' of our key financial measures and some insight into what's driving the outcome in 2018. Further analysis can be found on pages 36 to 39.

## ECONOMIC VALUE (ECV)

**£626.1M** 2017: £723.1M

Further detail on page 39

**What is it?**

Economic Value (EcV) was 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 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.

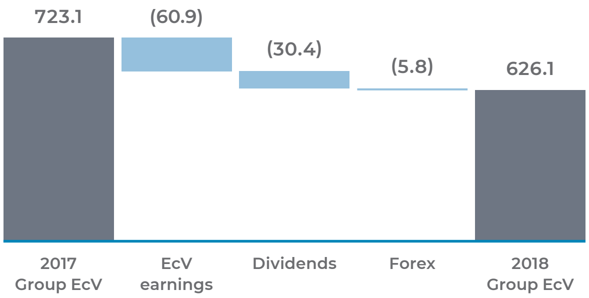
The EcV development of the Chesnara group over time can be a strong indicator of how we have delivered to our strategic objectives, in particular the value created from acquiring life and pensions businesses and enhancing our value through writing profitable new business. It ignores the potential of new business to be written in the future (the franchise value of our Swedish and Dutch businesses) 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, the EcV position of the group can be materially affected by exchange rate fluctuations. For example a 20.0% weakening of the Swedish krona and euro against sterling would reduce the EcV of the group by 14.7%, based on the composition of the group's EcV at 31 December 2018.

**Highlights**

£m




- EcV fell by 13.4% to £626.1m during the year.
- Of this reduction, £60.9m was attributable to an earnings loss, primarily a consequence of adverse economic conditions with falling equity values and widening bond spreads. However, an adverse operating result has also contributed to the loss.
- The movement in EcV since the start of the year includes the impact of the payment of the final 2017 and interim 2018 dividends.
- Foreign exchange losses arising on re-translating of the Dutch and Swedish divisions have contributed to the overall reduction, primarily representing the strengthening of sterling against the Swedish krona since the start of the year.

## ECV EARNINGS

**£(60.9)M** 2017: £139.5M (includes £65.4m gain on acquisition)

Further detail on page 38

**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 earnings 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; and
- 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 EcV earnings of the group can be a strong indicator of how we have delivered against all three of our core strategic objectives.

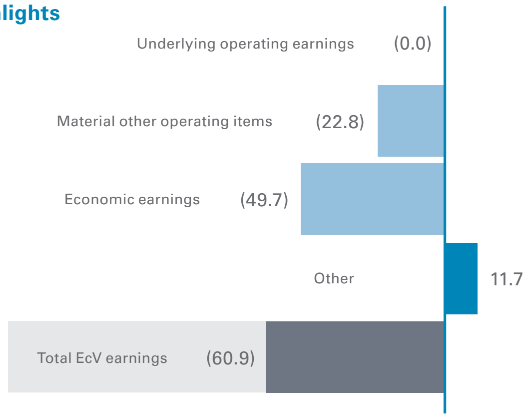
This includes new business profits generated from writing profitable new business, EcV profit emergence from our existing businesses, and the Economic Value impact of acquisitions.

**Risks**

The EcV earnings of the group can be affected by a number of factors, including those highlighted within our principal risks and uncertainties and sensitivities analysis as set out on pages 42 to 45. 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**

£m




- An EcV loss of £60.9m was incurred during the year.
- The underlying operating performance was nil, with positive mortality experience offset by adverse expense and lapse results.
- Material other operating items primarily relates to the strengthening of mortality assumptions in Scildon.
- Economic losses represent the largest component of the EcV loss, driven by equity falls and rising spreads.
- EcV earnings in the prior year benefitted from a one off gain of £65.4m arising as a result of the completion of the acquisition of Legal & General Nederland.

# FINANCIAL REVIEW • IFRS

## IFRS PRE-TAX PROFIT

**£27.0M** 2017: £89.6M

## IFRS TOTAL COMPREHENSIVE INCOME

**£23.7M** 2017: £86.9M

**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 core CA (excluding the S&P book) 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.

**2) Variable element:** Included within the CA segment is the S&P book. This can bring an element of short-term earnings volatility to the group, with the results being particularly sensitive to investment market movements due to product guarantees. The IFRS results of Scildon are potentially relatively volatile although this is, in part, due to reserving methodology rather than 'real world' value movements.

**(3) Growth operation:** The long-term financial models of Movestic and Scildon are 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.

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

| | 2018 £m | 2017 £m | Note |
|---|---|---|---|
| CA | 28.2 | 50.6 | 1 |
| Movestic | 9.3 | 9.8 | 2 |
| Waard Group | 3.5 | 5.2 | 3 |
| Scildon | (1.1) | 18.4 | 4 |
| Chesnara | (5.5) | (12.1) | 5 |
| Consolidation adjustments | (7.4) | (2.6) | 6 |
| **Profit before tax and profit on acquisition** | **27.0** | **69.3** | |
| Profit on acquisition | – | 20.3 | 6 |
| **Profit before tax** | **27.0** | **89.6** | |
| Tax | (2.9) | (11.2) | |
| **Profit after tax** | **24.1** | **78.4** | |
| Foreign exchange translation differences | (0.8) | 8.3 | 7 |
| Other comprehensive income | 0.3 | 0.2 | |
| **Total comprehensive income** | **23.7** | **86.9** | |

**Note 1.** The CA segment result remains strong but is lower than 2017. The year on year movement emerges within the more variable S&P book. This is mainly reflective of the positive economic factors in 2017 which have not been repeated in the current period, resulting in overall economic profits being circa £23m lower year on year. Operating profits of £27.1m are in line with the prior year. Within the operating profit total there is a £4.3m profit as a result of a general improvement in UK mortality tables.

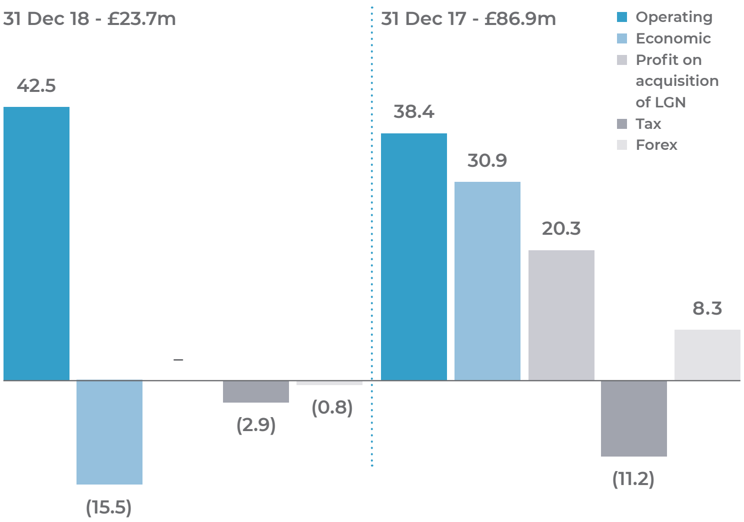
**Note 2**. Movestic continues to contribute positively to the overall group IFRS result despite a small reduction in profits when compared to the same period in 2017. Lower investment returns due to adverse market factors, together with a fall in the profits generated by its associate, Modernac, were the main drivers.

**Note 3**. The Waard Group result is in line with expectations, with profits emerging in line with the run-off book profile.

**Note 4.** Scildon's IFRS loss for the year of £1.1m compares with a profit of £18.4m in the prior year. Scildon has delivered a strong operating profit driven mainly by positive mortality experience. Within the Netherlands new mortality tables suggest less positive future mortality improvements, this however, because of our reserving policy (see note 31) has no impact on the IFRS results. The operating profit is more than offset by economic losses of £16.5m, largely driven by the widening of credit spreads which have caused valuation losses in its bond portfolio.

| | 2018 £m | 2017 £m | Note |
|---|---|---|---|
| Operating profit | 42.5 | 38.4 | 8 |
| Economic profit | (15.5) | 30.9 | 9 |
| **Profit before tax and profit on acquisition** | **27.0** | **69.3** | |
| Profit on acquisition | – | 20.3 | 6 |
| **Profit before tax** | **27.0** | **89.6** | |
| Tax | (2.9) | (11.2) | |
| **Profit after tax** | **24.1** | **78.4** | |
| Foreign exchange | (0.8) | 8.3 | 7 |
| Other comprehensive income | 0.3 | 0.2 | |
| **Total comprehensive income** | **23.7** | **86.9** | |

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




**Note 5.** The Chesnara result largely represents holding company expenses. The current year loss is significantly lower than last year largely due to 2017 including larger one off items such as foreign exchange loss of £2.6m coupled with the impact of providing for the group's IFRS 17 programme.

**Note 6.** Consolidation adjustments relate to items such as the amortisation of intangible assets. These are higher than last year largely due to the full year impact of the Scildon acquisition and an adjustment to the impairment of acquisition costs within Movestic. The prior year results also reported a one off gain of £20.3m arising on the acquisition of LGN.

**Note 7.** Sterling strengthened against the Swedish krona in the period, resulting in a small exchange loss in 2018.

**Note 8.** The IFRS operating result demonstrates the stability of the underlying business. Product based income and favourable movements in operating experience in the UK, were offset slightly by the marginal strengthening of expense reserves to support future developments. Strong premium growth and higher fund rebates, offset by unfavourable claims experience in the year supported the Movestic operating result. Both the Waard Group and Scildon have reported solid operating results.

**Note 9.** Economic profit represents the components of the earnings that are directly driven by movements in economic variables. During 2018, the economic result is mainly driven by the impact on Scildon of widening credit spreads, whereas 2017 benefitted from positive equity market growth which has not been witnessed in the same period in 2018.

# FINANCIAL REVIEW • CASH GENERATION

## GROUP CASH GENERATION

**£47.8M** 2017 £28.6M

## DIVISIONAL CASH GENERATION

**£63.9M** 2017: £86.7M

Significant cash generation in the UK has driven a total divisional cash result of £63.9m for the year, with supporting contributions from Movestic and Waard. Cash is generated from increases in the group's solvency surplus, which is represented by the excess of assets held over management's internal capital needs. These are based on regulatory capital requirements, with the inclusion of additional 'management buffers'.

## GROUP

- Sufficient group cash has been generated in the year to cover the cost of last year's dividend.
- The overall increase in group cash year on year is a factor of several material items. The 2017 result includes the impact of the completion of the Legal & General Nederland (Scildon) acquisition which, in line with expectations, resulted in a £55.3m negative impact on cash generation. A £26.8m release from the with-profit funds has driven a sizeable increase in UK cash in 2018. In the opposite direction there has been a £34m adverse year on year movement in Scildon's cash generation. Much of the movement is due to the fact that economic conditions had a positive impact on Own Funds in 2017 whereas in 2018 falling bond values resulted in Own Funds losses of over £20m. A strengthening of mortality assumptions also had an adverse impact in 2018.
- Other group activities reflect group expenses and the impact of consolidation routines, specifically movements in capital requirements determined at a group level. From a capital requirement 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, additional capital is principally required to be held for the currency risk associated with the Movestic, Scildon and Waard Group surplus assets.

| 2018 £m | Movement in Own Funds | Movement in management's capital requirement | Forex impact | Cash generated | 2017 £m Cash generated |
|---|---|---|---|---|---|
| UK | 18.0 | 37.8 | – | **55.8** | **34.5** |
| Sweden | (10.7) | 30.1 | (1.3) | **18.1** | **24.9** |
| Netherlands – Waard Group | 3.0 | 4.6 | 0.2 | **7.8** | **11.1** |
| Scildon | (23.5) | 6.2 | (0.4) | **(17.8)** | **16.2** |
| **Divisional cash generation** | **(13.2)** | **78.6** | **(1.4)** | **63.9** | **86.7** |
| Other group activities | (13.6) | (3.6) | 1.0 | **(16.1)** | **(2.7)** |
| Impact of LGN acquisition | | | | – | **(55.3)** |
| **Group cash generation** | **(26.8)** | **75.0** | **(0.4)** | **47.8** | **28.6** |

## UK

- The UK has continued to deliver substantial cash generation in 2018, following significant reductions in capital requirements.
- Own Funds (OF) growth includes the benefit of a £26.8m release of restricted surplus from the with-profit funds. A further £5.7m of surplus capital exists within the with-profit funds that has not been recognised in the results.
- Underlying Own Funds performance was hampered by investment markets in the later stages of the year, with widening spreads having a negative impact on Own Funds.
- The fall in equity markets also had a positive effect on cash generation due to the subsequent reduction in required capital through lower equity and mass lapse risk.
- This was supported by further reductions in equity risk and spread risk, following the capital transfer.

## NETHERLANDS – WAARD

- The Waard Group has continued to supply stable cash generation, with positive movements in both Own Funds and capital requirements.
- The growth in Own Funds was primarily a consequence of lower mortality experience and subsequent reductions in assumed mortality lapse rates.
- Falls in lapse risk and counterparty default risk underpin the reduction in the capital requirement.

## SWEDEN

- Sweden generated £18.1m of cash for the year, due to a fall in the level of required capital.
- Own Funds suffered from the decline in equity markets in the second half of 2018, with lower fund values and investment returns resulting in a reduction of £10.7m at the year end.
- Conversely, the fall in investment markets also created a significant positive cash impact. With equity values decreasing, the level of capital the business was required to hold also fell substantially, primarily through lower equity risk exposure and diminished lapse risk.
- SEK depreciation against sterling resulted in an exchange loss of £1.3m.

## NETHERLANDS – SCILDON

- Scildon has reported a cash loss in the year, owing to a reduction in Own Funds.
- The steep widening of spreads in the second half of the year compounded the valuation losses on Italian bonds reported earlier in 2018, driving down the value of Own Funds.
- Own Funds also include the impact of strengthening mortality assumptions in the year.
- Capital requirements moved favourably to partially offset the reduction in Own Funds. Investment market conditions had a positive impact with exposure to spread risk and equity risk shrinking materially in the second half of the year. This also drove significant favourable movements in lapse risk.

# FINANCIAL REVIEW • ECV EARNINGS

## ECV EARNINGS

**£(60.9)M** 2017: £139.5M*

*includes £65.4m gain on acquisition

The group's EcV earnings reflect the challenging investment market conditions that have been witnessed, including the general fall in equity prices during Q4.

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

| | 31 Dec 2018 £m | 31 Dec 2017 £m | Note |
|---|---|---|---|
| Expected movement in period | (0.8) | 0.2 | |
| New business | 10.6 | 12.4 | |
| Operating experience variances | (9.0) | 1.2 | 2 |
| Operating assumption changes | – | (3.6) | |
| Other operating variances | (0.8) | 0.7 | |
| **Total underlying operating earnings** | – | **10.8** | |
| Material other operating items | (22.8) | (19.2) | 3 |
| **Total operating earnings** | **(22.8)** | **(8.4)** | |
| Economic experience variances | (50.3) | 86.4 | 1 |
| Economic assumption changes | 0.6 | 2.2 | |
| **Total economic earnings** | **(49.7)** | **88.6** | |
| Other non-operating variances | 1.5 | 1.0 | |
| Risk margin movement | (1.9) | 4.0 | |
| Gain on acquisition | – | 65.4 | 4 |
| Tax | 12.0 | (11.1) | |
| **Total EcV earnings** | **(60.9)** | **139.5** | |

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

| | 31 Dec 2018 £m | 31 Dec 2017 £m | Note |
|---|---|---|---|
| UK | (11.0) | 54.5 | 5 |
| Sweden | (11.6) | 24.0 | 6 |
| Netherlands | (35.6) | 21.8 | 7 |
| Gain on acquisition | – | 65.4 | |
| Group and group adjustments | (14.8) | (15.1) | 8 |
| **EcV earnings before tax** | **(72.9)** | **150.6** | |
| Tax | 12.0 | (11.1) | 9 |
| **EcV earnings after tax** | **(60.9)** | **139.5** | |

**Note 1. Economic conditions:** The EcV result is sensitive to investment market conditions. Some of the key investment market conditions in the year are as follows:

- The FTSE All share index has decreased by 13.0% (12 months to 31 Dec 2017: increased by 9.0%);
- The Swedish OMX all share index has decreased by 7.7% (12 months to 31 Dec 2017: increased by 5.7%);
- The Netherland AEX all share index has decreased by 11.6% (12 months to 31 Dec 2017: increased by 11.7%); and
- 10 year UK gilt yields have increased from 1.26% to 1.32%.

**Note 2. Operating experience variances:** These reflect where the results have emerged differently to what was assumed. The reported experience loss of £9.0m for 2018 is made up of a number of smaller positive and adverse variances, including less fee income for Movestic, some adverse lapse experience in Scildon coupled with some adverse expense experience across the group.

**Note 3. Material other operating items:** This includes operating items in the year that are individually material and have therefore been separately analysed to aid an understanding of the operating result. In accordance with local practice Scildon adopt centrally defined mortality tables. Whilst there is no reason to believe this creates prudence, it is worthy to note that the resultant strengthening of reserves (with an adverse profit impact of £13.2m) is at odds with recent experience of mortality profits on the Scildon book. The remainder of the total relates to model enhancements regarding quantifying risk margins in Scildon (£3.8m) and how we recognise certain future central recurring costs (£5.8m).

**Note 4. Gain on acquisition of LGN:** The acquisition of LGN in April 2017 resulted in a 'day 1' gain of £65.4m, representing the difference between the purchase price of £137.6m and the EcV of LGN at the point of acquisition of £203.0m.

**Note 5. UK:** The UK sustained a pre-tax loss of £11.0m in the year. Economic losses suffered in the second half of 2018 shape the result, with a full year economic loss of £15.0m. Falling equity markets in the later stages of the year were the key factor behind the reported loss. Solid operating earnings of £4.8m were driven by favourable movements in both future expense and mortality assumptions. This was supported by lower than expected rates of attrition across the books of business, resulting in higher assumed future fee income.

**Note 6. Sweden:** Movestic reported an £11.6m loss for the year, with the result significantly hampered by investment market conditions in the tail end of 2018. Economic losses of £12.8m, predominantly arising in Q4, were the consequence of falling equities and offset operational gains through new business. This was reflected by the closing policyholder average investment return of (6.0)% (2017: +8.2%), though this remains ahead of the average Swedish stock market return of (7.7)%. New business profits of £8.9m reflect the combination of increased sales volumes (both transfers and single premiums) but lower average margin rates versus prior year. This was partially offset by adverse movement in future fund management fee and fund rebate assumptions in line with industry expectations.

**Note 7. Netherlands:** Our Dutch division has reported a pre-tax loss of £35.6m for 2018. Investment market volatility, primarily a significant widening of bond spreads, underpin economic losses of £21.6m in Scildon. The total pre-tax loss of £38.8m also includes £17.0m of exceptional items, relating to one-off mortality assumption and modelling changes. Waard delivered earnings of £3.2m owing, for the most part, to favourable mortality experience and subsequent impact of a reduction in assumed mortality rates.

**Note 8. Group:** This component includes costs incurred at group level, dividend payments and the impact of consolidation activities, with a loss reported for the year.

**Note 9. Tax:** The business is reporting a tax credit of £12.0m in the year. This is driven by a combination of current tax on the loss for the period and movements in deferred tax relating to group level activities.

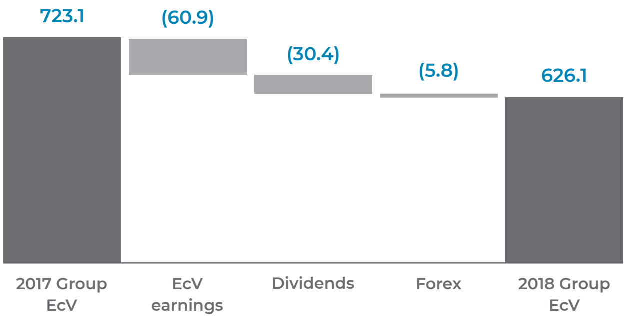
# FINANCIAL REVIEW • ECV

## ECV

**£626.1M** 2017: £723.1M

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 2018 to 31 Dec 2018**
£m

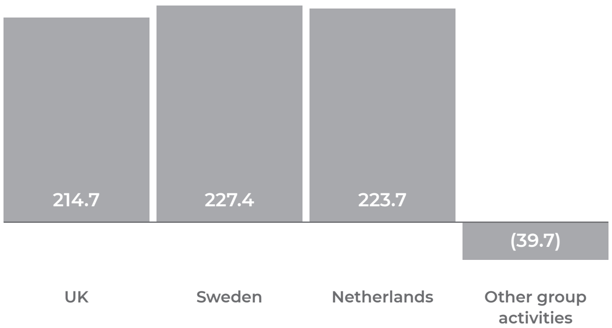



**EcV earnings:** A loss of £60.9m has been reported for the year. The primary driver of this are the significant economic losses arising from economic conditions in the second half of the year. This was compounded by a small number of individually material adverse operating items incurred in the year. Further detail can be found on page 38.

**Dividends:** Under EcV, dividends are recognised in the period in which they are paid. Dividends of £30.4m were paid during the period, being the final dividend from 2017 and the 2018 interim dividend.

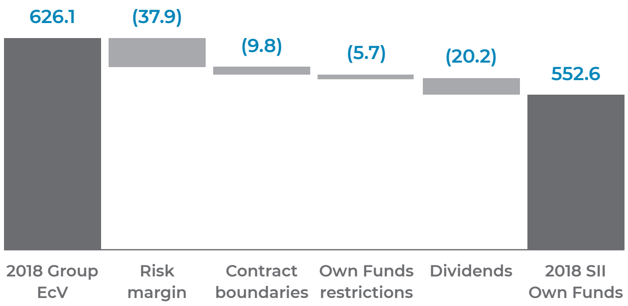
**Foreign exchange:** The EcV of the group suffered a foreign exchange loss in the period, a consequence of the sterling appreciation against the Swedish krona.

**EcV by segment at 31 Dec 2018**
£m




The above chart shows that the EcV of the group is diversified across its different markets, demonstrating that we are well-balanced and not over-exposed to one particular geographic market.

**EcV to Solvency II**
£m




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 3.25% 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.

**Dividends:** The proposed final dividend of £20.2m is recognised for SII regulatory reporting purposes. It is not recognised within EcV until it is actually paid.

# 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. |

## 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 | 4. Management actions |

## 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%. | 2016-2018 TSR 18.41%.<br><br>2018 dividend yield 5.4%.<br><br>Based on average 2018 share price and full year 2018 dividend of 20.67p. | Gearing ratio of 15.6%.<br><br>This does not include the financial reinsurance within the Swedish business. | Policyholders' reasonable expectations maintained.<br><br>Asset liability matching framework operated effectively in the year.<br><br>Sufficient liquidity in the Chesnara holding company. | Group remains a going concern.<br><br>(see page 41) |

## 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 15.6% at 31 December 2018 (19.8% at 31 December 2017).

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 12 months from which the Report and 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 3 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 32 indicates a strong solvency position as at 31 December 2018 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 86, the Financial Statements have continued to be prepared on a going concern basis.

**3. Assessment of prospects**

An understanding of the group's strategy and business model is central to assessing its prospects, and details can be found on pages 18 to 21.

Core books within our overall portfolio provide a level of more stable earnings, hence making the overall business and financial model more resilient to potential adverse movements on the books with more volatile earnings. In addition, in the short-term, solvency and cash are less affected by economic conditions which has a positive impact regarding confidence levels in our dividend paying capacity.

Our strategy of maximising value from our existing business, acquiring life and pensions businesses and enhancing value through profitable new business, is designed to support long-term and sustainable cash generation.

We assess our prospects on a regular basis through our financial planning process. Our 3 year medium-term group business plan forecasts the group's profitability, cash generation, economic value and solvency position and is reviewed by the board during the year.

The business plan is built from the bottom up forecasts of each of our business segments, supplemented by items managed at group level and assumptions to be used in the basis of preparation. The performance of the group and our business segments against these forecasts is monitored quarterly through a series of quarterly business reviews performed by the group executive and internal management information which is reviewed by the board.

The group also makes investments, such as life and pensions business acquisitions and longer-term business development programmes that have a business case beyond our core 3 year planning horizon. Significant expenditure of this nature is subject to a detailed business case being prepared and approved by the board.

**4. Longer-term viability statement**

In accordance with provision C.2.2 of the 2016 revision of the UK Corporate Governance Code, the directors have assessed the prospect of the company over a longer period than the 12 months required by the going concern provision. The board conducted this review for a period of 3 years because the group's business plan covers a 3 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;
- Credit spread rise;
- Swap rate fall;
- Adverse mortality and lapse experience;
- Adverse expense experiences;
- Reduced new business volumes; and
- Adverse exchange rate experience.

Other than the fact that Brexit could impact the investment markets to which our results are sensitive (see sensitivities on page 33) we consider that our operating model is relatively unaffected by Brexit. We do not trade across borders nor do we share resource between our European businesses. Each division operates to autonomous local regulatory frameworks and we believe we have the flexibility to change our regulatory structure if Brexit results in an inefficient regulatory structure of the organisation.

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 3 year period of their assessment.

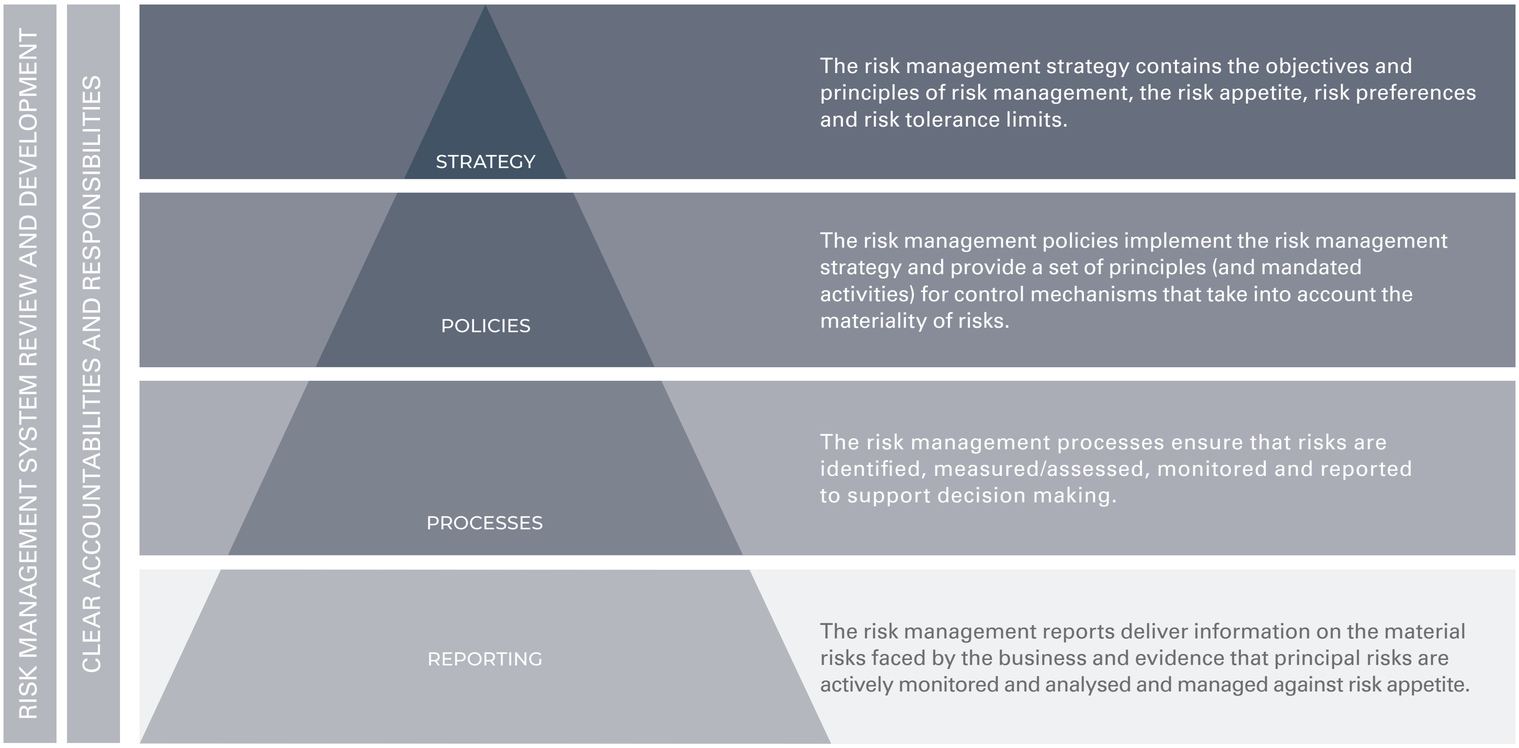
# RISK MANAGEMENT

Managing risk is a key part of our business model. We achieve this by understanding the current and emerging risks to the business, mitigating them where appropriate and ensuring they are appropriately monitored and managed.

## HOW WE MANAGE RISK

**RISK MANAGEMENT SYSTEM**

The risk management system supports the identification, assessment, and reporting of risks along with coordinated and economical application of resources to monitor and control the probability and/or impact of adverse outcomes within the board's risk appetite or to maximise realisation of opportunities.



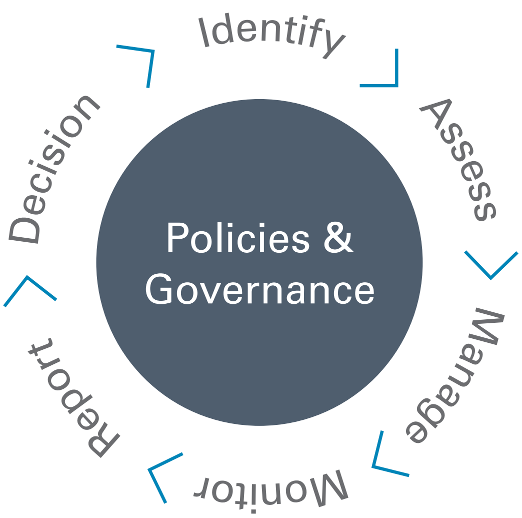

**RISK PROCESSES**

Risk management processes are applied at a group, divisional and business unit level and are documented within a set of board approved risk policies, for each category of risk.

**Chesnara adopts the 'three lines of defence' model across the group taking into account size, nature and complexity, with a single set of risk and governance principles applied consistently across the business.**

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.

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' (see pages 43 to 45). The outcome of this testing provides context against which the group can assess whether any changes to its risk appetite or to its management processes are required.



## CHESNARA RISK PREFERENCES

The Chesnara board has approved a set of risk preferences which articulate, in simple terms, the desire to increase, maintain, or reduce the level of risk taking for each main category of risk. The risk position of the business is monitored against these preferences using risk tolerance limits, where appropriate, and they are taken into account by the management teams across the group when taking strategic or operational decisions that affect the risk profile.

## PRINCIPAL RISKS AND UNCERTAINTIES

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 & Risk Committee of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity.

The impacts are not quantified in the table. However, by virtue of the risks being defined as principal, the impacts are potentially significant.

## RISK MANAGEMENT • PRINCIPAL RISKS AND UNCERTAINTIES

| RISK | IMPACT | CONTROL |
|---|---|---|
| **Exposure to financial losses or value reduction arising from adverse movements in investment markets, counterparty defaults, or through inadequate asset liability matching** | Market risk results from fluctuations in asset values, foreign exchange rates and interest rates and has the potential to affect the group's ability to fund its commitments to customers and other creditors, as well as pay a return to shareholders.<br><br>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 payment.<br><br>Other liquidity issues could arise from counterparty failures/credit defaults, a large spike in the level of claims or other significant unexpected expenses. | Chesnara performs regular monitoring of movements in the market and maintains matching programmes to ensure that exposure to any mismatching is at an acceptable level, forecasting cash requirements and adjusting investment management strategies to meet those requirements.<br><br>Chesnara seeks to limit the impacts of exposure to market risks by:<br><br>– Maintaining a well-diversified asset portfolio;<br>– Holding a significant amount of surplus in highly liquid 'Tier 1' assets such as cash and gilts;<br>– Utilising a range of investment funds and managers to avoid significant concentrations of risk;<br>– Having an established investment governance framework to provide review and oversight of external fund managers;<br>– Carrying out regular liquidity forecasts and asset and liability modelling; and<br>– Monitoring exchange rate movements. The group would consider the cost/benefit of hedging the currency risk on cash flows when appropriate.<br><br>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. |

## RISK MANAGEMENT • PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

| RISK | IMPACT | CONTROL |
|---|---|---|
| **Adverse changes in industry practice/ regulation, or inconsistent application of regulation across territories** | Chesnara currently operates in four regulatory domains (including Movestic's asset management company in Luxembourg) and is therefore exposed to inconsistent application of regulatory standards across divisions, such as the imposition of higher capital buffers over and above regulatory minimum requirements. Potential consequences of this risk for Chesnara is the constraining of efficient and fluid use of capital within the group, or creating a non-level playing field with respect to future new business/acquisitions.<br><br>The jurisdictions which Chesnara operates in are currently subject to significant change arising from political, regulatory and legal change. These may either be localised or may apply more widely, following from EU-based regulation and law, or the potential unwinding of this following the UK's decision to leave the EU.<br><br>The group is therefore exposed to the risk of:<br>– incurring one-off costs of addressing regulatory change as well as any permanent increases in the cost base in order to meet enhanced standards;<br>– erosion in value arising from pressure or enforcement to reduce future policy charges;<br>– erosion in value arising from pressure or enforcement to financially compensate for past practice; and<br>– regulatory fines or censure in the event that it is considered to have breached standards, or fails to deliver changes to the required regulatory standards on a timely basis. | Through the Risk Management Framework, regulatory risk is monitored and scenario tests are performed to understand the potential impacts of adverse political, regulatory or legal changes, along with consideration of actions that may be taken to minimise the impact, should they arise.<br><br>Chesnara seeks to limit any potential impacts of regulatory change on the business by:<br>– Having processes in place for monitoring changes, to enable timely actions to be taken, as appropriate;<br>– Maintaining strong open relationships with all regulators;<br>– Being a member of the ABI and utilising other means of joint industry representation;<br>– Performing internal reviews of compliance with regulations; and<br>– Utilising external specialist advice and assurance, when appropriate.<br><br>Chesnara will continue to monitor the outcome of Brexit including any restructuring required to align to changes in the requirements of cross border regulatory supervision. In extremis, Chesnara could consider the re-domiciling of subsidiaries or legal restructure of the business, should this result in a more commercially acceptable business model in a changed operating environment. |
| **Failure to source acquisitions that meet Chesnara's criteria or the execution of acquisitions with subsequent unexpected financial losses or value reduction** | The acquisition element of Chesnara's 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 within 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.<br><br>Through the execution of acquisitions, Chesnara is also 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 as part of the transaction. | Chesnara's financial strength, strong relationships and reputation as a 'safe hands acquirer' via regular contact with regulators, banks and target companies enables the company to adopt a patient and risk-based approach to assessing acquisition opportunities. Operating in multi-territories provides some diversification against the risk of changing market circumstances in one of the territories.<br><br>Chesnara seeks to limit any potential unexpected impacts of acquisitions by:<br>– Applying a structured board approved risk-based acquisition process including CRO involvement in the due diligence process and deal refinement processes;<br>– Having a management team with significant and proven experience in mergers and acquisitions; and<br>– Adopting a cautious risk appetite and pricing approach. |
| **Adverse demographic experience compared with assumptions** | In the event that demographic experience (rates of mortality, morbidity, persistency etc.) varies from the assumptions underlying product pricing and subsequent reserving, more or less profit will accrue to the group.<br><br>If mortality or morbidity experience is higher than that assumed in pricing contracts (I.e. more death and sickness claims are made than expected), this will typically result in less profit accruing to the group.<br><br>If persistency is significantly lower than that assumed in product pricing and subsequent reserving, this will typically lead to reduced group profitability in the medium to long-term, as a result of a reduction in future income arising from charges on those products. The effects of this could be more severe in the case of a one-off event resulting in multiple withdrawals over a short period of time (a 'mass lapse' event). | Chesnara ensures close monitoring of persistency levels across all groups of business to support best estimate assumptions and identify trends. There is also partial risk diversification in that the group has a portfolio of annuity contracts where the benefits cease on death.<br><br>Chesnara seeks to limit the impacts of adverse demographic experience by:<br>– Aiming to deliver good customer service and fair customer outcomes;<br>– Having effective underwriting techniques and reinsurance programmes, including the application of 'mass lapse reinsurance', where appropriate;<br>– Carrying out regular investigations, and industry analysis, to support best estimate assumptions and identify trends;<br>– Active investment management to ensure competitive policyholder investment funds; and<br>– Maintaining good relationships with Brokers which is independently measured via annual external surveys that considers Brokers attitude towards different insurers. |

| RISK | IMPACT | CONTROL |
|---|---|---|
| **Significant operational failure / business continuity event** | The group and its subsidiaries are exposed to operational risks which arise through daily activities and running of the business. Operational risks may, for example, arise due to technical or human errors, failed internal processes, insufficient personnel resources or fraud caused by internal or external persons. As a result the group may suffer financial losses, poor customer outcomes, reputational damage, regulatory intervention or business plan failure.<br><br>Part of the group's operating model is to outsource support activities to specialist service providers. Consequently, a significant element of the operational risk arises within its outsourced providers. | The group perceives operational risk as an inherent part of the day-to-day running of the business and understands that it can't be completely eliminated. However, the company's objective is to always control or mitigate operational risks, and to minimise the exposure when it's possible to do so in a convenient and cost effective way.<br><br>Chesnara seeks to reduce the impact and likelihood of operational risk by:<br>– Monitoring of key performance indicators and comprehensive management information flows;<br>– Effective governance of outsourced service providers including a regular financial assessment. 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;<br>– Regular testing of business continuity plans;<br>– Promoting the sharing of knowledge and expertise; and<br>– Complementing internal expertise with established relationships with external specialist partners.<br><br>All parts of the business have documented robust plans for operational resilience covering:<br>– Alternate physical working locations;<br>– Data back-ups (with suitable network isolation);<br>– Alternate systems/applications;<br>– Crisis Management Team Terms of Reference; and<br>– Crisis communication strategies. |
| **Expense overruns and unsustainable unit cost growth** | The company is exposed to expenses being higher than expected as a result of one-off increases in the underlying cost of performing key functions, or through higher inflation of variable expenses.<br><br>For the closed funds, the group is exposed to the impact on profitability of fixed and semi-fixed expenses, in conjunction with a diminishing policy base.<br><br>For the companies open to new businesses, the group is exposed to the impact of expense levels varying adversely from those assumed in product pricing. | For all subsidiaries, the group maintains a regime of budgetary control:<br>– Movestic and Scildon assume growth through new business such that the general unit cost trend is positive;<br>– The Waard Group pursues a low cost-base strategy using a designated service company. The cost base is supported by service income from third party customers;<br>– Countrywide Assured 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; and<br>– The group has an ongoing expense management programme in place to monitor and manage the overall expense base. |
| **IT/data security failures or cyber crime** | 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.<br><br>The potential impact of this risk includes financial losses, inability to perform critical functions, disruption to policyholder services, loss of sensitive data and corresponding reputational damage or fines. | Chesnara seeks to limit the exposure and potential impacts from IT/data security failures or cyber crime by:<br>– Embedding the Information Security Policy in all key operations and development processes;<br>– Seeking ongoing specialist external advice, modifications to IT infrastructure and updates as appropriate;<br>– Delivering regular staff training and attestation to the information security Policy;<br>– Conducting penetration and vulnerability testing, including third party service providers; and<br>– Having established Chesnara and supplier business continuity plans which are regularly monitored and tested.<br><br>All entities within the Chesnara Group have invested in improving their operational resilience during 2018. The nature of the developments vary across the group, dependent on the existing processes and infrastructure of the entity. Activities include:<br>– enhancements to preventative measures against external threats, and monitoring of such threats arising;<br>– education and training of employees on information security;<br>– improvement to the documentation of our incident response and crisis management protocol; and<br>– testing our resilience to external threats and the effectiveness of our response/recovery in the event of incidents occurring. |

# CORPORATE AND SOCIAL RESPONSIBILITY

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

## 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:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Male** | **Female** | **Male** | **Female** |
| Directors of Chesnara plc | 5 | 2 | 5 | 2 |
| Senior management of the group | 7 | 2 | 7 | 2 |
| Heads of business units and group functions | 16 | 7 | 20 | 6 |
| Employees of the group | 161 | 155 | 169 | 161 |
| **Total** | **189** | **166** | **201** | **171** |

The Hampton-Alexander Report recommends a board diversity target of 30% for FTSE 350 companies. Gender diversity forms an important part of the board appointment process.

Chesnara are committed to diversity and, over recent years, five out the eight senior executive and non executive appointments have been filled by females. Our group Audit & Risk Committee and group Remuneration Committee both have female chairmen and Movestic is headed up by 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. The company will make reasonable adjustments to give the disabled person as much access to any services and ability to be employed, trained, or promoted as a non-disabled person.

**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 2 days release on full pay each year where they can support a local charity project of their choice.

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

Being primarily office-based financial services companies, the directors believe that the group's activities do not materially contribute to pollution or cause material damage to the environment. However, the group takes all practicable steps to minimise its effects on the environment and encourages its employees to conserve energy, minimise waste and recycle work materials. In addition, as multinational group, we actively use video-conferencing throughout our interactions.

'OUR PEOPLE ARE OUR GREATEST ASSETS. WE RECOGNISE THAT TO BE ABLE TO MEET THE EXPECTATIONS WE HAVE SET OURSELVES, WE NEED TO ENSURE, IN A COMPETITIVE MARKET, WE CONTINUE TO ATTRACT, PROMOTE AND RETAIN THE BEST CANDIDATES'.

**Whistleblowing**
Across the group we have in place whistleblowing policies, which comply with local regulatory requirements. In the UK the Audit & Risk Committee Chairman is appointed as Whistleblowing Champion, whose responsibilities meet the requirements of the Senior Insurance Managers Regime. Similar arrangements are in operation within our overseas divisions.

**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.

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.

**Anti-Bribery and Corruption Policy**
Chesnara has in place an Anti-Bribery and Corruption Policy which is reviewed annually or more frequently by exception. Its scope includes all directors, employees and third-parties operating on its behalf and the company has a zero tolerance to all such matters. Controls operated in the period include the maintenance and review of a Gifts & Hospitality Register, the disallowance of any political contributions or inducements and careful consideration of any charitable donations. The internal financial control environment acts as a further monitoring and prevention system. There were no instances of bribery or corruption in the period.

'OUR APPROACH IS TO BE OPEN, ENTREPRENEURIAL AND INCLUSIVE IN HOW WE OPERATE'.

**Greenhouse gas reporting**

**Disclosure of emissions**
Global GHG emissions data for the year to 31 December 2018:

| | Tonnes of $CO_2e$ | |
|---|---|---|
| | **2018** | **2017** |
| Emissions from: | | |
| Combustion of fuel and operation of facilities (scope 1) | – | – |
| Electricity, heat, steam and cooling purchased for own use (scope 2) | 202.2 | 193.8 |
| Travel (scope 3) | 225.1 | 229.3 |
| Company's chosen intensity measurement = tonnes of $CO_2e$ per square metre of office space occupied | 0.064 | 0.063 |
| Emissions reported above normalised to per tonne of product output | | |

The emission figures above reflect the inclusion of Scildon from the date of acquisition in April 2017. The increase in our total emissions in 2018 therefore reflects the full year impact of Scildon when compared with the prior year. The overall measure for tonnes of $CO_2e$ per square metre of office space has remained broadly in line with the prior year.

**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 29 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 28 March 2019 and signed on its behalf by

Peter Mason
Chairman

John Deane
Chief Executive Officer

# SECTION C:

# CORPORATE GOVERNANCE



Amsterdam, Netherlands

# BOARD PROFILE AND BOARD OF DIRECTORS

One key role for the Chesnara Board of Directors is to provide leadership and maintain the highest possible standards of corporate governance.

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 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, Chairman

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

### JANE DALE
SENIOR INDEPENDENT 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. Appointed as the board's Senior Independent Non-Executive Director in October 2018.

**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 (resigned 31 December 2018)
- Bizspace Holdings Ltd, NED, Chairman of the Audit Committee

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

### MIKE EVANS
SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR (until 1 October 2018)

Mike stepped down from the Chesnara plc board effective 1 October 2018. Prior to this date he acted as Senior Independent Director, a position he had held since May 2013, and was a member of the Nomination & Governance, Audit & Risk and Remuneration Committees.

### JOHN DEANE
GROUP CHIEF EXECUTIVE

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

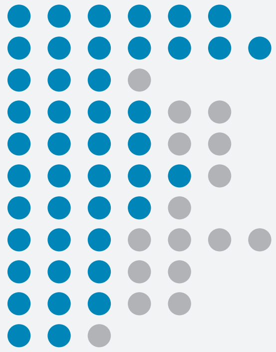
**Career, skills and experience:** John is a qualified Actuary and has over 30 years experience in the life assurance industry. John joined Century Life, a closed book acquisition company in 1993. As CEO, he oversaw the creation of the outsourcing company Adepta in 2000. He joined Old Mutual plc in 2003 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 |
|---|---|
| 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 |

**SUMMARY**



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 and as Chairman of the Remuneration Committee in May 2013.

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

**Current directorships/business interests:**
- Countrywide Assured plc, NED
- Hanley Economic Building Society, Chairman of the Risk Committee
- Hanley Mortgage Services Limited, NED
- Hanley Financial Services Limited, NED
- Sanlam Investment Holdings Limited, NED
- Investment & Life Assurance Group Limited, NED

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

### DAVID BRAND
NON-EXECUTIVE DIRECTOR

**Appointment to the board:** Appointed to the Chesnara plc board in January 2013 and as Chairman of the Movestic Audit & Risk Committee in October 2015.

**Committee membership:** Nomination & Governance, Audit & Risk and Remuneration (the latter from September 2018).

**Current directorships/business interests:**
- Countrywide Assured plc, NED
- 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

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

### 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 over 20 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

### MARK HESKETH
NON-EXECUTIVE DIRECTOR

**Appointment to the board:** Appointed to the Chesnara plc board in December 2018.

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

**Current directorships/business interests:**
- Countrywide Assured plc, NED
- Stonebridge International Insurance Limited, NED
- Centre for Ageing Better, NED
- Bethany Christian Trust, NED
- Powza Limited, NED

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

# GOVERNANCE OVERVIEW FROM THE CHAIRMAN

Good governance is the foundation of how we operate.

Dear Shareholder,

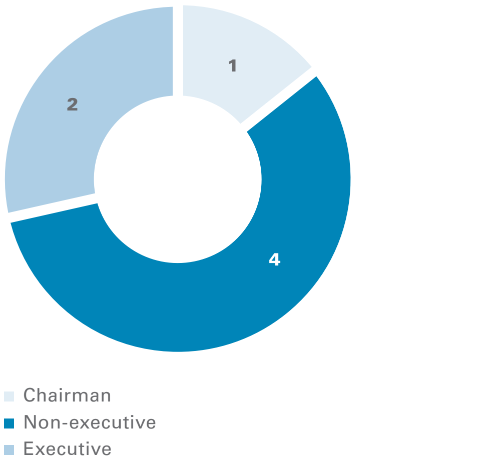
On behalf of the board, I am very pleased to present our Corporate Governance Report for the year ended 31 December 2018.

I am delighted to be able to report that the board considers that the company has complied fully throughout the year with the provisions of the UK Corporate Governance Code.

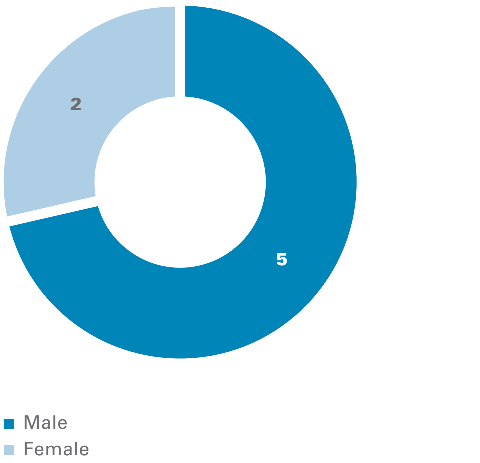
The board is accountable to our shareholders and wider stakeholders for generating and delivering sustainable value through good management of the group's business. The board plays a critical role in ensuring that the tone for the group's culture and values is set from the top. I firmly believe that 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 in both the short and the long-term.

This section of the Annual Report and Accounts sets out our governance policies and practices, and includes details of how the company has, during 2018, applied the Code.

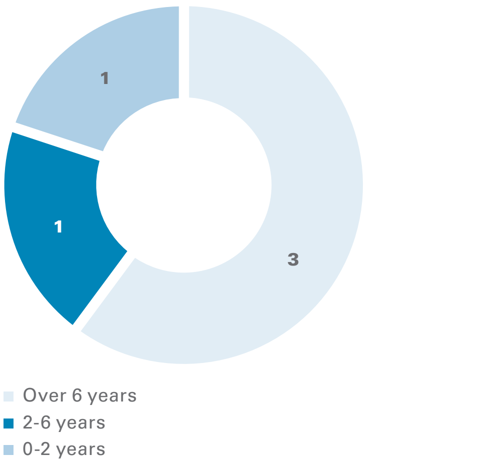
**Current balance of executive and non-executive directors**




**Current gender diversity of the board**




**Board tenure of NEDs**




The board is cognisant of the corporate governance reforms and proposed changes in legislation that are intended to encourage responsible corporate behaviour. The board is also mindful of the company's wider purpose, responsibilities and decision-making processes to a broader stakeholder group. In delivering sustainable performance, the board is aware of the need to consider and engage with the interests of its employees, customers and suppliers. In 2018, the board continued to engage with its shareholders to promote effective governance through open and constructive two-way dialogue, and we place great value on this engagement.

Significant progress has been made by managers and employees during the year. We remain mindful of the strong relationship between ethics and governance and the role the board plays in demonstrating these. The group's Governance Map, which sets out the governance approach and framework, continues to be developed and embedded across all divisions of the business.

The Audit & Risk Committee undertook an external audit tender process in 2017 and the appointment of Deloitte LLP received shareholder approval at the 2018 AGM.

This report demonstrates how the board and its committees have fulfilled their governance responsibilities.

Peter Mason
Chairman

28 March 2019

# 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 62 to 79, the Nomination & Governance Committee Report on pages 58 to 59, and the Audit & Risk Committee Report on pages 80 to 85 describes how the principles set out in the UK Corporate Governance Code 2016 (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 2018.

**Compliance with the Code**

The company has complied throughout the year with all of the relevant provisions of the Code. The UK Corporate Governance Code is available at **www.frc.org.uk**

**The board**

At 31 December 2018, the board comprised of a non-executive Chairman, four other non-executive directors and two executive directors.

Biographical details of directors are given on pages 50 and 51 and a board profile, which assesses the core competencies required to meet the group's strategic objectives, is provided on page 51. The board, which plans to meet at least eight times during the year, has a schedule that 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) two directors of the company, being Messrs Mason and Deane, were also directors of Chesnara Holdings BV throughout the year, whilst Mr Evans was a director of Chesnara Holdings BV until his resignation effective 1 October 2018; and

iii) four directors of the company, being Messrs Mason, Deane, Brand and Rimmington, were also directors of Movestic Livförsäkring AB throughout the year.

Under local legislation or regulation for all 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 Regulation Authority is the group supervisor and maintains oversight of all 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 strategic, financial and operational performance of the group.

**Senior independent director**

The board designated Jane Dale, who has been a non-executive board member since May 2016, as the Senior Independent Director in October, following the departure of Mike Evans, who had held the position throughout the year until that point. The Senior Independent Director supports the Chairman in the delivery of the board's objectives and to ensure that the view of all shareholders and stakeholders are conveyed to the board. Jane Dale 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. The Senior Independent Director also meets with the non-executive directors, without the Chairman present, at least annually, and conducts the annual appraisal of the Chairman's performance and provides feedback to the Chairman and the board on the outputs of that appraisal.

**Directors and directors' independence**

The board considers that all non-executive directors are independent. The Chairman was independent at the date of his appointment and that he was free from any business or other relationship with the company which could have materially influenced his judgement and he continues to represent a strong source of advice and independent challenge. There are currently four independent non-executive directors on the board: Jane Dale, Veronica Oak, David Brand and Mark Hesketh.

Other than their fees and reimbursement of taxable expenses, which are disclosed on page 63, the non-executive directors received no remuneration from the company during the year. 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 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.

**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 as 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 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 IFRS17. 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 (to October 2018), 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 regular reports and information, which cover all of the key areas relevant to the direction and operation of those subsidiary entities, including business development, key projects, financial performance and position, actuarial assumptions setting and results analysis, compliance, investments, operations, customer care and communication, internal audit, all aspects of the risk function and own risk and solvency assessment.

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

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.

Also, the divisions are required to submit a quarterly risk report and an annual report on risk management and internal control systems.

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 Jane Dale 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 2018. In summary, the principal governance actions are:

- the board has increased its employee engagement with the appointment of a NED who will be available to all employees;
- changes in reporting (appropriate for the size of the organisation) have been made and will continued to be reviewed in the light of the developments in FRC guidance;
- the implementation date for IFRS17 regulation has been deferred for a year but focus has continued on monitoring of the implementation project; and
- focus has remained on the potential impact of the UK leaving the European Union.

**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. No new material conflicts of interest are noted in 2018.

**Company secretary**
Al Lonie 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. Al Lonie took over from Zoe Kubiak as company secretary on 1 April 2018.

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

**Remuneration Committee**
Full details of the composition and work of the Remuneration Committee are provided on pages 60 to 61.

**Audit & Risk Committee**
Full details of the composition and work of the Audit & Risk Committee are provided on pages 80 to 85.

**Nomination & Governance Committee**
Full details of the composition and work of the Nomination & Governance Committee are provided on pages 58 to 59.

**UK Corporate Governance Code 2018**
This revised code applies to accounting periods beginning on or after 1 January 2019. It places greater emphasis on relationships between companies, shareholders and stakeholders. It also promotes the importance of establishing a corporate culture that is aligned with a company purpose, business strategy, promotes integrity and values diversity. We have undertaken a gap analysis against the revised code and delivered on a number of actions to ensure that we meet the requirements of the new code from its effective date of 1 January 2019, which will be reported against in future periods.

THE BOARD DIRECTORS RECEIVE REGULAR UPDATES AS WELL AS SPECIFIC SPECIALIST AND REGULATORY TRAINING.

# CORPORATE GOVERNANCE REPORT (CONTINUED)

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 | 9 (9) | 5 (5) | 4 (4) | 9 (9) |
| John Deane - Executive director | 9 (9) | 5 (5) | 4 (4) | 9 (9) |
| Veronica Oak - Non-executive director | 9 (9) | 5 (5) | 4 (4) | 9 (9) |
| David Brand - Non-executive director | 9 (9) | 5 (5) | 1 (1) | 9 (9) |
| David Rimmington - Executive director | 9 (9) | n/a | n/a | 9 (9) |
| Jane Dale - Senior independent non-executive director[1] | 9 (9) | 5 (5) | n/a | 9 (9) |
| Mark Hesketh – Non-executive director[2] | 0 (0) | 0 (0) | 0 (0) | 0 (0) |
| Mike Evans – Senior independent non-executive director[1] | 6 (6) | 3 (3) | 3 (3) | 6 (6) |

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

1. Mike Evans was senior independent non-executive director until he stepped down from the board effective 1 October 2018. Jane Dale was appointed as the board senior independent non-executive director from October 2018.
2. Mark Hesketh was appointed to board in mid-December 2018 and as such, did not attend any meetings in his capacity as a director.

**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, the Group Finance Director and 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. The company has a programme of meetings with its larger shareholders, which provides an opportunity to discuss, on the basis of publicly available information, the progress of the business.

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**

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 14 May 2019 can be found in the notice of the meeting on pages 181 to 182.

**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 on-going 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. 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 their 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, Movestic and Scildon. The principal risks and uncertainties of the group can be found on pages 43 to 45.

The maintenance of the principal risk registers is the responsibility of senior management, who report on them quarterly to the respective divisional Audit & Risk Committees and to each Chesnara Audit & Risk Committee meeting. The 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 audit 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, Scildon 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 plc 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 2018, 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. Conclusions of the Audit & Risk Committee annual review of effectiveness of the group's risk management and internal control systems is reported in more detail in the Audit & Risk Committee Report as set out on page 83 to 84. The board is not aware of any significant deficiencies in the effectiveness of the group's systems of internal control and risk management for the year under review. There has been no change of status to this up to the date of approval of this report.

**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 reporting processes in place. A summary of the group's financial results supported by commentary and performance measures are 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 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 88 and the Long-Term Viability Statement is set out on page 41.

# NOMINATION & GOVERNANCE COMMITTEE REPORT

The main focus of 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, Jane Dale, all of whom served throughout the period, and Mike Evans who served to October 2018. Mark Hesketh was appointed to the committee in December 2018. The chairman does not chair or attend when the committee is considering matters relating to his position, in which circumstances the committee is chaired by an independent non-executive director, usually the Senior Independent Director. No individual participates in discussion or decision-making when the matter under consideration relates to him or her.

The committee chairman reports material findings and recommendations at the next board meeting.

The terms of reference for the committee can be found on the company website, **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 for changes to the executive membership of the board.

During the period, the committee met five times and attendance at those meetings is shown on page 56 of the Corporate Governance Report.

**The composition of the board**
After a number of director changes in recent years, the committee has continued to focus on succession planning, with a view to identifying the best composition for the board and its committees for the next phase of development for the business. The review also identified areas where the board should evolve to meet any expected future business and strategic direction of the group.

The committee is mindful of the corporate governance developments in the areas of diversity and gender balance including the changes to the Disclosure and Transparency Rules. This will be kept under review during 2019, and any changes to the existing policies and objectives for board and management diversity will be reported in the next Annual Report.

The Nomination & Governance Committee agrees with the importance of having diversity on the board, including female representation and individuals with different experiences, skills, background and expertise, to ensure an appropriate board balance is maintained. During the year, the Nomination & Governance Committee reviewed and recommended the approval of the Chesnara Diversity Policy. The board currently comprises five men and two women (28.5%). The key objective of the policy is stated below:

Chesnara plc recognises and embraces the benefits of having diversity at its board table in order to achieve and optimise competitive advantage. The board will aim to include and utilise directly, or through the board subsidiaries, differences in the skills, background, ethnicity, gender, regional and industry experience along with other qualities brought by its directors and those of its subsidiaries. Such differences will be considered in determining the optimum composition of the board and will be re-balanced as appropriate and when possible to ensure optimal and efficient stewardship.

The organisation also recognises the benefits of behavioural diversity, such as temperament and approach of individual directors and seeks to build the right mix of such independent character and judgement.

All board appointments are made on merit, in the context of the skills and experience required for the board to operate effectively as a unit and taking account of succession planning. Candidates are assessed against pre-defined and professional profile criteria. Chesnara remains committed to meritocracy in the boardroom, which requires a diverse and inclusive culture where directors believe that their views are heard, their concerns are attended to and they serve in an environment where bias, discrimination and harassment on any matter are not tolerated.

The development of talent below board level is extremely important and an area of focus for the board. The company continues to build an internal leadership pipeline for senior roles. The board believes by focusing on creating a pool of internal talent that there is an increased probability of employee retention and the building of internal capabilities needed to support the growth of the business.

The biographical details of the board and the committee membership for each director who served during 2018 can be found on pages 50 and 51.

**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. As part of the appointment process, external recruitment consultants are asked to provide candidates from a diverse range of backgrounds. Candidates who are deemed suitable, based on merit and against objective criteria, are 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 suitably qualified candidates. Any candidate deemed suitable for appointment will, if necessary, first have to go through the fit and proper process as outlined in the Senior Managers & Certification Regime (SMCR), which came into full force on 10 December 2018.

**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. The board maintains its practice of embracing diversity and has therefore chosen, at this time, not to set any measurable gender based targets.

The board and its committees undertook annual effectiveness reviews and the respective chairmen discussed the findings in each forum. Other standard processes were also undertaken, including Fit & Proper assessments, Board Diversity Policy review, NED succession planning and the review of the effectiveness of the Chairman. Any areas where increased focus was considered to be of potential value will be taken into account as appropriate during 2019.

**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, in the year, has reviewed the succession plans for the board, the group executive committee and senior executives across the group.

**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 on-going 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 2018, a number of development initiatives have continued, these included one-to-one sessions with key members of the senior management team and training sessions given by external providers.

**Directors standing for re-election**
In accordance with the Code, all directors will offer themselves for re-election at the company's 2019 AGM. Following the annual board effectiveness reviews of individual directors, as applicable and subject to re-election, the Chairman considers that each director:

– continues to operate as an effective member of the board;
– has the necessary skills, knowledge and experience to enable them to discharge their duties and contribute to the continued effectiveness of the board; and
– has sufficient time available to fulfil their duties.

The board, on the advice of the committee, recommends the re-election of each director proposed for re-election at the 2019 AGM. The full 2019 AGM Notice can be found on page 181.

Peter Mason
Chairman of the Nomination & Governance Committee

28 March 2019

## DIRECTORS' REMUNERATION REPORT

# REMUNERATION COMMITTEE CHAIRMAN'S ANNUAL STATEMENT

Dear Shareholder

I am pleased to present the 2018 Directors' Remuneration Report, for which we seek your support at our forthcoming Annual General Meeting, in May 2019.

Our Remuneration Policy was last approved by shareholders in 2017 and provides a clear framework for reward linked to the strategy of the company, aligned to the interests of executives and shareholders. For ease of reference, this policy is appended to the Remuneration Report, starting on page 73.

**2018 – Another year of dividend delivery**

Chesnara has a very clear focus, to recap:

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

This clear strategic focus is underpinned by the culture, values and risk environment of the group, which 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 2018 we have seen delivery against:

1. Cash generation of £47.8m exceeding the funding requirements of the dividend.
2. Movestic has delivered new business profits of £8.9m, which although reduced when compared to the prior year, is within the challenging target range and represents a commercially attractive return. Movestic has provided to Chesnara a SEK31.5m (£2.7m) dividend payment.
3. Scildon has delivered new business profits of £1.7m. This is in line with expectations and shows marginal increases since acquisition but it is not currently generating sufficient new business profits and this is therefore a focus of management's improvement plans. Scildon has provided to Chesnara a EUR25m (£21.7m) dividend payment in the year.

**Executive performance in 2018**

In light of the performance of the executive team in 2018 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 2018 under the STI can be found on page 64.

The awards made in April 2016 under the 2014 LTI are due to vest in April 2019 and apply to John Deane (GCEO) and David Rimmington (GFD). The targets, performance outcome and estimated value of awards can be found in the table on page 66. As in 2018, disclosure of the Embedded Value/ Economic Value outcome now enables comparison with opening values.

**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.

UK employees received an average salary increase of 2.5% in 2018 and 2.2% in 2019. The salary of John Deane (GCEO) has been increased by the same percentages in both years. The salary for David Rimmington (GFD) increased by 4.9% in 2018 reflecting development in his role and by 2.2% in 2019 in line with other UK employees. The executive directors' remuneration for 2019 can be found on page 63.

In line with the average salary increase to staff, the board has increased the base fee and committee chairmanship fees for non-executive directors by 2.2%.

**Review of incentive scheme performance measures**
As noted in my report last year, we have considered the performance targets used within the Short-Term and Long-Term Incentive 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. In 2018, the Remuneration Committee reviewed whether the weightings and measures continued to be appropriate and made changes to better reflect achievement of an overall assessment of company financial performance when determining executive director bonus payments – see full details on page 71.

The Long-Term Incentive Scheme aims to align executive and shareholder interests via two equally weighted metrics: (1) Total Shareholder Return (TSR); and (2) Embedded Value (EEV)/Economic Value (EcV) – the latter being a measure of shareholder value. Following the advent of Solvency II, EEV has been replaced with EcV. Therefore, for performance years starting before 1/1/2016 the measure used is EEV, whilst EcV is the measure used for performance years starting on or after 1/1/2016.

**Shareholder engagement**
The Directors' Remuneration Report for the year ended 31 December 2018 comprises my Annual Statement as Chairman of the Remuneration Committee and our Annual Remuneration Report, which together are subject to an advisory shareholder vote at the AGM in May 2019.

The voting outcome at the 2018 AGM in respect of the Directors' Remuneration Report for the year ended 31 December 2017 is set out on page 72 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.

**Future developments**
We have continued to monitor developments in the area of remuneration, whether that is via enhancements to accepted best practice, regulatory guidance or legal requirements. Of particular note has been the committee's review of the new UK Corporate Governance Code. A review of our Remuneration Policy will be undertaken this year and put to shareholders at our AGM in 2020.

I hope my Annual Statement, together with our Remuneration Report, provides a clear account of the operation of the Remuneration Committee during 2018 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

28 March 2019

## DIRECTORS' REMUNERATION REPORT

# ANNUAL REMUNERATION REPORT

This section sets out how the Remuneration Committee has implemented its Remuneration Policy for executive directors during 2018.

Other than the single total figure of remuneration for each director tables on page 63, statement of directors' shareholding and share interests on pages 67 and 68, the information contained within this report has not been subject to audit.

**Composition and activities of the Remuneration Committee**
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 2018. Members of the Remuneration Committee during the course of the year were:

| Committee members | Role on the committee | Committee member since | Attendance in 2018 | Maximum possible meetings in 2018 |
|---|---|---|---|---|
| Veronica Oak | Committee chairman | January 2013 | 4 | 4 |
| Peter Mason | Committee member | March 2004 | 4 | 4 |
| Mike Evans | Committee member | March 2013 | 3 | 3 |
| David Brand | Committee member | September 2018 | 1 | 1 |

**Notes.**
1. Mike Evans stepped down from the board and board committees effective 1 October 2018.

Peter Mason was not present when the chairman's fees were discussed. By invitation, the GCEO attends Remuneration Committees, but was not present when matters relating to his own remuneration were discussed.

The committee does not retain the services of external advisers.

**Highlights 2018/2019**
In 2018, the committee met four times and dealt with the following matters:

| Area of focus | Matter considered |
|---|---|
| **Executive director remuneration and reward** | The committee considered the scheme awards and performance targets for the awards made in 2018 under the 2014 STI Scheme and the 2014 LTI Scheme 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 revision made to ensure that they continue to be appropriate for the activities of the committee and provide adequate scope to cater for the expectations set by the new UK Corporate Governance Code. |
| **Review of the Remuneration Policy** | The committee reviewed the Remuneration Policy last approved by shareholders in 2017 and deemed that it continued to be appropriate. |
| **Review of new UK Corporate Governance Code and other remuneration practices** | The committee considered the requirements of the new UK Corporate Governance Code and as a result brought the executives' Long-Term Incentive Scheme into compliance by adding a holding period of 2 years, which will be effective for awards made in 2019, and also amended the committee's Terms of Reference to slightly broaden the responsibilities of the committee. |
| **Committee evaluation** | An evaluation of the committee's performance by way of an internal questionnaire suggested that the committee continued to operate well. |
| **Annual salary review** | The committee reviewed the salaries of the executive directors and senior management and made changes in line with its Remuneration Policy and with due reference to staff salaries generally. |
| **Directors' remuneration reporting** | The committee reviewed the draft Directors' Remuneration Report for the 2017 Report and Accounts and recommended its approval by the Chesnara board. |
| **Performance against strategic targets** | The committee reviewed the executive directors' performance against targets set. |
| **Directors' minimum shareholding** | The committee reviewed and agreed that no changes be made at present in relation to the quantum of shares required to be held by executive directors. The committee also reviewed the value of shares held by executives relative to the minimum requirement. |
| **Shareholder engagement** | The committee sought feedback from institutional investors in relation to the direction of voting at the 2018 AGM. |
| **Chairman's fees** | The committee reviewed the level of fees payable to the Chairman. |
| **Remuneration principles** | The committee reviewed the Group Remuneration Principles, which guide the remuneration policies throughout the group. |
| **Review against UK Governance Code** | The committee conducted a review and prepared a gap analysis, which revealed that the Code had been complied with. |
| **Review of bonus scheme for group and UK staff** | The committee conducted a review of the bonus scheme for group and UK staff (excluding executive directors) which resulted in changes being approved, including to the metrics used to assess financial performance and for the UK staff scheme the weighting between personal and company performance. |

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

The remuneration of the executive directors for the years ended 31 December 2018 and 31 December 2017 is made up as follows:

**Executive directors' remuneration as a single figure - year ended 31 December 2018**

| Name of director | Salary and fees £000 | All taxable benefits[1] £000 | Non-taxable benefits £000 | Annual bonuses £000 | LTI[2] £000 | Pension[3] £000 | Total for 2018 £000 |
|---|---|---|---|---|---|---|---|
| John Deane | 439 | 27 | 5 | 136 | 316 | 42 | 965 |
| David Rimmington | 277 | 20 | 5 | 79 | 193 | 26 | 600 |
| **Total** | **716** | **47** | **10** | **215** | **509** | **68** | **1,565** |

**Executive directors' remuneration as a single figure - year ended 31 December 2017**

| Name of director | Salary and fees £000 | All taxable benefits £000 | Non-taxable benefits £000 | Annual bonuses £000 | LTI[4] £000 | Pension[3] £000 | Total for 2017 £000 |
|---|---|---|---|---|---|---|---|
| John Deane | 428 | 27 | 5 | 373 | 268 | 41 | 1,142 |
| David Rimmington | 264 | 17 | 4 | 206 | 179 | 25 | 695 |
| **Total** | **692** | **44** | **9** | **579** | **447** | **66** | **1,837** |

**Notes.**

1. All taxable benefits includes amounts paid in lieu of accrued dividends and interest arising upon the exercise of share options under the 2014 STI Scheme.
2. Includes amounts paid in lieu of accrued dividends and interest arising upon the exercise of share options under the 2014 LTI Scheme.
3. The pension component in the single figure table represents employer contributions. No directors were members of a defined benefit scheme.
4. These figures have been re-stated to reflect the actual share price at the date of vesting of 410.0 pence.

The remuneration of the non-executive directors for the years ended 31 December 2018 and 31 December 2017 is made up as follows:

**Non-executive directors' remuneration as a single figure - year ended 31 December 2018 and 2017**

| Name of director | 2018 Fees £000 | 2018 Benefits[7] £000 | 2018 Total £000 | 2017 Fees £000 | 2017 Benefits[7] £000 | 2017 Total £000 |
|---|---|---|---|---|---|---|
| Peter Mason | 120 | 1 | 121 | 111 | 1 | 112 |
| Veronica Oak | 59 | 1 | 60 | 58 | 1 | 59 |
| David Brand | 59 | 1 | 60 | 58 | 1 | 59 |
| Mike Evans[5] | 45 | 2 | 47 | 58 | 1 | 59 |
| Jane Dale | 65 | 1 | 66 | 63 | 1 | 64 |
| Mark Hesketh[6] | 5 | – | 5 | – | – | – |
| **Total** | **353** | **6** | **359** | **348** | **5** | **353** |

**Notes.**

5. Mike Evans stepped down from the board effective 1 October 2018.
6. Mark Hesketh was appointed to the board effective 17 December 2018.
7. Benefits shown here relate to expenses grossed up for income tax, which is settled by the company for travel to Chesnara's head office in Preston, which, for tax purposes, is deemed to be the NEDs' normal place of work.

# DIRECTORS' REMUNERATION REPORT • ANNUAL REMUNERATION REPORT (CONTINUED)

**Salary and fees**

The Remuneration Committee usually reviews basic salaries annually. 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), which was renewed this year.

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 directors' remuneration, including the average level of salary increase being budgeted for the UK workforce. The committee is also mindful of any changes to the pay and benefit conditions for employees more generally when considering 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 amounts reported as annual bonuses in 2018 derive from awards made under the 2014 STI. The amounts awarded to the executive directors under this scheme are based on performance against three core measures; IFRS pre-tax profit, EcV operating profit and group strategic objectives. The table below shows the outcome of each measure, the target set and the resulting award.

| | Upper threshold for minimum performance | Percentage award for min 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 (£) |
|---|---|---|---|---|---|---|---|---|---|---|
| **John Deane** | | | | | | | | | | |
| IFRS pre-tax result[1] | £25.760m | 0% | £34.347m[1] | 12.0% | £68.694m | 40.0% | £36.551m | 13.8% | 13.8% | 60,584 |
| EcV operating result[2] | £6.930m | 0% | £7.700m | 16.0% | £11.550m | 40.0% | £(22.848)m | 0% | 0% | – |
| Group strategic objectives | 60% of max | 0% | 80% of max | 10.0% | 100% | 20.0% | 86.5% of max | 17.3% | 17.3% | 75,876 |
| **Total** | | | | **38.0%** | | **100.0%** | | **31.1%** | **31.1%** | **136,460** |
| **David Rimmington** | | | | | | | | | | |
| IFRS pre-tax result[1] | £25.760m | 0% | £34.347m[1] | 12.0% | £68.694m | 40.0% | £36.551m | 13.8% | 12.4% | 34,395 |
| EcV operating result[2] | £6.930m | 0% | £7.700m | 16.0% | £11.550m | 40.0% | £(22.848)m | 0% | 0% | – |
| Group strategic objectives | 60% of max | 0% | 80% of max | 10.0% | 100% | 20.0% | 90.5% of max | 18.1% | 16.3% | 45,088 |
| **Total** | | | | **38.0%** | | **100.0%** | | **31.9%** | **28.7%** | **79,483** |

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

**Notes.**

1. This is stated after certain adjustments, such as consolidation adjustments. The actual results are also adjusted in the same manner.
2. The EcV operating earnings before exceptional items on page 38 has been adjusted in line with the basis of the target.

**The following table details the requirements for delivery of the strategic objectives for 2018 and actual outcomes:**

| Objectives area | Objectives and performance | Outcome |
|---|---|---|
| **John Deane** | | |
| **Governance (20%)** | Ensure a robust strategy and management reporting process is in place and that strong regulatory relationships are maintained. | Board papers consistently of a high standard and enhanced through the year, including improvements to integration with the strategy development process.<br>Actions on customer communications delivered and strong regulatory relationships maintained. |
| **New business (25%)** | Profitability of new business. | Movestic new business profits delivered within the target range. Scildon new business profits improved but further delivery is required. |
| **Acquisition and capital management (45%)** | Support the investigation of acquisitions within risk appetite.<br>Improve the consideration of capital management within the divisions and across the group. | Acquisitions that have been investigated have followed a defined risk based approach, with working parties established to oversee that process.<br>Progressed in 2018 with further work and opportunities identified for 2019. |
| **People (10%)** | Development of management teams and maintenance of an open culture. | The management teams have continued to develop with employee engagement and an open culture being areas of focus. |
| **David Rimmington** | | |
| **Statutory reporting (25%)** | Ensure improvements in reporting processes to meet new deadlines for SII Reports (QRTs and narratives at group and divisional level). | Processes developed to ensure delivery to the shorter deadlines with no impact on the quality of deliveries. |
| **Expense management (10%)** | Timely and appropriate analysis of expenses and appropriate plans actioned. | Improvement in analysis and MI to enhance controls with appropriate support to the cost reduction exercise undertaken in Movestic. |
| **Business support (25%)** | Guiding divisional teams through group-wide processes.<br>Deals well assessed, with stringent application of assessment criteria. | In addition to IFRS17, group-wide processes have been improved with further developments in risk management and systems of governance and controls.<br>Deals continue to be assessed against our investment criteria. |
| **Management reporting and financial analysis (25%)** | Enhancements in MI reporting and analysis to support capital and balance sheet management and decision-making. | Progressed in 2018 with further work and opportunities identified for 2019. |
| **IFRS 17 (15%)** | Planning and delivery of IFRS 17 across group and divisions. | Programme plan and resourcing fully established and delivery in line with the ARC approved plan. |

# DIRECTORS' REMUNERATION REPORT • ANNUAL REMUNERATION REPORT (CONTINUED)

**Annual bonuses (continued)**

In converting performance against the measures assessed for 2018 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 | 439,110 | 100% | 31.08% | 136,460 |
| David Rimmington | 277,000 | 90% | 28.69% | 79,483 |
| **Total** | | | | **215,943** |

35% of the above awards are granted as deferred share awards that will vest at the end of a 3 year deferred period.

**Long-Term Incentive Scheme awards**

The following table sets out the amounts that are due to vest on 28 April 2019 under the 2014 LTI, for which performance conditions were satisfied during the year.

| Individual | Measure | Weight | Ranges and targets | | | Actual outcome | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Minimum achievement (as % of target) | Target achievement | Max achievement | Opening EcV | Closing EcV[1] | Performance achieved | % of award vesting | Value of award £ |
| **John Deane** | TSR | 50% | =Median | 12.03% | 55.65% | | | 18.41% | 17.99% | 83,742 |
| | EcV | 50% | =95.7% | £480.9m | £545.8m | £417.2m | £643.3m | 133.8% | 50.0% | 232,745 |
| **David Rimmington** | TSR | 50% | =Median | 12.03% | 55.65% | | | 18.41% | 17.99% | 44,859 |
| | EcV | 50% | =95.7% | £480.9m | £545.8m | £417.2m | £643.3m | 133.8% | 50.0% | 124,686 |

The estimated value of the awards vesting disclosed above has been determined using the average share price over the 3 month period prior to the year-end (349.95p). The actual amounts upon vesting will be determined using the share price upon the vesting date.

**Notes.**

1. The closing value for EcV is based on that shown on page 39 with the addition of dividends paid out and the deduction of equity raised in the performance period which is consistent with basis upon which the targets are set. The closing value for EcV on this basis was £643.3m.

The table below sets out potential LTI 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[1] | Face value on the date of grant[2] | % of award vesting for minimum performance | Length of vesting period – 3 years Date of vesting |
|---|---|---|---|---|---|---|
| John Deane | 2014 LTI | 28 April 2018 | 107,100 | £439,110 based on share price (410.00p) | 10.0% | 28 April 2021 |
| | 2014 LTI | 28 April 2017 | 111,781 | £428,400 based on share price (383.25p) | 12.5% | 28 April 2020 |
| | 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 |
| David Rimmington | 2014 LTI | 28 April 2018 | 60,805 | £249,300 based on share price (410.00p) | 10.0% | 28 April 2021 |
| | 2014 LTI | 28 April 2017 | 61,996 | £237,600 based on share price (383.25p) | 12.5% | 28 April 2020 |
| | 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 |

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

**2014 LTI**
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, 100% in 2016, 2017 and 2018. David Rimmington; 75% in 2014 and 2015, 90% in 2016, 2017 and 2018. 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**
The LTI Scheme has transitioned 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 is EcV.

For awards granted prior to 2018, 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.

For the award granted in 2018, 50% of the award will vest subject to the 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 95.7% of target, up to a maximum pay-out if the outcome is greater than or equal to 104.1% of target.

**Notes.**
1. No awards are made if performance is below the minimum criteria.
2. The face value is reported as an estimate of the maximum potential value on vesting.

### Payments for loss of office (audited information)
No payments were made during the year for loss of office.

### Statement of directors' shareholding and share interests (audited information)
The Remuneration Policy requires executive directors to build up a shareholding through the retention of shares to the value of their basic salary. As at the reporting date this criterion has been met. 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.

# DIRECTORS' REMUNERATION REPORT • ANNUAL REMUNERATION REPORT (CONTINUED)

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 2018 or the date of resignation.

No changes took place in the interests of the directors between 31 December 2018 and 28 March 2019.

| Name of director | Shares held: 1 January 2018 | Shares held: 31 December 2018 | Options: With performance measures | Options: Without performance measures[1] | Options: Vested but unexercised | Options: Exercised during the year | Options: Percentage of shareholding target held[2] |
|---|---|---|---|---|---|---|---|
| John Deane | 29,677 | 35,975 | 351,898 | 101,978 | 68,516[3] | 6,298 | 103.9% |
| David Rimmington | 20,781 | 50,632 | 194,060 | 53,347 | – | 59,019 | 129.7% |
| Peter Mason | 25,743 | 25,743 | – | – | – | – | – |
| Veronica Oak | 3,000 | 3,000 | – | – | – | – | – |
| David Brand | 5,500 | 5,500 | – | – | – | – | – |
| Mike Evans | 7,956 | 2,296 | – | – | – | – | – |
| Jane Dale | 3,333 | 3,333 | – | – | – | – | – |
| Mark Hesketh | – | – | – | – | – | – | – |
| **Total** | **95,990** | **126,479** | **545,958** | **155,325** | **68,516** | **65,317** | **–** |

**Notes.**

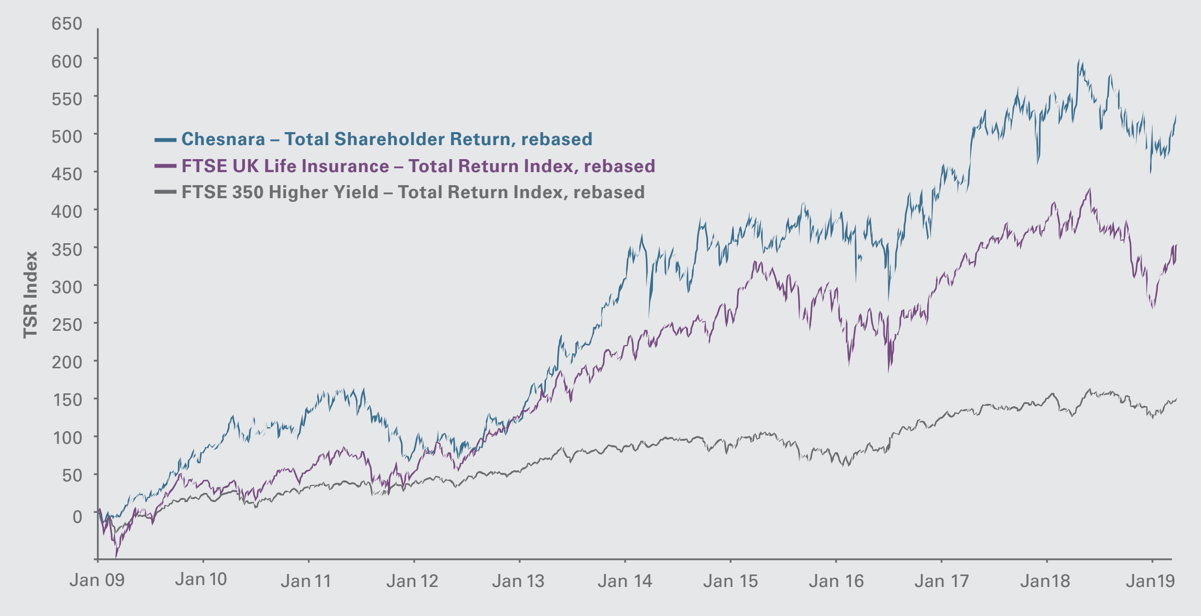
1. The 'options without performance measures' column in the table does not include the share options that will be awarded as part of the mandatory deferral rules under the 2014 STI in respect of awards made in relation to the 2018 financial year, which equate to 35% of the cash award under this scheme. The timetable for the administration of the scheme means that these will be reported in the 2019 Annual Report and Accounts.
2. Calculated using the share price of 345.50p at 31 December 2018.
3. Awarded under the 2014 LTI scheme and vested on 28 April 2018.

### Outstanding share options and share awards

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

| Name of executive director | Scheme | Grant date | Exercise price (p) | Number of shares under option at 1 January 2018 | Number granted during year | Number exercised during year | Number lapsed during year | Number waived during year | Number of shares under option and unexercised at 31 December 2018 | End of performance period | Vesting date | Performance period | Date of expiry of option |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| JOHN DEANE | 2014 LTI (2018 award) | 28/04/18 | Nil | – | 107,100 | – | – | – | 107,100 | 31/12/20 | 28/04/21 | 3 years | 28/04/28 |
| | 2014 LTI (2017 award) | 28/04/17 | Nil | 111,781 | – | – | – | – | 111,781 | 31/12/19 | 28/04/20 | 3 years | 28/04/27 |
| | 2014 LTI (2016 award) | 28/04/16 | Nil | 133,017 | – | – | – | – | 133,017 | 31/12/18 | 28/04/19 | 3 years | 28/04/26 |
| | 2014 STI (2015 award) | 28/04/15 | Nil | 84,639 | – | – | (16,123) | – | 68,516 | 31/12/17 | 28/04/18 | 3 years | 28/04/25 |
| | 2014 STI (2017 award) | 28/04/18 | Nil | – | 31,802 | – | – | – | 31,802 | n/a | 28/04/21 | n/a | 28/04/27 |
| | 2014 STI (2016 award) | 29/04/17 | Nil | 37,696 | – | – | – | – | 37,696 | n/a | 28/04/20 | n/a | 28/04/26 |
| | 2014 STI (2015 award) | 29/04/16 | Nil | 26,575 | – | – | – | – | 26,575 | n/a | 28/04/19 | n/a | 28/04/25 |
| | Share save | 29/09/18 | 304.80 | – | 5,905 | – | – | – | 5,905 | n/a | 01/12/21 | n/a | n/a |
| | Share save | 29/09/15 | 285.08 | 6,298 | – | (6,298) | – | – | – | n/a | 01/11/18 | n/a | n/a |
| | | | | **400,006** | **144,807** | **(6,298)** | **(16,123)** | **–** | **522,392** | | | | |
| DAVID RIMMINGTON | 2014 LTI (2018 award) | 28/04/18 | Nil | – | 60,805 | – | – | – | 60,805 | 31/12/20 | 28/04/21 | 3 years | 28/04/28 |
| | 2014 LTI (2017 award) | 28/04/17 | Nil | 61,996 | – | – | – | – | 61,996 | 31/12/19 | 28/04/20 | 3 years | 28/04/27 |
| | 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) | 20/05/15 | Nil | 47,727 | – | (38,635) | (9,092) | – | – | 31/12/17 | 28/04/18 | 3 years | 28/04/25 |
| | 2014 STI (2017 award) | 28/04/18 | Nil | – | 17,620 | – | – | – | 17,620 | n/a | 28/04/21 | n/a | 28/04/27 |
| | 2014 STI (2016 award) | 28/04/17 | Nil | 20,293 | – | – | – | – | 20,293 | n/a | 28/04/20 | n/a | 28/04/26 |
| | 2014 STI (2015 award)) | 27/03/16 | Nil | 15,434 | – | – | – | – | 15,434 | n/a | 28/04/19 | n/a | 28/04/25 |
| | 2014 STI (2014 award) | 29/09/15 | Nil | 14,086 | – | (14,086) | – | – | – | n/a | 27/03/18 | n/a | 20/05/24 |
| | Share save | 27/03/15 | 285.08 | 6,298 | – | (6,298) | | – | – | n/a | 01/11/18 | n/a | n/a |
| | | | | **237,093** | **78,425** | **(59,019)** | **(9,092)** | **–** | **247,407** | | | | |

**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, 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:

| 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 |
|---|---|---|---|---|---|
| 2018 | John Deane | 965 | 31.08% | 67.99% | 1 |
| 2017 | John Deane | 1,142 | 86.96% | 80.95% | 1 |
| 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 |
| 2009 | Graham Kettleborough | 502 | 94.27% | n/a | 5 |

**Notes.**
1. John Deane was appointed CEO on 1 January 2015.

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% 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.

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

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 contributed no value to the total single remuneration figure as it did not vest until performance criteria were achieved in 2014.

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 executive directors**
The table below shows the percentage change in remuneration for the executive directors and the company's employees as a whole between the years 2018 and 2017.

| Percentage change in remuneration in 2018 compared with 2017 | Group Chief Executive % | Group Finance Director % | Group employees % |
|---|---|---|---|
| Salary and fees | 2.50 | 4.90 | 2.50 |
| All taxable benefits | 0.58 | 18.39[1] | 2.93 |
| Annual bonuses | (63.37) | (61.49) | (9.68) |

**Notes.**
1. All taxable benefits includes amounts paid in lieu of accrued dividends and interest arising upon the exercise of share options under the 2014 STI Scheme.

# DIRECTORS' REMUNERATION REPORT • ANNUAL REMUNERATION REPORT (CONTINUED)

**Comparison of total remuneration for the group CEO and UK employees**
Our 2017 Remuneration Report provided a comparison of total remuneration for the GCEO and an average of total remuneration for UK employees.

While recognising that the requirements on CEO pay ratio reporting as set out in The Companies (Miscellaneous Reporting) Regulations 2018 do not apply until reporting financial years beginning 1 January 2019 onwards, we set out here such analysis in line with those requirements. This analysis has been conducted using 'Option A' as set out in the regulations and has consisted of:

- Determining the total FTE remuneration of all UK employees for the 2018 financial year;
- Ranking all those employees based on their total FTE remuneration from low to high; and
- Identifying the employees whose remuneration places them at the 25th, 50th (median) and 75th percentile points of this ranking.

The analysis is then presented to show the ratio of the GCEO's 2018 single total figure of remuneration to the:

- Median (i.e. 50th percentile) FTE remuneration of our UK employees;
- 25th percentile FTE remuneration of our UK employees; and
- 75th percentile FTE remuneration of our UK employees.

In future years, this analysis will be repeated to provide a multi year analysis of GCEO pay ratio.

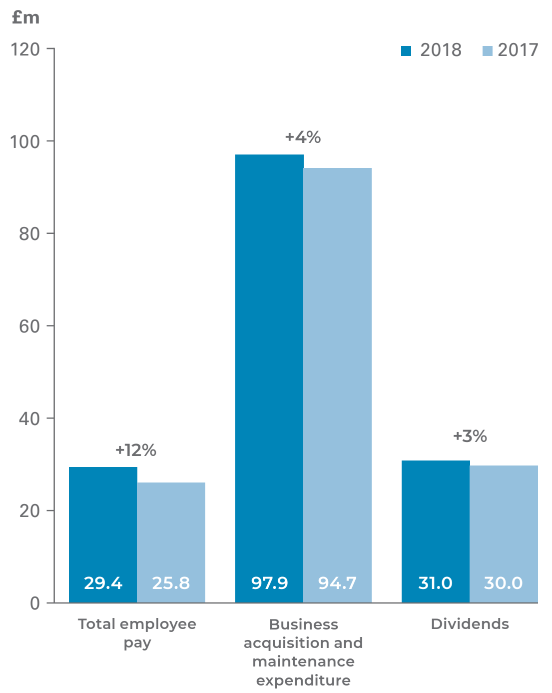
| Comparison of total remuneration in 2018 | 25th percentile pay ratio (FTE UK employees total remuneration) | Median pay ratio (FTE UK employees total remuneration) | 75th percentile pay ratio (FTE UK employees total remuneration) |
|---|---|---|---|
| 2018 | 15.2 : 1 | 9.8 : 1 | 6.4 : 1 |

The Remuneration Committee considers that the ratio is consistent with our Remuneration Policy and that no actions arise from this analysis.

**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.

2018 employee pay and acquisition and maintenance expenditure includes a full year of costs in relation to Scildon, whereas 2017 only incorporates 9 months of Scildon costs from the point of acquisition in April 2017.

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. This has been chosen as a comparator to give an indication of the employee pay relative to the overall cost base. As can be seen, the total employee pay is a relatively small component.




**Statement of implementation of Remuneration Policy in the following financial year**
The Remuneration Policy took effect following approval at the 2017 AGM. This section sets out how the policy will be implemented during 2019.

**Salaries and fees**
Will be set in accordance with the company's Remuneration Policy.

**Executive directors**
The salary of John Deane (GCEO) has been increased from £439.1k to £448.8k and the salary of David Rimmington, (GFD) has been increased from £277.0k to £283.1k, both in line with the 2.2% average pay increase awarded to UK staff.

**Non-executive directors**
In line with the average salary increase to staff, the board has increased the base fee and committee chairmanship fees for non-executive directors by 2.2%. The Chairman's fee has also increased by 2.2% to £122.6k.

The table below sets out the anticipated payments to non-executive directors for 2019:

| | Fees £000 | Benefits[1] £000 | Total £000 |
|---|---|---|---|
| Peter Mason | 122.6 | 1.0 | 123.6 |
| Veronica Oak | 60.8 | 1.0 | 61.8 |
| David Brand[2] | 66.0 | 1.0 | 67.0 |
| Jane Dale | 66.0 | 1.0 | 67.0 |
| Mark Hesketh | 60.8 | 1.0 | 61.8 |
| **Total** | **376.2** | **5.0** | **381.2** |

**Notes.**

1. Benefits shown here relate to expenses grossed up for income tax, which is settled by the company for travel to Chesnara's head office in Preston, which, for tax purposes, is deemed to be the non-executive director's normal place of work.
2. David Brand's fee reflects his appointment to the Chesnara Remuneration Committee effective 28 September 2018.

**2019 award under the 2014 Short-Term Incentive Scheme**

The Remuneration Committee proposes to grant awards to the executive directors under the 2014 Short-Term Incentive Scheme.

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, they will be disclosed in 2020 together with the performance outcome relative to these targets.

| Individual | Measures | Weighting | Ranges and targets | | | Potential outcomes in terms of % of basic salary | | |
|---|---|---|---|---|---|---|---|---|
| | | | Minimum achievement (as % of target) | Target achievement (as % of target) | Maximum achievement (as % of target) | Minimum achievement | Target achievement | Maximum achievement |
| John Deane | Cash generation | 40.0% | 80.0% | 100.0% | 130.0% | nil | 12.0% | 40.0% |
| | EcV profit | 40.0% | 70.0% | 100.0% | 150.0% | nil | 16.0% | 40.0% |
| | Group strategic objectives | 20.0% | 75.0% | 100.0% | 125.0% | nil | 10.0% | 20.0% |
| David Rimmington | Cash generation | 40.0% | 80.0% | 100.0% | 130.0% | nil | 10.8% | 36.0% |
| | EcV profit | 40.0% | 70.0% | 100.0% | 150.0% | nil | 14.4% | 36.0% |
| | Group strategic objectives | 20.0% | 75.0% | 100.0% | 125.0% | nil | 9.0% | 18.0% |

The STI will be implemented and operated by the Remuneration Committee as set out within the Remuneration Policy.

*Measures*

In 2018, three measures were used by the Remuneration Committee, namely IFRS pre-tax profit, EcV profit (together accounting for 80% of the assessment) and achievement of group strategic objectives (20%). Following review by the Remuneration Committee, changes were approved for 2019 to remove the IFRS component and base performance assessment on cash generation, EcV profit metrics with appropriate adjustments and group strategic objectives. The two financial measures are deemed to be complementary when operated together, to encourage sensible executive behaviour and better reflect an overall assessment of company financial performance. Our assessment measures 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 financial measures are recognised outputs from the audited year-end Financial Statements, although it should be noted that the Remuneration Committee is, in accordance with the Remuneration Policy, 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.

We include the latest approved Remuneration Policy on page 73 of the Report and Accounts. Whilst the policy makes several specific reference to IFRS profit as being one of the key financial metrics, it also refers to the fact that 'targets may include, but are not limited to costs, IFRS pre-tax profit, EcV operating profit, cash generation, group strategic objectives and personal performance'. As such, the proposed shift in focus in 2019 from IFRS profit and EcV operating profit to cash generation and total EcV profits is deemed to be in accordance with our approved policy.

*Weightings*

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

*Targets*

The cash generation and EcV 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, in accordance with the scheme rules.

*Malus and clawback*

This scheme includes malus and clawback provisions covering material misstatement, assessment error and misconduct if this arises within 2 years of an award vesting.

# DIRECTORS' REMUNERATION REPORT • ANNUAL REMUNERATION REPORT (CONTINUED)

**2019 award made under the 2014 LTI**

In 2019, 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 2022 together with the actual performance against those targets.

| Individual | Share award | Measures | Weighting | Ranges and targets | | | Vesting rates | | |
|---|---|---|---|---|---|---|---|---|---|
| | % of basic salary | | | Minimum achievement (as % of target) | Target achievement | Maximum achievement (as % of target) | Minimum achievement | Target achievement | Maximum achievement |
| John Deane | 100% | TSR | 50% | =Median | Median | Upper quartile | nil | 12.5% | 50.0% |
| | | EcV | 50% | | | | nil | | 50.0% |
| David Rimmington | 90% | TSR | 50% | =Median | Median | Upper quartile | nil | 12.5% | 50.0% |
| | | EcV | 50% | | | | nil | | 50.0% |

The 2019 award under the 2014 LTI will be implemented and operated by the Remuneration Committee as set out within the Remuneration Policy.

*Measures*

The two performance measures for the 2019 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 which are set with due regard to the board approved business plan. 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 3-year performance period ending 31 December 2021.

*Weightings*

For the 2019 award, the two measures have been assigned equal weighting.

*Holding period*

Following the Remuneration Committee's review of the new UK Corporate Governance Code, a 2 year holding period has been introduced to the LTI Scheme, to follow the 3 year performance period.

*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.

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 and Scildon.

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, in accordance with the scheme rules and the Remuneration Policy.

*Malus and clawback*

This scheme includes malus and clawback provisions covering material misstatement, assessment error and misconduct if this arises within 2 years of an award vesting.

The following table sets out the voting in respect of the Directors' Remuneration Report at the 2018 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 | 96,518,190 | 98.51% | 1,461,107 | 1.49% | 97,979,297 | 8,635 |

The following table sets out the voting in respect of the Directors' Remuneration Policy at the 2017 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 Policy | 92,417,545 | 97.93% | 1,958,029 | 2.07% | 94,375,574 | 65,457 |

**Approval**

This report was approved by the Board of Directors on 28 March 2019 and signed on its behalf by:

Veronica Oak
Chairman of the Remuneration Committee

## DIRECTORS' REMUNERATION REPORT

# REMUNERATION POLICY

The current Remuneration Policy was approved by our shareholders at the Annual General Meeting 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**

**Introduction**

**Remuneration 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.

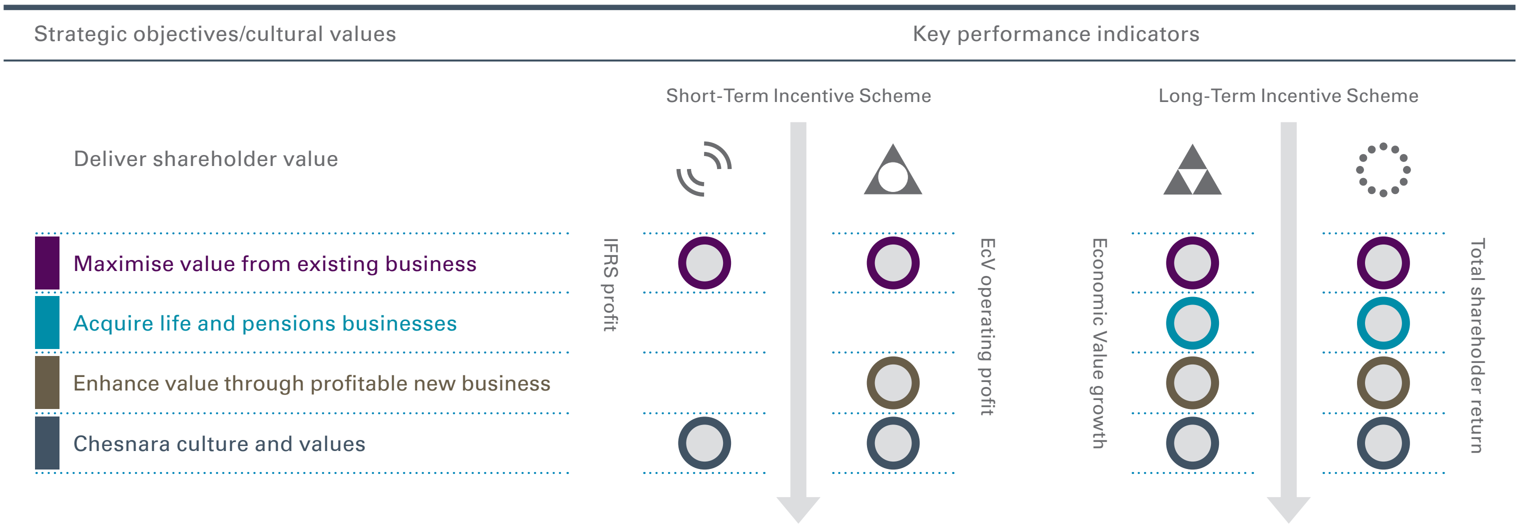
The achievement of these objectives are considered against the culture and risk environment of the company to ensure that rewards do not encourage excessive risk taking or an inappropriate culture to develop.

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 short and long-term incentives 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 Total Shareholder Return 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 73 to 79 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.



## DIRECTORS' REMUNERATION REPORT • REMUNERATION POLICY (CONTINUED)

**The implementation of this policy involves:**

- paying salaries that reflect individual roles, an 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 policy table**
*Executive directors' remuneration*
The following tables give an overview of the company's policy on the different elements of the remuneration package.

| Purpose and link to strategy | Operation | Performance measures and maximum |
|---|---|---|
| **Basic salary** | | |
| **To recruit and retain individuals with the skills and experience needed for the role and to contribute to the success of the group.** | 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:<br>– assessment of the responsibilities of the role<br>– the experience and skills of the jobholder on commencement of the role and their development at the review point;<br>– the group's salary budgets and results;<br>– the jobholder's performance;<br>– with the use of periodic benchmarking exercises, the external market for roles of a similar size and accountability;<br>– inflation and salaries across the company; and<br>– balance between fixed and variable pay to help ensure good risk management.<br>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.<br>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). | 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. |
| **Taxable benefits** | | |
| **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.** | 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.<br>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. | No performance measures attached. |

### The remuneration policy table (continued)

| Purpose and link to strategy | Operation | Performance measures and maximum |
|---|---|---|
| **Pensions** | | |
| **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. |
| **Short-Term Incentive Scheme (STI)** | | |
| **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.** | 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.<br><br>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 3 year deferral period and the balance in cash.<br><br>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.<br><br>It is the intention of the committee to grant awards annually and the performance criteria will be set out in the corresponding Remuneration Report.<br><br>The STI Scheme includes malus and clawback provisions. | 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%.<br><br>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.<br><br>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.<br><br>The committee may substitute, vary or waive the performance measures in accordance with the Scheme rules.<br><br>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. |
| **Long-Term Incentive Scheme (LTI)** | | |
| **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.** | 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 3 year period.<br><br>It is the intention of the committee to grant awards annually and the performance criteria will be set out in the corresponding Remuneration Report.<br><br>The LTI Scheme includes malus and clawback provisions. | 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:<br><br>**1. Total Shareholder Return:** 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.<br><br>**2. Group Economic Value:** 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.<br><br>The committee may substitute, vary or waive the performance measures in accordance with the scheme rules.<br><br>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. |

# DIRECTORS' REMUNERATION REPORT • REMUNERATION POLICY (CONTINUED)

## Non-executive directors' remuneration

| Purpose and link to strategy | Operation | Performance measures and maximum |
|---|---|---|
| **Fees & expenses** | | |
| **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.** | 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.<br>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.<br>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. | Fees for the Chairman and non-executive directors are not performance related.<br>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. |

**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 to 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 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 Scheme (STI)**

(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 Scheme (LTI)**

(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 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 2021. 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 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.

# DIRECTORS' REMUNERATION REPORT • REMUNERATION POLICY (CONTINUED)

### Service contracts and loss of office

***Executive directors***

Our policy is for executive directors to have service contracts with a rolling 12 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 Leaver' 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 |
|---|---|---|---|---|---|
| **By executive director or company giving notice (and where deemed to be a Bad Leaver).** | 12 months | Cease on date employment ends.<br>Payment may be made for any unused holiday entitlement. | No grants following service of notice.<br>Right to cash payment and unvested deferred share awards cease on date employment ends.<br>Outstanding options must be exercised within 6 months of date employment ends. | No grants following service of notice.<br>Unvested awards lapse on date employment ends.<br>Outstanding options must be exercised within 6 months of date employment ends. | Cease on date employment ends. |
| **By company summarily (Bad Leaver).** | None | Cease on date employment ends. | No further grants.<br>Right to cash payment and unvested deferred share awards cease on date employment ends.<br>Outstanding options must be exercised within 6 months of date employment ends. | No further grants.<br>Unvested awards lapse on date employment ends.<br>Outstanding options must be exercised within 6 months of date employment ends. | Cease on date employment ends |
| **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.** | None prescribed | Normally cease on date employment ends.<br>Payment may be made for any unused holiday entitlement.<br>Discretion for the 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.<br>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.<br>Where employment ends before deferred share awards made, at the discretion of the committee, the award may be retained.<br>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.<br>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.<br>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.<br>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.<br>Where employment ends before share awards vest, at the discretion of the committee the award may be retained.<br>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.<br>In either case the award will be pro-rated to reflect the period of the Performance Period that has been worked.<br>The committee has discretion to pro-rate using a longer period.<br>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. |

**Non-executive directors**

- Appointments are made under a contract for services for an initial term of 3 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 3 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 3 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.

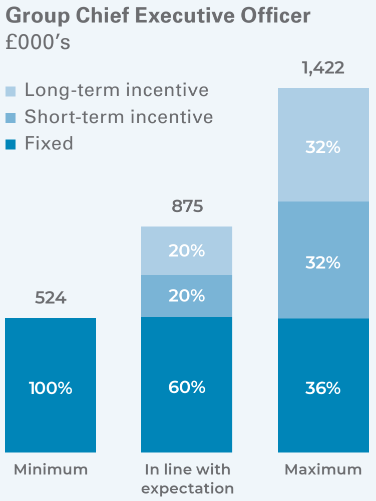
**Other directorships**

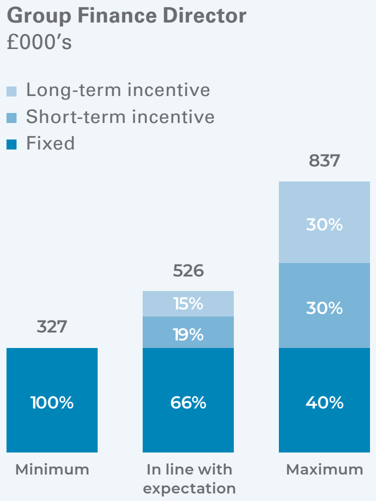
Executive directors may, if approved by the board, accept appointments as non-executive directors of suitable organisations. Normally fees for such positions are paid to the company, unless the board determines otherwise.

**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 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 2019:

| Director | Salary and fees £000 | Benefits £000 | Pension £000 | Total fixed pay £000 |
|---|---|---|---|---|
| Group Chief Executive | 448.8 | 32.3 | 42.6 | 523.7 |
| Group Finance Director | 283.1 | 16.8 | 26.9 | 326.8 |

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.

# AUDIT & RISK COMMITTEE REPORT

IFRS 17, the potential risks of Brexit and the embedding of Scildon into the group have been key areas of focus for the committee during the year

**NUMBER OF MEETINGS DURING YEAR: 9**

**MEMBERS:**

Jane Dale - Chairman
Mike Evans - Member
(resigned 1 October 2018)
David Brand - Member
Veronica Oak - Member
Mark Hesketh - Member
(appointed 17 December 2018)

The requirements for the composition of the Audit & Risk Committee are detailed within its terms of reference. The composition of the committee in accordance with the requirements of the UK Corporate Governance Code and with DTR 7.1.1AR and committee member biographies are detailed on pages 50 and 51.

### Chairman's introduction

It has been another busy year for the Chesnara Audit & Risk Committee. As well as the usual responsibilities that the committee has undertaken, we have also spent significant time on non-routine matters. These have included the commissioning of an External Quality Assessment (EQA) of the internal audit function, overseeing the implementation of General Data Protection Regulations (GDPR) across the group, focusing on developments in IFRS financial reporting – most notably IFRS 17 'Insurance Contracts' – and monitoring Brexit and its potential impact on the group. The committee has had a change in membership during the year, with Mike Evans moving on from Chesnara in October 2018 and Mark Hesketh joining in December 2018. I would like to thank Mike for his excellent contribution to the committee and extend a warm welcome to Mark.

**IFRS 17:** The group's IFRS 17 programme commenced in earnest during the year, kicking off with an impact assessment that focused on the technical, financial and operational implications of the standard. This work was supported by a consultancy firm, with the findings and observations from this phase being used to scope and subsequently commence the delivery phase of the programme. It is too early to say at this stage what the full operational and financial effects will be on the business, especially in light of certain aspects of the standard remaining under review, but the implementation is expected to require significant effort and as a result will be closely monitored by the committee.

**Brexit:** The Brexit situation and the potential impacts on the group have been monitored closely. From an Audit & Risk Committee perspective, the main focus has been on ensuring any associated risks are understood to the fullest extent possible to ensure that management and the board are sufficiently informed on its potential impact. Further information on the group's view of the impact of Brexit can be found on page 15 of the Chairman's Statement. In addition, our prospects and viability reporting has been updated to reflect this view, as shown on page 41.

**Scildon embedding:** This year is the first full year of ownership of Scildon following its acquisition in 2017. During the year, the committee continued to monitor the integration of the business into the wider Chesnara group. Particular focus was given to the alignment of Scildon's risk and governance framework with that of Chesnara's, coupled with overseeing the ongoing integration of the company's financial reporting routines. These developments have supported the committee in performing its oversight of the financial performance, risks and issues within the business.

**Internal audit EQA:** During the year, the committee oversaw an external quality assessment over the group's internal audit function. As the group has grown over recent years, most recently with the acquisition of Scildon in the Netherlands, it felt appropriate to take stock by obtaining an external view of the current internal audit arrangements and benchmarking them against industry practice and peers. A report has been provided by the external firm performing the review and is currently being considered by the committee. The committee will oversee the implementation of any relevant actions in response to the observations arising from the review.

**GDPR:** The committee oversaw, through its risk oversight obligations, the implementation risks associated with complying with the GDPR. Regular reporting was provided to the committee on the group's GDPR readiness programme with all divisions delivering their plans successfully and on time.

The committee has continued its oversight of the risk management system and internal controls and it is pleasing to report that the results of the annual report presented to the committee on these areas continue to show that the risk management system and internal control framework continue to operate effectively.

Looking forward, there continues to be a full agenda for the committee. It will continue to closely monitor the IFRS 17 implementation programme, where it will be responsible for reviewing key technical and implementation decisions, including developments in the financial reporting processes where necessary. In addition, the committee is planning on overseeing a group-wide operational resilience programme as part of its responsibilities to ensure that the group continues to operate with the high standards that are expected of it from its customers and regulators. Reviews of the external audit profession will also be monitored with great interest given the potential for far-reaching reforms in this area.

Jane E Dale

Jane Dale
Chairman of the Audit & Risk Committee

28 March 2019

## THE RESPONSIBILITIES OF THE CHESNARA AUDIT AND RISK COMMITTEE COVER A COMBINATION OF RISK AND AUDIT MATTERS RELEVANT TO CHESNARA. THE FOLLOWING REPORT HAS BEEN STRUCTURED TO REFLECT THIS.

### Audit responsibilities

This section of the report includes the following:

1. **Activities during 2018:** A summary of the work performed by the Audit & Risk Committee during the year.
2. **External audit:** Further detail of how the committee has overseen various aspects of the external audit process.
3. **Internal audit:** The work performed by the committee in overseeing the internal audit function of Chesnara.
4. **Significant issues:** Provides some insight into the significant issues that the committee has considered during the year in relation to the financial statements, and how these were addressed.

**1. Activities during 2018**

The committee's activity during the calendar year is driven by a combination of 'business as usual' items and non-standard areas on which the committee has decided to focus. For 2018, these non-standard areas have included, amongst other things, monitoring and actively steering the group's IFRS 17 'Insurance contracts' programme and overseeing the delivery of an external quality assessment of the internal audit function. A summary of all the activities performed by the committee during the year in relation to its audit responsibilities is included in the table below.

| | |
|---|---|
| **Financial reporting** | – **Solvency II narrative reporting:** Supported the further development of, and review of, the Chesnara group Solvency and Financial Condition Report and Regular Supervisory Report and the supporting quantitative reporting templates.<br>– **Financial performance:** Monitored and scrutinised the financial performance of the group during the year, covering IFRS, Solvency, EcV and cash generation.<br>– **Actuarial assumptions:** Reviewed and challenged the actuarial assumptions underpinning the quarterly financial reporting process, covering IFRS, Solvency II and EcV. See 'Significant issues' section on page 84 for further detail.<br>– **Annual Report and Accounts:** Reviewed all aspects of the Annual Report and Accounts, including; compliance with accounting standards, accounting policy appropriateness, consideration of financial reporting changes and emerging practice, whether they are fair, balanced and understandable and disclosures surrounding going concern, prospects and longer-term viability (including any associated management supporting papers). See 'Significant issues' section on page 83 to 84 for further details on certain aspects of the 2018 Annual Report and Accounts.<br>– **Scildon embedding:** Oversaw the embedding of the financial reporting routines of Scildon into the wider Chesnara group.<br>– **Half Year Report:** Reviewed and challenged the Chesnara Half Year Financial Report for the 6 months ended 30 June 2018.<br>– **IFRS 17:** Oversaw the group's IFRS 17 programme, which commenced during the year. The programme was initially supported by partnering with a consultancy firm.<br>– **FRC updates:** Actively monitored key publications issued by the Financial Reporting Council regarding financial reporting matters. |
| **External audit** | – **External audit plans:** Reviewed the group-wide plans of the external auditor, including consideration of the key audit risks. See page 82 for further detail.<br>– **External audit quality:** Assessed the quality of the external auditor during the year, including consideration of feedback from management and reports issued by the Financial Reporting Council.<br>– **External audit reporting and feedback:** Reviewed key findings reported by the external auditor on the Annual Report and Accounts and Half Year Report, including financial reporting judgements and control matters. As part of its interactions with the external auditor, the committee met with the external auditor without the presence of executive directors.<br>– **External audit independence:** Reviewed the assessment regarding the independence of the external auditor, with specific consideration given to audit fees and also the nature / volume of the services delivered by the external auditor during the year. |
| **Internal audit** | – **Review of plans:** Reviewed and approved the plans of the internal audit functions across the group, via interactions with local Audit & Risk Committees. See page 82 for more information.<br>– **Oversight of external quality assurance review:** The committee oversaw the delivery of an external quality assessment over the internal audit function of Chesnara. Plans are being created in consideration of the assessment.<br>– **Review of internal audit findings:** Received regular updates from local Audit & Risk Committees regarding key findings from divisional internal audits that have been performed during the year. Reviewed the internal audit findings, management responses and tracking of required follow up actions for Chesnara entity internal audits. See page 82 for more information. |
| **Other** | – **Feedback from divisional Audit and Risk Committees:** Reviewed and challenged regular feedback provided by the group's divisional Audit & Risk Committees.<br>– **Committee terms of reference:** The committee reviewed its terms of reference during the year and also completed its annual assessment of compliance with its terms of reference.<br>– **Performance evaluation:** The committee conducted a performance evaluation, completed by members regarding various aspects of the committee's performance. |

**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 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**

# AUDIT & RISK COMMITTEE REPORT (CONTINUED)

## 2. External audit

**Effectiveness of the audit process**
The effectiveness of the external audit process is performed on an annual basis and 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 2016 and this will be his third year leading the Chesnara audit;
- 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;
- The report produced by the Financial Reporting Council dated June 2018 entitled 'Deloitte 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. The company is committed to putting its audit out to tender at least every ten years, having completed its last external audit tender during 2017. The next audit tendering process will need to take place at the latest during 2027, following the 2026 audit.

**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. Approval is granted where the service is clearly related to the process of audit services, including regulatory returns ('Assurance services'). In other cases, the approval of the committee is required and documented governance processes are followed.

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 Deloitte, and its associates, for both audit and non-audit services during the year have been provided below, with associated commentary.

| Audit fees | 2018 £000 | % proportion | 2017 £000 | % proportion |
|---|---|---|---|---|
| Audit services | 808 | 77 | 647 | 61 |
| Assurance services | 235 | 23 | 413 | 39 |
| Non-audit services | – | – | – | – |
| **Total** | **1,043** | | **1,060** | |

*Audit services*
The fees charged for audit services have increased when compared with 2017. The main reason for this is due to Deloitte now performing the external audit of Scildon NV's local statutory accounts. In 2017, this was performed by Ernst & Young.

*Assurance services*
The cost of assurance services performed by the external auditor has reduced compared with the prior year. The key reason for this is that the Chesnara group no longer requires the external auditor to provide an opinion on the group's or Countrywide Assured's Solvency and Financial Condition Report, following UK regulatory rule changes during the year.

*Non-audit services*
There were no other non-audit services in 2018 aside from the assurance services as detailed above.

## 3. Internal audit

During the year, Chesnara has continued to adopt its devolved, federal model for internal audit. This means that each subsidiary company is responsible for the oversight of its own internal audit work, supervised by each local Audit & Risk Committee. As a result, the group utilises a mix of outsourced and in-house capabilities, adapted to meet the specific needs of each local market. The Chesnara Audit & Risk Committee maintains oversight of each subsidiary via regular updates from each local Audit & Risk Committee.

During 2018, the committee commissioned the delivery of an external quality assessment of the internal audit function of the group. The assessment, which is consistent with the Chartered Institute of Internal Auditors (CIIA) requirement to undertake an external review of a company's internal audit function, sought to report back to the committee on the effectiveness of internal audit across the group. It was performed through a combination of interviews with senior management and internal audit personnel, coupled with a review of various planning and reporting documentation that is produced by the internal audit function. A draft report was presented to the committee during December 2018 and is in the process of being finalised. Following completion of this phase, the committee will be charged with overseeing the delivery of any enhancements that have been identified from this review.

**4. Significant issues:**

The table below/overleaf provides information regarding the significant issues that the committee has considered in relation to the preparation of these financial statements:

| Area of focus | Reporting issue | Role of the committee | Conclusion/action taken |
|---|---|---|---|
| **New accounting standards** | There are a number of new accounting standards that affect the preparation of these financial statements. A summary of their impact is below:<br>– **IFRS 9 'Financial Instruments':** This new standard replaces IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for financial statements with accounting periods beginning on or after 1 January 2018. However, for reporting entities whose activities are predominantly connected with insurance, a temporary exemption is available such that IFRS 9 will apply from the earlier of IFRS 17 'Insurance Contracts' coming into force and 1 January 2022. Certain deferral disclosures are required for the group as a result of applying this exemption. IFRS 9 has, however, been applied in the Chesnara plc company only balance sheet.<br>– **IFRS 15 'Revenue from Contracts with Customers':** IFRS 15 is a new accounting standard that applies for the first time in this year's financial statements and deals with revenue recognition and disclosures from contracts with customers, and replaces IAS 18 'Revenue'. The financial statements have been reviewed and updated in order to comply with the requirements of IFRS 15. The result of the review was that there was no requirement to change the recognition profile of any components of revenue as they already comply with the requirements of IFRS 15. However, we have taken the opportunity to refine some of the revenue category descriptions.<br>– **IFRS 16 'Leases':** A new accounting standard for leases comes into force for accounting periods beginning on or after 1 January 2019, with the consequence that Chesnara will be reporting against this new standard for the first time in the 2019 Half Year Report. Whilst the new standard does not apply to this set of financial statements, IAS 8 requires companies to disclose, to the extent this is possible, the impact of applying new or revised IFRSs that are issued but not yet effective. The group's impact assessment has shown, as expected, that the group does not make extensive use of leases, either through direct lease arrangements or through the use of assets that form part of wider contractual arrangements, and as a result the impacts on the balance sheet and income statement are not expected to be significant. The most material leases within the group relate to occupied office space.<br>– **IFRS 17 'Insurance Contracts':** IFRS 17 is the new accounting standard for insurance contracts and represents an extensive re-working of the existing insurance contracts accounting framework. During the year, it was proposed that the effective date of the new standard is delayed a year to periods beginning on or after 1 January 2022, and certain aspects of the standard are currently under review by the IASB. The group's IFRS 17 programme is underway and developments in the accounting standard are being monitored closely. Further information can be found in Note 2(a) on pages 106 and 107 | The committee's involvement has been centred around ensuring that it is appropriately educated regarding the requirements of the new accounting standards, and to have reviewed impact assessment papers prepared by management regarding their application. In addition to this the committee has paid close attention to the disclosures in the IFRS Financial Statements regarding the application of the new standards.<br>For IFRS 17, which is a group-wide, cross-functional and multi-year programme, the committee has been closely involved in initial scoping of the programme and is involved in decision making as the programme progresses. | The committee is satisfied that the impact assessments and disclosures as included in Note 2 of the IFRS Financial Statements are appropriate and reflect the facts and circumstances of the business. |

# AUDIT & RISK COMMITTEE REPORT (CONTINUED)

**4. Significant issues continued:**

| Area of focus | Reporting issue | Role of the committee | Conclusion/action taken |
|---|---|---|---|
| **Prospects and longer-term viability** | The uncertainty surrounding Brexit has heightened the focus on company disclosures surrounding prospects and longer term viability. In particular, the Financial Reporting Council has reminded companies regarding the reporting of the risks and potential impacts of Brexit and how these are reflected in such statements. In light of this, the company's prospects and longer-term viability statements, as shown on page 41 have been updated to reflect the most recent views of the directors, and in particular cover their views on the impact of Brexit. | The committee has reviewed the disclosures in the Financial Statements and management's' papers supporting the disclosures that have been made. It was concluded that the disclosures were appropriate. | The committee is satisfied with the group's prospects and longer-term viability statements as included on page 41. Further information regarding the impact of Brexit has been included on page 41. |
| **Actuarial assumptions** | A key aspect of the Audit & Risk Committee's role is to review and challenge the actuarial assumptions that underpin the valuation of the policyholder liabilities in the financial statements. The assumptions are inherently judgemental and are updated at least annually to reflect the facts and circumstances available at the time. The assumptions are underpinned by a combination of internally observed experience coupled with data that is available at a market level. The key assumptions include estimates over:<br>– future mortality and morbidity rates;<br>– future lapse assumptions;<br>– future expense required to manage the policies in force; and<br>– policyholder options. | The committee reviewed and approved the actuarial basis of assumptions report underpinning the valuation of insurance liabilities. | The committee concluded that the actuarial assumptions were appropriate. Disclosures over key judgements are included in on pages Note 3 and Note 30 of the IFRS financial statements. |
| **Scildon acquired value in-force intangible asset** | The purchase of Scildon resulted in the recognition of a material intangible asset, representing the value of the policies that were in-force at the point of acquisition. As part of the process for preparing the Financial Statements, and in the context of the loss that Scildon reported for the year, an impairment review over the carrying value of the intangible asset was performed. | The committee has ensured that a review of the carrying value of the Scildon AVIF asset was performed. | The committee concluded that the carrying value of the intangible AVIF asset was not impaired. |

## Risk responsibilities

This section of the report provides information regarding the risk oversight responsibilities of the Audit & Risk Committee. Overall the committee is responsible for:

– the group's risk management and internal control systems and their effectiveness;
– overseeing the group's risk profile in the context of its current and future strategy;
– discussing and recommending to the board for approval, the group's risk appetite statement, reverse stress testing and scenario stress testing;
– advising the board on proposed changes to the group's risk appetite statement where this is deemed appropriate;
– monitoring risk exposures across the group and advising the board where such exposures do not appear to accord with the group's risk appetite statement;
– reviewing the group's capability to identify and manage emerging and new risk types;
– challenging the regular stress and scenario testing of the group's business;
– determining whether there is a sufficient level of risk mitigation in place;
– overseeing due diligence of a major strategic transaction, including any proposed acquisition or disposal, prior to the board taking a decision to proceed with a view to ensuring that the board is aware of all material risks associated with the transaction;
– considering the adequacy and effectiveness of the technology infrastructure and supporting documentation in the risk management system and framework;
– considering and approving the remit of the risk function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards;
– providing qualitative and quantitative advice to the Remuneration Committee on risk weightings to be applied to any performance objectives; and
– considering and recommending to the board for approval, the group's risk related regulatory submissions, including the ORSA.

The table below provides some further information regarding the specific activities that the committee has performed during the year in discharging its risk oversight responsibilities:

- **Quarterly risk reporting:** During the year, the committee reviewed the quarterly group and divisional risk reports on the identification, evaluation and management of principal risks across the group, including any emerging risks. As part of this process, it flags any items of concern or clarification requiring follow up. The quarterly risk reporting included 'in focus' sections as required, including amongst other things;
  - a focus on operational resilience following the publication of the Bank of England's discussion paper on 'Building the UK financial sector's operational resilience';
  - Brexit;
  - Capital risk appetites following the issue of the PRA's policy statement 10/18 entitled 'Financial management and planning by insurers'; and
  - reporting on plans and progress regarding integrating the Scildon risk management framework into the wider group. This has facilitated greater oversight by the committee over the risks and issues in the Scildon business.
- **Principal risk definition:** Reviewed and challenged the group's definition of principal risks for the purpose of reporting and monitoring against these risks, including how they are mitigated through the group's internal control framework.
- **Risk plan review and sign off:** The committee reviewed and approved the group and divisional risk plans and associated resourcing needs.
- **Internal control report:** The committee reviewed and approved the annual internal controls assessment report, which concluded that the controls across the group are operating effectively.
- **Systems of governance review:** An annual review of the effectiveness of the systems of governance review was facilitated by the risk function. This considered a number of areas of the overall system of governance including its completeness, effectiveness, its use and the overall culture. This concluded there were no major areas of concern. Any areas for improvement have been built into the 2019 plans, with suitable priorities attached.
- **ORSA review:** The committee reviewed the 2018 ORSA, and made a formal recommendation to the board to approve it. The ORSA includes the outcome of the group's stress and scenario testing. The stresses that are modelled are reviewed and approved as part of the ORSA planning process, and the results are included in the final ORSA report.
- **Risk appetite:** Reviewed and approved developments to the group's risk appetite framework, which was improved to more clearly and consistently articulate risk taking preferences across the group and to increase alignment of the key risk indicators/tolerance limits with stakeholder interests and key business performance measures.
- **Continuous solvency monitoring:** Reviewed the output from the group's continuous solvency monitoring activities. There were no issues arising from this process during the year.
- **Standard formula assessment:** As part of its annual cycle, the actuarial function performs an assessment of the appropriateness of the standard formula for the purposes of calculating the group's capital requirements under Solvency II. The work and associated findings was reviewed and challenged by the committee.

Jane Dale
Chairman of the Audit & Risk Committee

28 March 2019

# DIRECTORS' REPORT

**Chesnara plc - Company No. 4947166**

The directors present their annual report and the audited consolidated financial statements of Chesnara plc for the year ended 31 December 2018. The Corporate Governance Report on pages 54 to 57 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 40 to 41 and the 'Risk management' section on pages 42 to 45.

*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 24 to 29.

*Greenhouse gas reporting*
The 'Corporate and social responsibility' section on page 47.

*Environmental, employee and social community matters*
The 'Corporate and social responsibility' section on page 46.

**Directors**
Full information of the directors who served in 2018 is detailed in the Corporate Governance Report on pages 54 to 57. 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 54 to 57. 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 62 to 79, 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 1 year's duration and will offer themselves for re-election at least every 3 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 2017 and 31 December 2018 and the period to 28 March 2019.

**Director evaluations**
During the year, the Chairman evaluated the performance of the directors in one-to-one meetings and the Senior Independent Director evaluated the performance of the Chairman. It was confirmed that each director continued to make effective contributions to their role and the board as a whole.

**Director appointments**
With regard to the appointment and replacement of directors, the company follows the UK Corporate Governance Code 2016 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. In December 2018, Mark Hesketh was appointed to the board following the departure of Mike Evans who stepped down on 1 October 2018.

**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 40 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 2018, the company had 149,908,956 ordinary shares in issue, of which none were held as treasury shares. During the year, the maximum number of treasury shares held was 86,040 with a nominal value £4,302. The number of treasury shares disposed of during the year was 86,040, with a nominal value of £4,302.

In order to retain maximum flexibility, the company proposes to renew the authority granted by ordinary shareholders at the Annual General Meeting in 2019, 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 2018, shareholders approved resolutions to allot shares up to an aggregate nominal value of £4,991,274 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.

**Articles of Association**
The company's Articles of Association may only be amended by special resolution of the company at a general meeting of its shareholders.

**Conflicts of interest**
Procedures are in place to ensure compliance with the directors' conflict of interest duties as set out in the Companies Act 2006. The company has complied with these procedures during the year and the board considers that the procedures operated effectively. During the year, details of any new conflicts or potential conflicts were advised and submitted to the board for consideration, and where appropriate, approved.

**Results and dividends**

The Consolidated Statement of Comprehensive Income for the year ended 31 December 2018, prepared in accordance with International Financial Reporting Standards adopted by the EU and set out on page 100 shows:

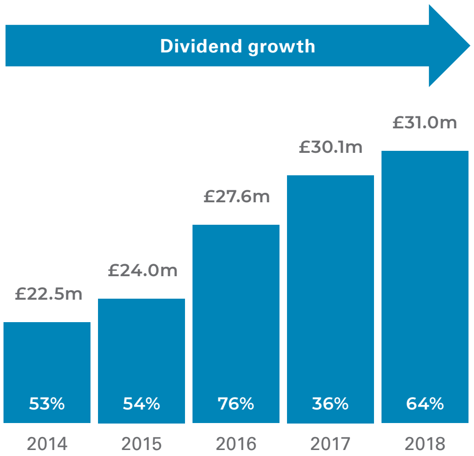
| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Profit for year attributable to shareholders | 24,124 | 78,434 |

An interim dividend of 7.21p per ordinary share was paid by Chesnara on 12 October 2018. The board recommends payment of a final dividend of 13.46p per ordinary share on 24 May 2019 to shareholders on the register at the close of business on 12 April 2019.

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%.

**Total dividend as a ratio of cash generated**




Over the past 5 years £135m of dividends have been paid at an average annual yield of 5.5% (based on average annual share prices) representing 53% of the cash generated over the period.

**Considerations**

| | |
|---|---|
| **Cash generation** | Historical 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. |
| **Solvency** | Dividends will not be paid if they were to result in a breach in our Group Capital Management Policy which currently sets a minimum dividend paying solvency constraint of 110%. |
| **Acquisition strategy** | 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. |
| **Investor expectations** | In addition to a stable and 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 historical financial results and the Group Capital Management Policy.

# DIRECTORS' REPORT (CONTINUED)

**Substantial shareholdings**

Information provided to the company by major shareholders pursuant to the FCA's Disclosure and Transparency Rules (DTR), is 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 2018 and 21 March 2019:

| Name of substantial shareholder | Total number of ordinary shares held | Percentage of the issued share capital as at 31 December 2018 |
|---|---|---|
| Aberdeen Standard Investments | 20,915,445 | 13.95% |
| Columbia Threadneedle Investments | 19,843,004 | 13.24% |
| Invesco Ltd | 9,815,819 | 6.55% |
| Hargreaves Lansdown Asset Management | 7,215,343 | 4.81% |
| M&G Investment Management | 6,042,744 | 4.03% |
| Janus Henderson Investors | 5,822,656 | 3.88% |
| Canaccord Genuity Wealth Management | 5,436,489 | 3.63% |
| Royal London Asset Management | 4,776,509 | 3.19% |

Subsequent to 31 December 2018 there have been changes to this position and the holdings as at 21 March 2019 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 2019 |
|---|---|---|
| Aberdeen Standard Investments | 21,088,051 | 14.06% |
| Columbia Threadneedle Investments | 19,833,322 | 13.23% |
| Invesco Ltd | 9,879,331 | 6.59% |
| Hargreaves Lansdown Asset Management | 7,189,420 | 4.80% |
| Canaccord Genuity Wealth Management | 6,671,864 | 4.45% |
| M&G Investment Management | 6,042,744 | 4.03% |
| Janus Henderson Investors | 5,406,656 | 3.61% |
| Royal London Asset Management | 4,748,782 | 3.17% |

**Related party transactions and significant contracts**

During the year ended 31 December 2018, the company did not have any material transactions or transactions of an unusual nature with, and did not make loans to, related parties in which any director has or had a material interest.

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

**Post balance sheet events**

There have been no post balance sheet events that either require adjustment to the Financial Statements or are important in the understanding of the company's current position, financial performance or results.

**Charitable donations**

Charitable donations made by group companies during the year ended 31 December 2018 were £14,000 (2017: £nil). No political contributions were made during the year ended 31 December 2018 (2017: £nil).

**Employees**

The average number of employees during the year was 363 (2017: 329).

**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. Detailed analysis of relevant risks and other factors is included within the Risk Management section on pages 42 to 45, within the Financial Management section on pages 40 to 41 and within Notes 5 and 6 to the IFRS Financial Statements.

**Disclosure of information to auditor**

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditor is unaware; and each director has taken all the steps that he 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**

The 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 28 March 2019 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

- 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

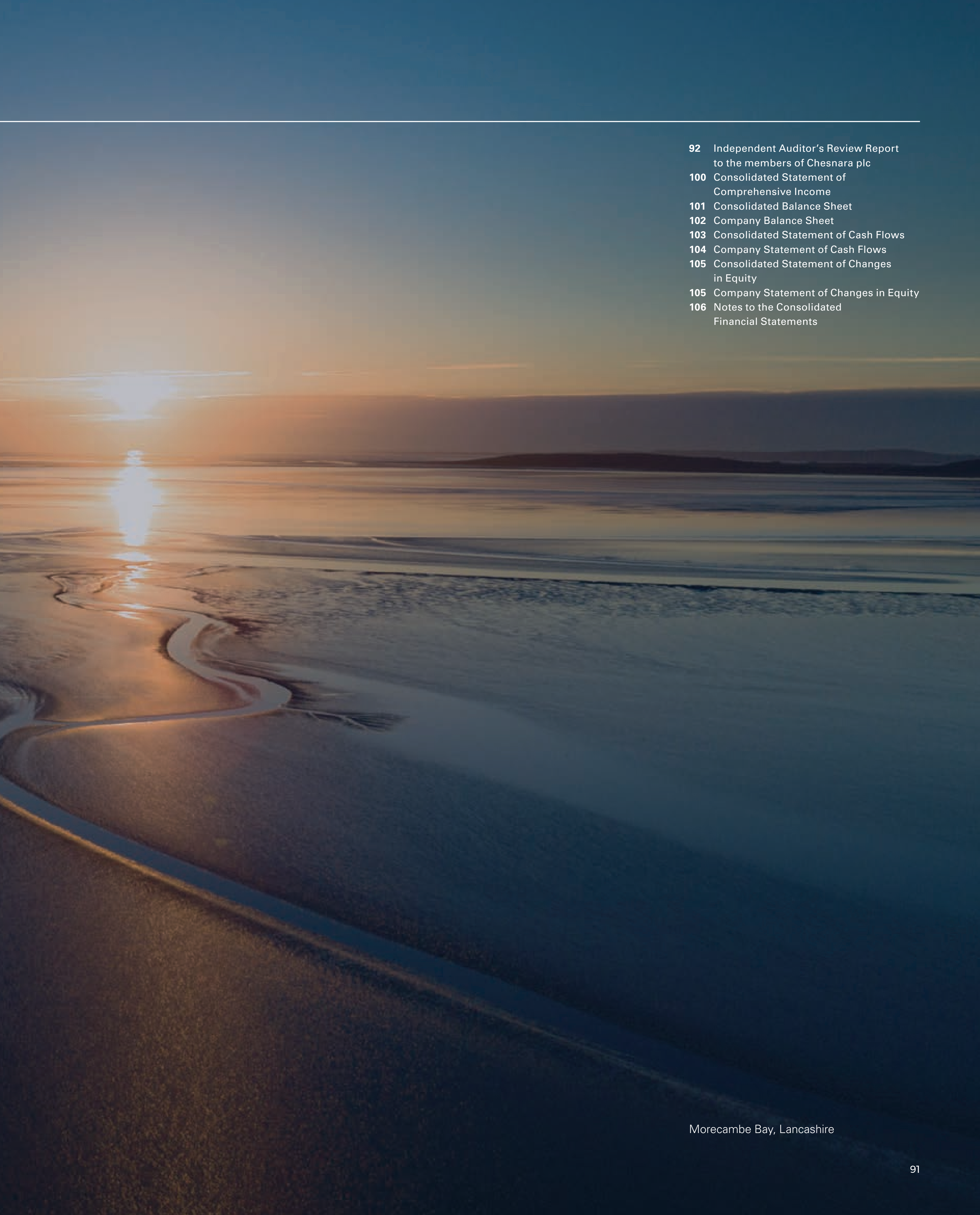
28 March 2019

John Deane
Chief Executive Officer

28 March 2019

SECTION D:

# IFRS FINANCIAL STATEMENTS





Morecambe Bay, Lancashire

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

## Report on the audit of the financial statements

### Opinion

**In our opinion**

- **the financial statements of Chesnara plc (the 'parent company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2018 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 and as applied in accordance with the provisions of the Companies Act 2006; and**
- **the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.**

We have audited the financial statements which comprise:

- the consolidated statement of comprehensive income;
- the consolidated and parent company balance sheets;
- the consolidated and parent company statements of cash flows;
- the consolidated and parent company statements of changes in equity;
- the statement of accounting policies; and
- the related Notes 1 to 51 excluding the capital adequacy disclosures in Note 29c calculated in accordance with the Solvency II regime which are marked as unaudited.

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.

### Basis for opinion

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

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

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

### Summary of our audit approach

| | |
|---|---|
| **Key audit matters** | The key audit matters that we identified in the current year were:<br>– Valuation of insurance liabilities, which includes the accuracy of the Save & Prosper ('S&P') Cost of Guarantees and the Scildon Liability Adequacy Test;<br>– Valuation of the Scildon Acquired Value In-Force ('AVIF') intangible asset; and<br>– Valuation of specific Level 2 financial instruments. |
| **Materiality** | The materiality that we used for the group financial statements was £12.0m (2017: £11.6m) which was determined on the basis of 3% of net assets. |
| **Scoping** | We focused our group audit scope on the audit work at three UK locations where the group's policies are administered, three overseas locations where the group's policies are also administered, and in Luxemburg where the group undertake certain fund management activities. |
| **Significant changes in our approach** | We have identified a new key audit matter in the period. This is around the valuation of certain financial instruments where the fair value is modelled using Level 2 inputs; specifically, the judgements used in the valuation of the embedded derivative within Movestic and the interest rate swap within Scildon. This is a new key audit matter in the period as, cumulatively with the Scildon interest rate swap, there is now a significant quantum of such complex instruments. |

## Conclusions relating to going concern, principal risks and viability statement

**Going concern**

We have reviewed the directors' statement in Note 2c 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 and company's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements.

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

We considered as part of our risk assessment the nature of the group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

**Principal risks and viability statement**

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

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

– the disclosures on pages 43-45 that describe the principal risks and explain how they are being managed or mitigated;

– the directors' confirmation on page 57 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; or

– the directors' explanation on page 41 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 are also required to report whether the directors' statement relating to the prospects of the group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

## Key audit matters

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

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

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

## Valuation of insurance liabilities

| | |
|---|---|
| **Key audit matter description** | Across the group, there are two matters relating to insurance liabilities which we have identified as key audit matters:<br><br>**a) Accuracy of Save & Prosper Cost of Guarantees:**<br>The assessment of the Cost of Guarantee reserves for policies written by Save & Prosper is complex and material, including the use of a stochastic model based on a variety of possible economic scenarios.<br><br>Historically, the residual cost to shareholders arising from the cost of guarantees has fluctuated as a result of movements in bond yields and equity markets with a value of £23.1m at 31 December 2018 (31 December 2017: £19.3m). This movement is mainly due to lower asset returns over 2018, which decreased policyholder asset shares, and increased the residual cost to shareholders. 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.<br><br>Due to the highly judgemental nature of this balance, we identified manipulation of this estimate as an area of potential fraud.<br><br>See Note 3e for management's consideration of critical accounting judgement and key sources of estimation and uncertainty, Note 30c for disclosure of the calculation methodology and the charge to income for the current and prior year.<br><br>**b) Scildon Liability Adequacy Test (LAT)**<br>Scildon measures the majority of its insurance contract liabilities using historical market rates of interest along with a number of other parameters and assumptions.<br><br>IFRS 4 requires an insurer, at the end of each reporting period, to assess whether its recognised insurance liabilities are adequate, using current estimates of future cash flows (the 'Liability adequacy test', or 'LAT'). Given Scildon's accounting policy makes use of historical market interest rates, there is a heightened risk that its insurance liabilities are not adequate. There is also a risk of management override over the setting of the parameters used to calculate the reserves at inception.<br><br>We therefore view the liability adequacy test and initial parameter setting process as key audit matters, specifically in relation to the mortality, lapse and expense assumptions which feed into the test, given that the insurance liabilities are most sensitive to these factors.<br><br>The accounting policy adopted by the group is documented within Note 2h to the financial statements. |
| **How the scope of our audit responded to the key audit matter** | In respect of the Accuracy of Save & Prosper Cost of Guarantees:<br><br>– 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.<br><br>– 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.<br><br>– 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.<br><br>– We developed an independent expectation of how the assumptions impact the model and challenged management's explanation and analysis to support any variations.<br><br>In respect of the Scildon Liability Adequacy Test we performed the following procedures:<br><br>– Evaluation of the design and implementation of the key controls over the setting of the assumptions feeding in to the LAT;<br><br>– Performed checks on the initial parameters used in setting the book cost reserves;<br><br>– Performed analytical checks on policy cash flows to identify outliers and movements compared to the prior period, which were then investigated;<br><br>– For a sample of policies, ran the policy cash flows through a model to test whether the calculations within management's model are accurate; and<br><br>– Assessed the results of the experience investigations carried out by management in comparison to industry studies and other sources of evidence to determine whether they provide support for the assumptions. |
| **Key observations** | Based on the audit procedures performed, we consider that the S&P Cost of Guarantees reserve is not materially misstated and we found that the initial parameter setting process and Liability Adequacy Test performed by management were reasonable, supporting the adequacy of Scildon's insurance contract liabilities. |

### Valuation of the Scildon AVIF intangible asset

| | |
|---|---|
| **Key audit matter description** | Following the acquisition of Scildon, Chesnara recorded an AVIF intangible asset of £66m on the group balance sheet, reflecting the capitalised future profit in the Scildon business.<br><br>Our key audit matter in the prior year related to the valuation of the intangible; this risk has then evolved in the current period, based on our ongoing assessment, to focus on the discount rate used by Management to discount the future policyholder cash flows underpinning the VIF.<br><br>Management is required to assess the impairment of the Scildon AVIF intangible balance at least annually, in line with IAS 36 Impairment of assets for investment contracts or, for insurance contracts, under the IFRS 4 Insurance Contracts liability adequacy test, which involves significant judgement.<br><br>Due to the highly judgemental nature of this balance, we identified manipulation of this assessment as an area of potential fraud.<br><br>See Note 3a for management's consideration of significant accounting judgements. The accounting policy adopted by the group is documented within Note 2o to the financial statements and the acquired in-force business intangible is disclosed in Note 19. |
| **How the scope of our audit responded to the key audit matter** | We assessed the design and implementation of the internal controls in place to monitor and mitigate the risk of inappropriate management adjustments to the key assumptions.<br><br>We constructed an independent discount rate, comparing this to the discount rate used by management and performing sensitivity analysis.<br><br>We challenged the amortisation profile produced by management for the future run off of the Scildon book. |
| **Key observations** | Based on the audit procedures performed, we consider the assumptions in the base VIF, and the calculation and magnitude of the adjustments thereof, and the resultant AVIF to be reasonable. We conclude that the discount rate used and amortisation profile are appropriate. |

### Valuation of specific Level 2 financial instruments

| | |
|---|---|
| **Key audit matter description** | There are a number of complex financial instruments held on the group's balance sheet, with a fair value modelled using Level 2 inputs, per IFRS 13. Due to the significance of the balance, a small difference in input sources could result in a material variation. The instruments of focus are the financial reinsurance contract, within Movestic (£39.1m), and the interest rate swap, within Scildon (£21.2m).<br><br>The financial reinsurance contract within Movestic is deemed to have one component that transfers significant insurance risk, and a component that is deemed not to transfer significant insurance risk. The component 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.<br><br>The interest rate swap held within Scildon has been entered into to hedge some of the risk of changes in the value of its obligations under insurance contract liabilities.<br><br>Due to the judgement involved in the valuation of these complex financial instruments, namely the margin applied to the embedded derivative, we identified manipulation of these as an area of potential fraud.<br><br>The accounting policy adopted by the group is documented within Note 2u to the financial statements and the derivatives are disclosed in Note 27. |
| **How the scope of our audit responded to the key audit matter** | We assessed the design and implementation of the internal controls in place to understand and challenge the valuation methods used.<br><br>We used financial instrument specialists within our audit team to challenge the appropriateness of assumptions input into the model and benchmark against external actuarial data.<br><br>We developed an independent expectation of the valuations and challenged management's explanation and analysis to support any variations. |
| **Key observations** | Based on the audit procedures performed, we conclude that the valuation of the embedded derivative and the interest rate swap, and the associated judgements used, namely the margin used for the embedded derivative, to be reasonable. |

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

## 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 judgment, we determined materiality for the financial statements as a whole as follows:

| | Group financial statements | Parent company financial statements |
|---|---|---|
| **Materiality** | £12.0m (2017: £11.6m) | £10.5m (2017: £9.7m) |
| **Basis for determining materiality** | 3% of adjusted Q2 net assets<br>The adjustment is 90% of this net asset benchmark to determine materiality due to the level of inherent volatility in equity prices in the net asset amount so that materiality does not exceed 3% of the net asset figure. | |
| **Rationale for the benchmark applied** | In our judgement we believe that a net assets measure is more closely aligned to the objectives of capital solvency and efficiency, dividend payments and ultimately cash generation that is relevant for this business model. This represents a stable long-term measure of value in a business which has a significant closed insurance book. | |

Excluding the parent company, the component materiality levels set by the group auditor range from £4.8m to £6.0m (2017: £5.8m to £6.4m). 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 £600,000 (2017: £578,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. 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

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 this assessment, we focused our group audit scope primarily on the audit work at seven (2017: seven) locations where the group's policies are administered. Three (2017: three) relate to Countrywide Assured plc and are in the United Kingdom, and the remaining four (2017: four) locations in the Netherlands, Sweden and Luxembourg relate to Waard Leven, Waard Schade, Movestic Livförsäkring AB, Movestic Fund Management S.A., and Scildon. All components except for Movestic Fund Management S.A., which is immaterial and therefore scoped out for group purposes, were subject to a full scope audit.

The group audit team performed the audit work directly at three of the seven locations. The remaining four locations involved the use of component audit teams, and included 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 in the financial year, except for Luxemburg which was not considered to be material for group reporting purposes.

## Other information

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

The directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon.

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

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

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

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

– Fair, balanced and understandable – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or

– Audit & Risk Committee reporting – the section describing the work of the Audit & Risk Committee does not appropriately address matters communicated by us to the Audit & Risk Committee; or

– Directors' statement of compliance with the UK Corporate Governance Code – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

## Responsibilities of directors

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

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

## Auditor's responsibilities for the audit of the financial statements

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

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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

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

## Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

**Identifying and assessing potential risks related to irregularities**
In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, internal audit and the Audit & Risk Committee, including obtaining and reviewing supporting documentation, concerning the group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team including significant component audit teams and involving relevant internal specialists, including tax, IT, financial instrument and actuarial specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the potential manipulation of the estimates used in the valuation of insurance liabilities, valuation of the Scildon Acquired Value In-Force ('AVIF') intangible asset, and valuation of specific Level 2 financial instruments; and
- obtaining an understanding of the legal and regulatory frameworks that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the group. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pensions legislation, tax legislation, and the regulations set out by the Prudential Regulation Authority, Financial Conduct Authority, the Finansinspektionen and De Nederlandshe Bank. In addition, compliance with terms of the group's operating licence and regulatory solvency requirements were fundamental to the group's ability to continue as a going concern.

**Audit response to risks identified**
As a result of performing the above, we identified the valuation of insurance liabilities, Valuation of the Scildon Acquired Value In-Force ('AVIF') intangible asset and the valuation of specific Level 2 financial instruments as key audit matters. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

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

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

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

## Report on other legal and regulatory requirements

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

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

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

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; 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 the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

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

**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.**

### Other matters

**Auditor tenure**
Following the recommendation of the Audit & Risk Committee, we were appointed by the group's board with effect from 1 October 2009 to audit the financial statements for the year ending 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 10 years, covering the years ended 2009 to 2018.

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

### Use of our report

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

Stephen Williams FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP

Statutory Auditor

Manchester, United Kingdom

28 March 2019

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| **Year ended 31 December** | **Note** | **2018 £000** | **2017 £000** |
|---|---|---|---|
| Insurance premium revenue | | 274,916 | 231,515 |
| Insurance premium ceded to reinsurers | | (55,536) | (54,191) |
| **Net insurance premium revenue** | | **219,380** | **177,324** |
| Fee and commission income | **8** | 101,783 | 90,301 |
| Net investment return | **9** | (335,035) | 531,817 |
| **Total revenue net of reinsurance payable** | | **(13,872)** | **799,442** |
| Other operating income | **10** | 41,236 | 40,789 |
| **Total income net of investment return** | | **27,364** | **840,231** |
| Insurance contract claims and benefits incurred | | | |
| Claims and benefits paid to insurance contract holders | **11** | (471,205) | (465,729) |
| Net decrease in insurance contract provisions | **11** | 351,812 | 51,033 |
| Reinsurers' share of claims and benefits | **11** | 43,648 | 49,449 |
| Net insurance contract claims and benefits | | (75,745) | (365,247) |
| Change in investment contract liabilities | **12** | 196,940 | (293,603) |
| Reinsurers' share of investment contract liabilities | **12** | (1,611) | 3,681 |
| Net change in investment contract liabilities | | 195,329 | (289,922) |
| Fees, commission and other acquisition costs | **13** | (28,158) | (24,405) |
| Administrative expenses | **14** | (69,795) | (70,269) |
| Other operating expenses | | | |
| Charge for amortisation of acquired value of in-force business | **15** | (12,093) | (13,271) |
| Charge for amortisation of acquired value of customer relationships | **15** | (83) | (101) |
| Other | **15** | (4,840) | (4,239) |
| **Total income/(expenses) net of change in insurance contract provisions and investment contract liabilities** | | **4,615** | **(767,454)** |
| **Total income less expenses** | | **31,979** | **72,777** |
| Share of profit of associate | **23** | (616) | 949 |
| Profit recognised on business combination | | – | 20,319 |
| Financing costs | **16** | (4,351) | (4,443) |
| **Profit before income taxes** | **7** | **27,012** | **89,602** |
| Income tax expense | **17** | (2,888) | (11,168) |
| **Profit for the year** | **7** | **24,124** | **78,434** |
| **Items that will not be reclassified to profit and loss:** | | | |
| Foreign exchange translation differences arising on the revaluation of foreign operations | **4** | (783) | 8,274 |
| Revaluation of pension obligations | **34** | 56 | 124 |
| Revaluation of investment property | | 277 | 90 |
| **Total comprehensive income for the year** | | **23,674** | **86,922** |
| Basic earnings per share (based on profit for the year) | **46** | 16.10p | 52.38p |
| Diluted earnings per share (based on profit for the year) | **46** | 16.01p | 52.13p |

The Notes and information on pages 106 to 177 form part of these financial statements.

# CONSOLIDATED BALANCE SHEET

| 31 December | Note | 2018 £000 | 2017 £000 |
|---|---|---|---|
| **Assets** | | | |
| Intangible assets | | | |
| Deferred acquisition costs | 18 | 65,039 | 61,858 |
| Acquired value of in-force business | 19 | 106,609 | 119,039 |
| Acquired value of customer relationships | | 537 | 641 |
| Goodwill | 20 | 781 | 806 |
| Software assets | 21 | 5,711 | 6,358 |
| Property and equipment | 22 | 4,293 | 4,327 |
| Investment in associates | 23 | 5,840 | 6,407 |
| Investment properties | | 1,299 | 1,199 |
| Reinsurers' share of insurance contract provisions | 30 | 213,369 | 233,154 |
| Amounts deposited with reinsurers | 31 | 34,349 | 38,776 |
| Financial assets | | | |
| Equity securities at fair value through income | 24 | 413,851 | 512,724 |
| Holdings in collective investment schemes at fair value through income | 24 | 4,835,621 | 5,202,772 |
| Debt securities at fair value through income | 24 | 1,521,616 | 1,628,817 |
| Policyholders' funds held by the group | 24 | 259,836 | 265,729 |
| Mortgage loan portfolio | 24/25 | 41,191 | 48,106 |
| Insurance and other receivables | 24/26 | 55,849 | 59,448 |
| Prepayments | 24 | 7,309 | 7,325 |
| Derivative financial instruments | 24/27 | 446 | 1,682 |
| Total financial assets | | 7,135,719 | 7,726,603 |
| Reinsurers' share of accrued policyholder claims | 37 | 17,640 | 25,888 |
| Income taxes | | 10,702 | 7,681 |
| Cash and cash equivalents | 28 | 215,212 | 210,647 |
| **Total assets** | | **7,817,100** | **8,443,384** |
| **Liabilities** | | | |
| Insurance contract provisions | 30 | 3,569,014 | 3,962,279 |
| Other provisions | | 882 | 1,098 |
| Financial liabilities | | | |
| Investment contracts at fair value through income | 31 | 3,235,519 | 3,420,273 |
| Liabilities relating to policyholders' funds held by the group | 32 | 259,836 | 265,729 |
| Borrowings | 33 | 109,202 | 129,202 |
| Derivative financial instruments | 27 | 22,714 | 22,494 |
| Total financial liabilities | | 3,627,271 | 3,837,698 |
| Deferred tax liabilities | 35 | 19,463 | 22,794 |
| Reinsurance payables | 36 | 10,535 | 11,406 |
| Payables related to direct insurance and investment contracts | 37 | 91,229 | 97,163 |
| Deferred income | 38 | 3,948 | 4,701 |
| Income taxes | | 3,428 | 8,514 |
| Other payables | 39 | 44,756 | 44,984 |
| Bank overdrafts | 28 | 958 | 1,091 |
| **Total liabilities** | | **7,371,484** | **7,991,728** |
| **Net assets** | 7 | **445,616** | **451,656** |
| **Shareholders' equity** | | | |
| Share capital | 40 | 43,767 | 43,766 |
| Share premium | 40 | 142,053 | 141,983 |
| Treasury shares | 41 | – | (98) |
| Other reserves | 42 | 27,158 | 27,664 |
| Retained earnings | 43 | 232,638 | 238,341 |
| **Total shareholders' equity** | | **445,616** | **451,656** |

The Notes and information on pages 106 to 177 form part of these financial statements.
Approved by the board of directors and authorised for issue on 28 March 2019 and signed on its behalf by:

Peter Mason
Chairman

John Deane
Chief Executive Officer

Company number: 04947166

# COMPANY BALANCE SHEET

| 31 December | Note | 2018 £000 | 2017 £000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Financial assets | | | |
| Investments in subsidiaries | **24** | 354,720 | 354,720 |
| Deferred tax asset | | 388 | 338 |
| **Total non-current assets** | | **355,108** | **355,058** |
| **Current assets** | | | |
| Financial assets | | | |
| Holdings in collective investment schemes at fair value through income | **24** | 47,288 | 29,091 |
| Receivables and prepayments | | 2,486 | 3,060 |
| Income taxes | | 2,665 | 3,032 |
| Cash and cash equivalents | **28** | 7,990 | 11,867 |
| **Total current assets** | | **60,429** | **47,050** |
| **Total assets** | | **415,537** | **402,108** |
| **Current liabilities** | | | |
| Borrowings | **33** | 15,306 | 22,029 |
| Other payables | **39** | 2,811 | 4,651 |
| **Total current liabilities** | | **18,117** | **26,680** |
| **Non-current liabilities** | | | |
| Borrowings | **33** | 54,274 | 67,428 |
| **Total non-current liabilities** | | **54,274** | **67,428** |
| **Total liabilities** | | **72,391** | **94,108** |
| **Net assets** | | **343,146** | **308,000** |
| **Shareholders' equity** | | | |
| Share capital | **40** | 7,495 | 7,494 |
| Share premium | **40** | 142,053 | 141,983 |
| Treasury shares | **41** | – | (98) |
| Other reserves | **42** | 50 | 50 |
| Retained earnings | **43** | 193,548 | 158,571 |
| **Total shareholders' equity** | | **343,146** | **308,000** |

The Notes and information on pages 106 to 177 form part of these financial statements.

The profit for the financial year of the parent company was £64.9m (2017: £22.5m).

The financial statements of Chesnara plc (registered number 4947166) were approved by the board of directors and authorised for issue on 28 March 2019 and signed on its behalf by:

Peter Mason
Chairman

John Deane
Chief Executive Officer

# CONSOLIDATED STATEMENT OF CASH FLOWS

| Year ended 31 December | Note | 2018 £000 | 2017 £000 |
|---|---|---|---|
| **Profit for the year** | | **24,124** | **78,434** |
| Adjustments for: | | | |
| Depreciation of property and equipment | **22** | 647 | 698 |
| Amortisation of deferred acquisition costs | **18** | 13,629 | 14,506 |
| Amortisation of acquired value of in-force business | **19** | 12,093 | 13,271 |
| Amortisation of acquired value of customer relationships | | 83 | 101 |
| Amortisation of software assets | **21** | 1,671 | 2,218 |
| Share based payment | | 501 | (159) |
| Tax paid | | 2,888 | 11,209 |
| Interest receivable | | (4,796) | 4,785 |
| Dividends receivable | | (2,939) | (4,619) |
| Interest expense | **16** | 4,351 | 4,443 |
| Fair value gains on financial assets | | (205,410) | (210,706) |
| Profit arising on business combination | | – | (20,319) |
| Share of loss/(profit) of associate | **23** | 616 | (949) |
| Increase in intangible assets related to insurance and investment contracts | | (18,457) | (28,634) |
| Interest received | | 5,360 | 4,560 |
| Dividends received | | 1,579 | 4,336 |
| Changes in operating assets and liabilities (excluding the effect of acquisitions) | **34** | 56 | 124 |
| Changes in operating assets and liabilities: | | | |
| Decrease/(increase) in financial assets | | 715,390 | (145,613) |
| Decrease in reinsurers' share of insurance contract provisions | | 26,462 | 17,074 |
| Decrease/(increase) in amounts deposited with reinsurers | | 4,427 | (1,339) |
| Decrease in insurance and other receivables | | 11,937 | 11,317 |
| (Increase)/decrease in prepayments | | (86) | 12,722 |
| Decrease in insurance contract provisions | | (409,405) | (91,110) |
| (Decrease)/increase in investment contract liabilities | | (102,577) | 414,014 |
| (Decrease)/increase in provisions | | (180) | 272 |
| (Decrease)/increase in reinsurance payables | | (792) | 4,424 |
| (Decrease)/increase in payables related to direct insurance and investment contracts | | (5,947) | 2,432 |
| Decrease in other payables | | (2,549) | (935) |
| **Net cash generated from operations** | | **72,676** | **86,987** |
| Income tax paid | | (12,104) | (27,480) |
| **Net cash generated from operating activities** | | **60,572** | **59,507** |
| **Cash flows from investing activities** | | | |
| Business combinations | | – | (117,993) |
| Development of software | | (1,839) | (928) |
| Disposal/(purchases) of property and equipment | | 71 | (314) |
| **Net cash utilised by investing activities** | | **(1,768)** | **(119,235)** |
| **Cash flows from financing activities** | | | |
| Proceeds/(loss) from issue of share capital | | 1 | (75) |
| Proceeds from the issue of share premium | | 70 | – |
| Net (loss)/proceeds from borrowings | | (18,974) | 42,022 |
| Sale of treasury shares | | 98 | 63 |
| Dividends paid | | (30,384) | (29,484) |
| Interest paid | | (4,174) | (4,266) |
| **Net cash (utilised by)/generated from financing activities** | | **(53,363)** | **8,260** |
| **Net increase/(decrease) in net cash and cash equivalents** | | **5,441** | **(51,468)** |
| Net cash and cash equivalents at beginning of year | **28** | 209,556 | 258,731 |
| Effect of exchange rate changes on net cash and cash equivalents | | (743) | 2,293 |
| **Net cash and cash equivalents at end of the year** | **28** | **214,254** | **209,556** |

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

The Notes and information on pages 106 to 177 form part of these financial statements.

# COMPANY STATEMENT OF CASH FLOWS

| Year ended 31 December | Note | 2018 £000 | 2017 £000 |
|---|---|---|---|
| **Profit for the year** | | **64,860** | **22,465** |
| Adjustments for: | | | |
| Tax recovery | | (1,044) | (1,860) |
| Interest receivable | | 2,394 | 1,683 |
| Share based payment | | 501 | 669 |
| Dividends receivable | | (69,320) | (32,701) |
| (Increase)/decrease in financial assets | | (18,197) | 43,848 |
| Changes in operating assets and liabilities: | | | |
| Decrease/(increase) in loans and receivables | | 559 | (213) |
| (Increase)/decrease in prepayments | | (35) | 24 |
| Decrease in other payables | | (1,792) | (23) |
| **Net cash (utilised by)/generated from operating activities** | | **(22,074)** | **33,892** |
| Income tax received | | 1,363 | 996 |
| **Net cash (utilised by)/generated from operating activities** | | **(20,711)** | **34,888** |
| **Cash flows from investing activities** | | | |
| Business combinations | | – | (105,486) |
| Dividends received from subsidiary company | | 69,320 | 32,701 |
| **Net cash generated from/(utilised by) investing activities** | | **69,320** | **(72,785)** |
| **Cash flows from financing activities** | | | |
| Net proceeds from the issue of share capital | | 1 | – |
| Net proceeds from the issue of share premium | | 70 | (75) |
| Sale of treasury shares | | 98 | 63 |
| Net proceeds from borrowings | | (19,877) | 36,760 |
| Dividends paid | | (30,384) | (29,484) |
| Interest paid | | (2,394) | (1,683) |
| **Net cash (utilised by)/generated from financing activities** | | **(52,486)** | **5,581** |
| **Net decreases increase in net cash and cash equivalents** | | **(3,877)** | **(32,316)** |
| Net cash and cash equivalents at beginning of year | | 11,867 | 44,183 |
| **Net cash and cash equivalents at end of the year** | **28** | **7,990** | **11,867** |

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

The Notes and information on pages 106 to 177 form part of these financial statements.

# STATEMENT OF CHANGES IN EQUITY

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

**Year ended 31 December 2018**

| | Note | Share capital £000 | Share premium £000 | Other reserves £000 | Treasury shares £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Equity shareholders' funds at 1 January 2018** | | **43,766** | **141,983** | **27,664** | **(98)** | **238,341** | **451,656** |
| Profit for the year | | – | – | – | – | 24,124 | 24,124 |
| Dividends paid | | – | – | – | – | (30,384) | (30,384) |
| Foreign exchange translation differences | 4 | – | – | (783) | – | – | (783) |
| Revaluation of pension obligations | | – | – | – | – | 56 | 56 |
| Revaluation of investment property | | – | – | 277 | – | – | 277 |
| Share based payment | | – | – | – | – | 501 | 501 |
| Issue of share capital | | 1 | – | – | – | – | 1 |
| Issue of share premium | | – | 70 | – | – | – | 70 |
| Sale of treasury shares | | – | – | – | 98 | – | 98 |
| **Equity shareholders' funds at 31 December 2018** | | **43,767** | **142,053** | **27,158** | **–** | **232,638** | **445,616** |

**Year ended 31 December 2017**

| | Note | Share capital £000 | Share premium £000 | Other reserves £000 | Treasury shares £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Equity shareholders' funds at 1 January 2017** | | **43,766** | **142,058** | **1 9,300** | **(161)** | **188,598** | **393,561** |
| Profit for the year | | – | – | – | – | 78,434 | 78,434 |
| Dividends paid | | – | – | – | – | (29,484) | (29,484) |
| Foreign exchange translation differences | 4 | – | – | 8,274 | – | – | 8,274 |
| Revaluation of pension obligations | | – | – | – | – | 124 | 124 |
| Revaluation of investment property | | – | – | 90 | – | – | 90 |
| Share based payment | | – | – | – | – | 669 | 669 |
| Sale of treasury shares | | – | (75) | – | 63 | – | (12) |
| **Equity shareholders' funds at 31 December 2017** | | **43,766** | **141,983** | **27,664** | **(98)** | **238,341** | **451,656** |

## COMPANY STATEMENT OF CHANGES IN EQUITY

**Year ended 31 December 2018**

| | Note | Share capital £000 | Share premium £000 | Other reserves £000 | Treasury shares £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Equity shareholders' funds at 1 January 2018** | | **7,494** | **141,983** | **50** | **(98)** | **158,571** | **308,000** |
| Profit for the year | | – | – | – | – | 64,860 | 64,860 |
| Dividends paid | | – | – | – | – | (30,384) | (30,384) |
| Share based payment | | – | – | – | – | 501 | 501 |
| Issue of share capital | | 1 | – | – | – | – | 1 |
| Issue of share premium | | – | 70 | – | – | – | 70 |
| Sale of treasury shares | | – | – | – | 98 | – | 98 |
| **Equity shareholders' funds at 31 December 2018** | | **7,495** | **142,053** | **50** | **–** | **193,548** | **343,146** |

**Year ended 31 December 2017**

| | Share capital £000 | Share premium £000 | Other reserves £000 | Treasury shares £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Equity shareholders' funds at 1 January 2017** | **7,494** | **142,058** | **50** | **(161)** | **164,921** | **314,362** |
| Profit for the year | – | – | – | – | 22,465 | 22,465 |
| Dividends paid | – | – | – | – | (29,484) | (29,484) |
| Share based payment | – | – | – | – | 669 | 669 |
| Sale of treasury shares | – | (75) | – | 63 | – | (12) |
| **Equity shareholders' funds at 31 December 2017** | **7,494** | **141,983** | **50** | **(98)** | **158,571** | **308,000** |

The Notes and information on pages 106 to 177 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 is limited by shares and 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 is represented by the CA segment, as described in Note 7. Its activities are performed almost entirely in the UK, where it underwrites 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. It is 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, as 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 and Scildon segments, as described in Note 7. These represent the group's Dutch life and general insurance businesses. The Waard Group originally consisted of three insurance companies Waard Leven N.V., Hollands Welvaren Leven N.V. and Waard Schade N.V., and a servicing company, Waard Verzekering. During 2017, the book of policies held within Hollands Welvaren Leven N.V. was successfully integrated into Waard Leven and the company was subsequently de-registered on 19 December 2018. 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. Scildon's policy base is predominantly made up of individual protection and savings contracts. It is open to new business and sells protection, individual savings and group pension contracts via a broker-led distribution model.

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 28 March 2019.

## 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 and the Dutch 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.

'IFRS 9 Financial Instruments' is effective from 1 January 2018 and replaces 'IAS 39 Financial Instruments: Recognition and Measurement'. The group has however elected to defer the application of IFRS 9 in the consolidated financial statements, applying the temporary exemption available under 'Amendments to IFRS 4 Insurance Contracts: Applying IFRS 9 Financial Instruments with IFRS 4'. The temporary exemption is available to reporting entities whose activities are predominantly connected with insurance and the IASB has recommended that the exemption applies until the earlier of the introduction of 'IFRS 17 Insurance Contracts' and 1 January 2022.

An assessment of the group's liabilities has been made as at 31 December 2017, the year-end following the most recent acquisition. The assessment determined that the proportion of liabilities within the scope of IFRS 4, together with other liabilities connected with insurance was greater than 90% of the total liabilities of the group as at that date. Other liabilities connected with insurance include non-derivative investment contract liabilities measured at fair value under IAS 39, with a value of £3,420.3m at 31 December 2017. Certain disclosures are required as a result of deferring the application of IFRS 9 and these disclosures are contained in Note 5 and Note 24 to the financial statements.

Chesnara plc (the company) does not meet the qualifying criteria for temporary exemption from applying IFRS 9 as a stand-alone reporting entity. Therefore, IFRS 9 has been applied to the parent company financial instruments within these financial statements. Within the group, Movestic Kapitalförvältning AB, has also applied IFRS 9 to its individual financial statements and these are available at **www.movestic.se**

IFRS 15 Revenue from contracts with customers, establishes a single comprehensive framework for determining whether, how and when revenue is recognised. The standard does not apply to insurance contracts or financial instruments within the scope of IAS 39 Financial Instruments: Recognition and Measurement. The group adopted IFRS 15 using the full retrospective method of adoption however the effect of adopting IFRS 15 has been minimal and has not resulted in any adjustment to the amount of revenue recognised in either the current or prior period. There has been no change to the group's accounting policies or to the basis of revenue recognition. As part of the assessment of IFRS 15, we performed a detailed analysis of our revenue streams and consequently, we have taken the opportunity to refine some of the revenue category descriptions, with the comparatives restated. Consequently, investment management fee rebate income of £23,547,000, has been reclassified from Note 8 Fees and commission income to Note 10 Other operating income. This amount represents investment management fee rebates in Movestic, which had previously not been recognised in a consistent manner with similar income streams in other parts of the group. This re-statement has no impact on the profit for the year, the total comprehensive income for the year, or the total shareholder equity. The 'Disaggregation of Revenue' disclosures required by the standard, are disclosed in Note 7 to the consolidated financial statements. The practical expedient under IFRS 15 has been applied and remaining performance obligations are not disclosed as the group has the right to consideration from customers in amounts that correspond with the performance completed to date.

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 |
|---|---|
| IFRS 16 | Leases |
| IFRIC 23 | Uncertainty over income tax treatments |
| Amendments to IFRS 9 (Oct 2017) | Prepayment features with negative compensation |
| Amendments to IAS 28 (Oct 2017) | Long-term interests in associates and joint ventures |
| Annual improvements to IFRS Standards 2015 - 2017 cycle (Dec 2017) | Annual improvements to IFRSs: 2015-17 cycle |
| Amendments to IAS 19 (Feb 2018) | Plan amendment, curtailment or settlement |
| Amendments to references to the conceptual framework in IFRS Standards | Amendments to references to the conceptual framework in IFRS Standards |
| Amendments to IFRS 3 (Oct 2018) | Definition of business |
| Amendments to IAS 1 and IAS 8 (Oct 2018) | Definition of material |
| IFRS 17 | Insurance contracts |
| Amendments to IFRS 10 and IAS 28 (Sept 2014) | Sale or contribution of assets between an investor and its associate or joint venture |

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 16 Leases (2019). IFRS 16 will replace IAS 17 Leases. The new standard removes the classification of leases as either operating or finance leases for the lessee, thereby treating all leases as finance leases. This will result in the recognition of a right to use asset and a lease liability for all of the group's previously classified operating leases. Short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements. The group has commenced an assessment of the impact of the new standard and has concluded that it will bring its property leases currently classified as operating leases (see Note 47) onto the consolidated balance sheet. A depreciation charge on the right-of-use assets and an interest expense on the lease liabilities will be recognised. The overall impact on financial performance and net equity will be immaterial due to the limited number of these contracts and their relative value.

– IFRS 17 was issued in May 2017 and will replace IFRS 4, the current insurance contract accounting standard. In November 2018, the IASB recommended a one year extension to the implementation date for the standard to 1 January 2022. The new standard will significantly change how the group measures and reports its insurance contracts. An initial impact assessment of the standard was performed in 2018 and implementation activities are ongoing. These activities will continue in 2019 and the financial impact of adopting the standard will continue to be assessed.

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 43 and on the face of the Company Balance Sheet.

**(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.

## 2 Significant accounting policies (continued)

### (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 company balance sheet is also presented in this manner.

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 the S&P component of the CA segment, 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 the original CA book, 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 four 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 30.

(iii) Acquisition costs

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

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 2 Significant accounting policies (continued)

### (h) Insurance contracts (continued)

(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 CA (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 (original book) 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 business, 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.

Investment contract liabilities are managed together with related investment assets on a fair value basis as part of the documented risk management strategy.

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

**(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 over time, 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 over time in which services will be provided.

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

For both insurance and investment contracts, initial fees, annual management charges and contract administration charges are recognised over time 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 over time 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 over time 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 over time as revenue over the period in which services are rendered.

**(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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 2 Significant accounting policies (continued)

### (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 to 5 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 12 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 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.

**(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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 2 Significant accounting policies (continued)

### (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 3 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 1 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) on page 111) 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 (Waard)*

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.

*Dutch business (Scildon)*

Scildon has a defined benefit plan. The pension scheme is administered by Stichting Pensionfonds Legal & General Nederland. The company has agreed to contribute to the premium for the unconditional part of the pension. Part of the plan consists of a defined contribution scheme. The company pays a contribution to the scheme and subsequently has no further financial obligations with respect to this part of the scheme. Further disclosure can be found in Note 34. Net liability arising from defined benefit obligations on page 158.

(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.

## 3 Critical accounting judgements 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 judgements in applying the group's accounting policies. Such estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. The more critical areas, where accounting estimates and judgements are made, are set out below. Each item identifies the business segments, as described in Note 7, to which it is relevant.

During the year, the company continued to assess the potential operational and financial impacts of the Brexit outcome. This is discussed in more detail in the key sources of estimation and uncertainty section below.

### Critical accounting judgements

**(a) Classification of long-term contracts (CA, Movestic, Waard Group and Scildon)**

The group has exercised judgement 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 judgement is applied in assessing whether the risk so transferred is significant, especially with regard to pensions contracts, which are predominantly, but not exclusively, created for investment purposes. Refer to Note 2(g) – Product Classification on page 109.

**(b) 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. Refer to Note 2(bb) – Employee Benefits on page 114.

**(c) Accounting for pension plans (Scildon)**

Scildon has a defined benefit plan. The pension scheme is an indexed average pay scheme with a pension of 1.75% per year of service. Indexation is conditional since 1 January 2013. The pension scheme is administered by Stichting Pensionfonds Legal & General Nederland. The company has agreed to contribute to the premium for the unconditional part of the pension. Apart from the obligations which may arise from the collective agreement provisions, the company is not obliged to make additional contributions to the claims brought under the pension fund. The company is not entitled to refunds or discounts. Part of the plan consists a defined contribution scheme. The company pays a contribution to the scheme and subsequently has no further financial obligations with respect to this part of the scheme. This contribution is recognised as an expense when paid. Refer to Note 2(bb) – Employee Benefits on page 114.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 3 Critical accounting judgments and key sources of estimation and uncertainty (continued)

### Key sources of estimation and uncertainty

**(a) Acquired value of in-force business (CA, Movestic, Waard Group and Scildon)**

The group applies accounting estimates and judgements in determining the fair value, amortisation and recoverability of acquired in-force business relating to insurance and investment contracts. In the initial determination of the acquired value of in-force business, the group uses actuarial models to determine the expected net cash flows (on a discounted basis) of the policies acquired. The key assumptions applied in the models are driven by the expected behaviour of policyholders on termination rates, expenses of management and age of individual contract holders as well as global estimates of investment growth, based on recent experience at the date of acquisition. The assumptions applied within the models are considered against historical experience of each of the relevant factors. Refer to accounting policy Note 2(o) on page 112 and Note 19 on page 140.

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 judgement. 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, 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%, 6%, 8%, 10% and 12%.

From the results of the most recent impairment tests, we can conclude that we have sufficient headroom between the AVIF carrying values and the underlying value of in-force business, to make the sensitivity with regard to discount rate movements irrelevant for the foreseeable future.

As at 31 December 2018, the carrying value of acquired in-force business, net of amortisation, was £7.2m in respect of CA (31 December 2017: £11.2m), £3.4m in respect of S&P (31 December 2017: £4.0m), £28.6m in respect of Movestic (31 December 2017: £32.8m), £4.4m in respect of Waard Group (31 December 2017: £5.0m) and £63.0m in respect of Scildon (31 December 2017: £66.1m).

**(b) Deferred acquisition costs and deferred income – investment contracts (CA, Movestic and Scildon)**

The group applies judgement in deciding the amount of direct costs that are incurred in acquiring the rights to provide investment management services in connection with the issue of investment contracts. Judgement is also applied in establishing the amortisation of the assets representing these contractual rights and the recognition of initial fees received in respect of these contracts. The assets are amortised over the expected lifetime of the investment management service contracts and deferred income, where applicable, is amortised over the expected period over which it is earned. Estimates are applied in determining the lifetime of the investment management service contracts and in determining the recoverability of the contractual rights assets by reference to expected future income and expense levels. This test for recoverability is performed using best estimates of future cash flows, using a market consistent estimate of future investment returns. Refer to accounting policy 2(k) on page 111 and Note 18 on page 139.

As at 31 December 2018, the carrying values of deferred acquisition costs, net of amortisation, and of deferred income, in respect of CA, were £2.1m and £3.9m respectively (as at 31 December 2017: £2.5m and £4.7m respectively). The impact on the above numbers of a 1 year movement in the estimated lifetime of the management services contract or amortisation period is not material.

As at 31 December 2018, the carrying values of deferred acquisition costs, net of amortisation, in respect of Movestic, was £55.0m (as at 31 December 2017: £55.2m). An increase in the length of the amortisation period by one year would have increased profit before tax for the year ended 31 December 2018 by £3.6m and shareholders' equity as at 31 December 2018 by £2.9m.

As at 31 December 2018, the carrying values of deferred acquisition costs, net of amortisation, in respect of Scildon, was £8.0m (as at 31 December 2017: £12.3m). An increase in the length of the amortisation period by one year would have increased profit before tax for the year ended 31 December 2018 by £1.0m and shareholders' equity as at 31 December 2018 by £0.8m.

**(c) Estimates of future benefits payments arising from long-term insurance contracts (CA and Scildon)**

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 30 on page 150.

**(d) Estimates of future maintenance expenses (CA and Scildon)**

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 judgement. 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. The sensitivity in respect of a 10% increase maintenance expenses is quantified in Note 30 on page 150.

**(e) 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 2018, the carrying value of insurance contract liabilities which contain S&P discretionary participation features was £286.4m (31 December 2017: £299.4m).

**(f) 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 2018, the carrying value of the insurance claim reserves, gross of reinsurance, was £80.4m (as at 31 December 2017: £81.5m). The key sensitivities in respect of insurance claim reserves are considered in Note 30 on page 150.

**(g) 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 2018, such claims ceded to reinsurers and reflected on the balance sheet were £53.2m (31 December 2017: £54.1m). The application of a 10% bad debt provision on the reinsurance balance would reduce 2018 profit before tax by £5.3m and shareholders' equity by £4.2m.

**(h) Brexit**

Other than the fact that Brexit could impact the investment markets to which our results are sensitive (see sensitivities on page 33) we consider that our operating model is relatively unaffected by Brexit. We do not trade across borders nor do we share resource between our European businesses. Each division operates to autonomous local regulatory frameworks and we believe we have the flexibility to change our regulatory structure if Brexit results in potentially adverse regulatory outcomes in the UK.

## 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 11.60 (2017: £1 = SEK 11.00) for the Swedish business and £1 = EUR 1.13 (2017: £1 = EUR 1.14) for the Dutch business.

Assets and liabilities have been translated at the year end rate of £1 = SEK 11.43 (31 December 2017: £1 = SEK 11.08) for the Swedish business and £1 = EUR 1.11 (31 December 2017: £1 = EUR 1.13) for the Dutch business.

Total foreign currency exchange rate movements for the year ended 31 December 2018 resulted in a loss recognised in the Consolidated Statement of Comprehensive Income of £0.8m (year ended 31 December 2017: profit of £8.3m).

# 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 and Waard businesses which are substantially closed to new business, are differentiated in the information provided below, where necessary. The Swedish and Dutch businesses, which are open to new business, comprises the Movestic and Scildon segments respectively.

### (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 business and of the ways in which the associated risks are managed.

**Sums assured/benefits per annum – gross and net of reinsurance**
**31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Gross £000 | Net £000 | Gross £000 | Net £000 |
| Long-term unit-linked without DPF (sums assured) | 2,047,087 | 1,826,007 | 2,414,486 | 2,147,432 |
| Long-term non-linked without DPF (sums assured) | 9,504,793 | 1,232,298 | 10,276,621 | 1,371,461 |
| Immediate annuities (benefits per annum) | 5,577 | 5,541 | 5,683 | 5,647 |
| Deferred annuities with DPF (benefits per annum) | 1,949 | 1,949 | 2,035 | 2,035 |
| Long-term with DPF (sums assured) | 310,102 | 300,962 | 325,162 | 315,422 |

**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 75% 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.

**(a) UK business (continued)**

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*

Exposures to material insurance risks on individual cases are avoided, through the use of reinsurance.

**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 – CA (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*

Exposures to material insurance risks, on individual cases, are avoided through the use of reinsurance.

**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 30 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**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Gross £000** | **Net £000** | **Gross £000** | **Net £000** |
| **Group** | | | | |
| Sweden | 19,821 | 6,032 | 22,343 | 6,630 |
| Norway | 16 | 3 | 19 | 4 |
| **Individual** | | | | |
| Death | 3,343 | 1,488 | 3,534 | 1,529 |
| Waiver of premium | 2,896 | 847 | 3,373 | 986 |
| Income protection | 6,779 | 5,749 | 7,656 | 6,520 |
| | **32,855** | **14,119** | **36,925** | **15,669** |

**Claims outstanding**
**As at 31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Gross £000** | **Net £000** | **Gross £000** | **Net £000** |
| **Group** | | | | |
| Sweden | 44,142 | 12,494 | 44,995 | 13,057 |
| Norway | 996 | 215 | 1,103 | 238 |
| **Individual** | | | | |
| Death | 837 | 324 | 721 | 293 |
| Waiver of premium | 9,696 | 3,249 | 10,359 | 3,444 |
| Income protection | 23,583 | 12,230 | 24,895 | 12,991 |
| | **79,254** | **28,512** | **82,073** | **30,023** |

**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 2018: SEK 45,500, being approximately £3,923) 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 2018 NOK: 96,883, being approximately £8,742) although most policies are between 10 to 19 times the base amount.

All contracts are for an annual period.

**(b) Swedish business (continued)**

*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 £10.5m).

*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 £13.1m) 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 31 Insurance Contract Provisions.

**(c) Waard Group**

**Sums assured/benefits per annum – gross and net of reinsurance**
**31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Gross £000 | Net £000 | Gross £000 | Net £000 |
| Long-term unit-linked without DPF (sums assured) | 14,571 | 14,571 | 22,198 | 22,198 |
| Long-term non-linked without DPF (sums assured) | 1,834,153 | 1,738,223 | 2,221,481 | 2,107,479 |

**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*

Waard 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 5 Management of insurance risk (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 Waard are set out in Note 31 Insurance Contract Provisions.

### (d) Scildon

**Sums assured/benefits per annum – gross and net of reinsurance**
**31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Gross £000 | Net £000 | Gross £000 | Net £000 |
| Long-term unit-linked without DPF (sums assured) | 2,891,183 | 1,738,948 | 2,885,027 | 2,281,513 |
| Long-term non-linked without DPF (sums assured) | 24,247,953 | 8,009,496 | 22,925,387 | 13,484,481 |
| Immediate annuities (benefits per annum) | 88,790 | 77,611 | 91,639 | 8,188 |

### Protection

*Product feature*

The division mainly wrote term life, sold as a regular premium policy. Older policy profit sharing conditions (before 2011) allow for a surrender value at lapse or profit sharing at maturity. The current mass market product has no surrender value or profit sharing. The most significant factors that could increase risk are epidemics and changes in lifestyle leading to higher mortality.

*Management of risks*

The product is the main new business product, significant underwriting occurs. Reinsurance agreements, quota share with a maximum retention per policy, to mitigate the risk in excess of risk appetite for mortality at the moment of underwriting are in place. The national NHT cover in case of terrorism is in place but no additional catastrophe or stop loss reinsurance is in place.

*Concentration of insurance risk*

Scildon does write group pensions contracts (SME segment) with an excess of loss limit of €200,000 per life, hence concentration risk is limited.

### Unit-linked

*Product features*

Scildon writes unit-linked and index linked business, with most policies paying out 0%, 90% or 110% of the unit-value at death of the policyholder and 100% at expiry. Early surrender triggers smaller charges for policyholders. Index linked policies contains either explicit of or implicit guarantees triggers smaller charges for policyholders. Group pension is also unit-linked based.

*Persistency and expense risk.*

The portfolio is large, but slowly decreasing. 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, due to the guarantees given for some policies the risk is high persistency.

Assumptions and sensitivities

The assumptions and sensitivities relating to insurance contract provisions for Scildon are set out in Note 31 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, Scildon 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 CA (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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 6 Management of financial risk (continued)

The Notes below explain how market risks are managed using the categories utilised in the businesses' (Asset Liability Matching) ALM frameworks. In particular, the ALM frameworks require the management of interest risk, equity price risk, and liquidity risk at the portfolio level, so that the appropriate risks for each portfolio may be managed in an effective way. The following tables reconcile the classes and portfolios used in the businesses' ALM frameworks to relevant items in the consolidated balance sheet and are followed by a portfolio-by-portfolio description of the nature of the related market risk and how that risk is managed.

| 31 December 2018 | Unit-linked contracts £000 | *Insurance contracts with DPF £000 | Annuities in payment £000 | Other non-linked contracts and other shareholder £000 | Total £000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Property and equipment | – | – | – | 4,293 | 4,293 |
| Investment in associates | – | – | – | 5,840 | 5,840 |
| Investment properties | 245 | – | – | 1,054 | 1,299 |
| Reinsurers' share of insurance contract provisions | 6,668 | 37,486 | – | 169,215 | 213,369 |
| Amounts deposited with reinsurers | 34,349 | – | – | – | 34,349 |
| Financial assets | | | | | |
| Equity securities at fair value through income | 413,851 | – | – | – | 413,851 |
| Holdings in collective investment schemes at fair value through income | 4,498,553 | 181,378 | – | 155,690 | 4,835,621 |
| Debt securities at fair value through income | 651,237 | 139,005 | 100,584 | 630,790 | 1,521,616 |
| Mortgage loan portfolio | – | – | – | 41,191 | 41,191 |
| Insurance and other receivables | 19,274 | 2,192 | – | 34,383 | 55,849 |
| Prepayments | 315 | 135 | – | 6,859 | 7,309 |
| Derivative financial instruments | 75 | 136 | – | 235 | 446 |
| Total financial assets | 5,583,305 | 322,846 | 100,584 | 869,148 | 6,875,883 |
| Reinsurers' share of accrued policyholder claims | 6,487 | – | – | 11,153 | 17,640 |
| Income taxes | – | – | – | 10,702 | 10,702 |
| Cash and cash equivalents | 92,801 | 2,694 | 5,380 | 114,337 | 215,212 |
| **Total assets** | **5,723,855** | **363,026** | **105,964** | **1,185,742** | **7,378,587** |
| **Liabilities** | | | | | |
| Insurance contract provisions | 2,424,881 | 323,603 | 104,710 | 715,820 | 3,569,014 |
| Other provisions | – | – | – | 882 | 882 |
| Financial liabilities | | | | | |
| Investment contracts at fair value through income | 3,231,314 | – | – | 4,205 | 3,235,519 |
| Borrowings | – | – | – | 109,202 | 109,202 |
| Derivative financial instruments | 259 | 1,264 | – | 21,191 | 22,714 |
| Total financial liabilities | 3,231,573 | 1,264 | – | 134,598 | 3,367,435 |
| Deferred tax liabilities | – | – | – | 19,463 | 19,463 |
| Reinsurance payables | 328 | 8 | – | 10,199 | 10,535 |
| Payables related to direct insurance and investment contracts | 24,452 | 4,690 | 1,254 | 60,833 | 91,229 |
| Income taxes | – | – | – | 3,428 | 3,428 |
| Other payables | 8,633 | 538 | – | 35,585 | 44,756 |
| Bank overdrafts | 231 | 90 | – | 637 | 958 |
| **Total liabilities** | **5,690,098** | **330,193** | **105,964** | **981,445** | **7,107,700** |

*Insurance contracts with DPF include shareholder funds within the CA (S&P) with-profits funds.

| 31 December 2017 | Unit-linked contracts £000 | *Insurance contracts with DPF £000 | Annuities in payment £000 | Other non-linked contracts and other shareholder £000 | Total £000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Property and equipment | – | – | – | 4,327 | 4,327 |
| Investment in associates | – | – | – | 6,407 | 6,407 |
| Investment properties | 245 | – | – | 1,760 | 2,005 |
| Reinsurers' share of insurance contract provisions | 40,410 | 39,897 | – | 152,847 | 233,154 |
| Amounts deposited with reinsurers | 38,776 | – | – | – | 38,776 |
| Financial assets | | | | | |
| Equity securities at fair value through income | 512,710 | 6 | – | 8 | 512,724 |
| Holdings in collective investment schemes at fair value through income | 4,860,152 | 216,980 | – | 125,640 | 5,202,772 |
| Debt securities at fair value through income | 691,412 | 155,341 | 108,838 | 673,226 | 1,628,817 |
| Mortgage loan portfolio | – | – | – | 48,106 | 48,106 |
| Insurance and other receivables | 14,431 | 1,555 | – | 43,462 | 59,448 |
| Prepayments | 188 | 32 | – | 7,105 | 7,325 |
| Derivative financial instruments | 76 | 559 | – | 1,047 | 1,682 |
| Total financial assets | 6,078,969 | 374,473 | 108,838 | 898,594 | 7,460,874 |
| Reinsurers' share of accrued policyholder claims | 8,933 | – | – | 16,955 | 25,888 |
| Income taxes | – | – | – | 7,681 | 7,681 |
| Cash and cash equivalents | 89,765 | 1,922 | 4,667 | 114,293 | 210,647 |
| **Total assets** | **6,257,098** | **416,292** | **113,505** | **1,202,864** | **7,989,759** |
| **Liabilities** | | | | | |
| Insurance contract provisions | 2,774,427 | 349,541 | 111,547 | 726,764 | 3,962,279 |
| Other provisions | – | – | – | 3,098 | 3,098 |
| Financial liabilities | | | | | |
| Investment contracts at fair value through income | 3,415,666 | – | – | 4,607 | 3,420,273 |
| Borrowings | – | – | – | 129,202 | 129,202 |
| Derivative financial instruments | 22,421 | 73 | – | – | 22,494 |
| Total financial liabilities | 3,438,087 | 73 | – | 133,809 | 3,571,969 |
| Deferred tax liabilities | – | – | – | 22,794 | 22,794 |
| Reinsurance payables | 372 | 8 | – | 11,026 | 11,406 |
| Payables related to direct insurance and investment contracts | 32,122 | 5,061 | 1,050 | 58,930 | 97,163 |
| Income taxes | – | – | – | 8,514 | 8,514 |
| Other payables | 7,099 | 516 | – | 35,369 | 42,984 |
| Bank overdrafts | 259 | 5 | – | 827 | 1,091 |
| **Total liabilities** | **6,252,366** | **355,204** | **112,597** | **1,001,131** | **7,721,298** |

*Insurance contracts with DPF include shareholder funds within the CA (S&P) with-profits funds.

## 6 Management of financial risk (continued)

**Unit-linked contracts**

For unit-linked contracts, which may be insurance or investment contracts, the group matches the financial liabilities, with units in the financial assets of the funds to which the value of the liabilities is linked, such that the policyholders bear the principal market risk (being interest rate, equity price and foreign currency risks) and credit risk. Accordingly, this approach results in the group having no significant direct market or credit risk on these contracts. Its primary exposure to market risk is the risk of volatility in asset-related fees due to the impact of interest rate, equity price and foreign exchange rate movements on the fair value of the assets held in the linked funds, on which asset-related fees are based.

There is residual exposure to market risk on certain unit-linked contracts where the group provides to policyholders guarantees as to fund performance or additional benefits which are not dependent on fund performance. This exposure is mitigated to the extent that the group matches the obligations with suitable financial assets external to the unit-linked funds, such that the residual exposure is not considered to be material.

**Insurance contracts with discretionary participation features**

Insurance contracts with discretionary participation features subsist entirely within the UK businesses in the form of with-profits policies.

For the CA business, where the policyholder benefits comprise a discretionary annual bonus and a discretionary terminal bonus, the with-profits business is wholly reinsured to 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 CA (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.

**(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 2018**

| | | Contractual cash flows (undiscounted) | | | | | |
|---|---|---|---|---|---|---|---|
| **Carrying values and cash flows arising from:** | **Carrying value £000** | **0-5 years £000** | **5-10 years £000** | **10-15 years £000** | **15-20 years £000** | **>20 years £000** | **Total £000** |
| **Insurance contract liabilities** | | | | | | | |
| Unit-linked | 2,424,881 | 2,424,881 | – | – | – | – | 2,424,881 |
| With DPF | 323,603 | 142,977 | 75,618 | 54,537 | 21,095 | 7,478 | 301,705 |
| Annuities in payment | 104,710 | 25,946 | 21,726 | 17,285 | 12,886 | 15,994 | 93,837 |
| Other non-linked | 715,820 | 444,722 | 290,279 | 165,678 | 78,815 | 42,813 | 1,022,307 |
| **Investment contract liabilities** | | | | | | | |
| Unit-linked | 3,231,314 | 3,231,314 | – | – | – | – | 3,231,314 |
| Other | 4,205 | 4,205 | – | – | – | – | 4,205 |
| Derivatives | 22,714 | 22,714 | – | – | – | – | 22,714 |
| Other liabilities | 280,453 | 280,453 | – | – | – | – | 280,453 |
| **Total** | **7,107,700** | **6,577,212** | **387,623** | **237,500** | **112,796** | **66,285** | **7,381,416** |

**31 December 2017**

| | | Contractual cash flows (undiscounted) | | | | | |
|---|---|---|---|---|---|---|---|
| **Carrying values and cash flows arising from:** | **Carrying value £000** | **0-5 years £000** | **5-10 years £000** | **10-15 years £000** | **15-20 years £000** | **>20 years £000** | **Total £000** |
| **Insurance contract liabilities** | | | | | | | |
| Unit-linked | 2,772,893 | 2,772,893 | – | – | – | – | 2,772,893 |
| With DPF | 349,541 | 197,293 | 80,819 | 58,936 | 27,688 | 8,145 | 372,881 |
| Annuities in payment | 111,548 | 26,534 | 22,456 | 18,146 | 13,841 | 18,506 | 99,483 |
| Other non-linked | 713,877 | 411,658 | 282,146 | 163,817 | 81,912 | 44,249 | 983,782 |
| **Investment contract liabilities** | | | | | | | |
| Unit-linked | 3,415,407 | 3,415,407 | – | – | – | – | 3,415,407 |
| Other | 4,867 | 4,867 | – | – | – | – | 4,867 |
| Derivatives | 22,794 | 324 | 22,470 | – | – | – | 22,794 |
| Other liabilities | 330,371 | 330,371 | – | – | – | – | 330,371 |
| **Total** | **7,721,298** | **7,159,347** | **407,891** | **240,899** | **123,441** | **70,900** | **8,002,478** |

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 129. The maturity analysis in respect of the CA (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.

The undiscounted contractual cash flows stated above, are based upon the cash flows payable directly to customers and hence do not include an estimate of future expenses incurred, as is the case in the balance sheet carrying values.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6 Management of financial risk (continued)

### (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 and Scildon, the assets and liabilities of which are principally denominated in euros.

The group's currency risk through its ownership of Movestic, Scildon and Waard Group is reflected in:

(i) foreign exchange translation differences arising on the translation into sterling and consolidation of Movestic, Scildon 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, Scildon and Waard to Chesnara by way of dividend payments. The risk on cash flows is managed by closely monitoring exchange rate movements and buying forward foreign exchange contracts, where deemed appropriate.

The following tables set out the group's exposure to assets and liabilities denominated in foreign currencies, expressed in sterling, at the respective balance sheet date:

| 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **Swedish krona** | | |
| Assets | 3,016,091 | 3,127,868 |
| Liabilities | (2,942,005) | (3,057,590) |
| **Net assets** | **74,086** | **70,278** |
| **Euro** | | |
| Assets | 2,149,809 | 2,312,577 |
| Liabilities | (1,865,796) | (1,976,235) |
| **Net assets** | **284,013** | **336,432** |
| **Norwegian krone** | | |
| Assets | 687 | 968 |
| Liabilities | – | (1,312) |
| **Net assets** | **687** | **(344)** |
| **US dollar** | | |
| Assets | 682 | 528 |
| Liabilities | (223) | (106) |
| **Net assets/(liabilities)** | **459** | **422** |

**(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 equity and property values;

(ii) a 100 basis point increase and decrease in per annum market rates of interest; and

(iii) 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 below.

| Variation in/arising from | 2018 | | 2017 | |
|---|---|---|---|---|
| | Profit before tax £m | Shareholders' equity £m | Profit before tax £m | Shareholders' equity £m |
| 100 bp increase in market rates of interest | (37.3) | (27.9) | (46.8) | (35.2) |
| 100 bp decrease in market rates of interest | 38.6 | 28.8 | 45.8 | 34.3 |
| 10% increase in equity and property prices | 15.5 | 13.5 | 11.9 | 9.5 |
| 10% decrease in equity and property prices | (13.7) | (11.0) | (12.8) | (10.2) |
| 10% favourable movement in SEK: sterling exchange rate | 1.0 | 8.2 | 1.1 | 7.8 |
| 10% adverse movement in SEK: sterling exchange rate | (0.8) | (6.7) | (0.9) | (6.4) |
| 10% favourable movement in EUR: sterling exchange rate | 0.2 | 31.5 | 2.5 | 37.4 |
| 10% adverse movement in EUR: sterling exchange rate | (0.2) | (25.8) | (2.1) | (30.6) |

**(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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6 Management of financial risk (continued)

### (v) Credit risk management (continued)

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 | 2018 Amount not subject to credit risk £000 | 2018 Amount subject to credit risk £000 | 2018 Balance sheet carrying value £000 | 2017 Amount not subject to credit risk £000 | 2017 Amount subject to credit risk £000 | 2017 Balance sheet carrying value £000 |
|---|---|---|---|---|---|---|
| Holdings in collective investment schemes | 4,766,342 | 69,279 | 4,835,621 | 5,155,886 | 46,886 | 5,202,772 |
| Debt securities | 689,364 | 832,252 | 1,521,616 | 751,393 | 877,424 | 1,628,817 |
| Cash and cash equivalents | 101,958 | 113,254 | 215,212 | 82,322 | 128,325 | 210,647 |
| Derivative financial instruments | 75 | 371 | 446 | 1,123 | 559 | 1,682 |
| Reinsurers' share of insurance contract liabilities | – | 213,369 | 213,369 | – | 233,154 | 233,154 |
| Amounts deposited with reinsurers | – | 34,349 | 34,349 | – | 38,776 | 38,776 |
| Mortgage loan portfolio | – | 41,191 | 41,191 | – | 48,106 | 48,106 |
| Insurance and other receivables | 38,889 | 16,960 | 55,849 | 38,941 | 20,507 | 59,448 |
| Reinsurers' share of accrued policyholder claims | 4,226 | 13,414 | 17,640 | 10,267 | 15,621 | 25,888 |
| Income taxes | – | 10,702 | 10,702 | – | 7,681 | 7,681 |
| **Total** | **5,600,854** | **1,345,141** | **6,945,995** | **6,039,932** | **1,417,039** | **7,456,971** |

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<br>As at 31 December 2018 | AAA £000 | AA £000 | A £000 | Below A £000 | Unrated £000 | Total £000 |
|---|---|---|---|---|---|---|
| Reinsurers share of insurance contract liabilities | – | 138,090 | 1,315 | 4,861 | 69,103 | 213,369 |
| Holdings in collective investment schemes | – | – | 65,168 | – | 4,111 | 69,279 |
| Amounts deposited with reinsurers | – | – | – | – | 34,349 | 34,349 |
| Debt securities at fair value through income | 97,615 | 253,776 | 196,965 | 251,468 | 32,428 | 832,252 |
| Mortgage loan portfolio | – | – | – | – | 41,191 | 41,191 |
| Insurance and other receivables | 881 | 8,491 | 1,165 | 2,516 | 3,907 | 16,960 |
| Reinsurers share of accrued policyholder claims | – | 4,486 | 1,065 | 951 | 6,912 | 13,414 |
| Derivative financial instruments | – | – | 136 | – | 235 | 371 |
| Income taxes | 519 | 1,669 | – | – | 8,514 | 10,702 |
| Cash and cash equivalents | – | 12,883 | 97,389 | 2,982 | – | 113,254 |
| **Total** | **99,015** | **419,395** | **363,203** | **262,778** | **200,750** | **1,345,141** |
| **As at 31 December 2017** | | | | | | |
| Reinsurers share of insurance contract liabilities | – | 139,258 | – | 4,991 | 88,905 | 233,154 |
| Holdings in collective investment schemes | – | – | 42,961 | – | 3,925 | 46,886 |
| Amounts deposited with reinsurers | – | – | – | – | 38,776 | 38,776 |
| Debt securities at fair value through income | 92,796 | 258,910 | 188,279 | 301,201 | 36,238 | 877,424 |
| Mortgage loan portfolio | – | – | – | – | 48,106 | 48,106 |
| Insurance and other receivables | 1,139 | 9,600 | 1,242 | 3,333 | 5,193 | 20,507 |
| Reinsurers share of accrued policyholder claims | – | 5,906 | 48 | 732 | 8,935 | 15,621 |
| Derivative financial instruments | – | – | 559 | – | – | 559 |
| Income taxes | – | 7,198 | – | – | 483 | 7,681 |
| Cash and cash equivalents | – | 54,906 | 69,459 | 1,428 | 2,532 | 128,325 |
| **Total** | **93,935** | **475,778** | **302,548** | **311,685** | **233,093** | **1,417,039** |

The 'Mortgage Loan Portfolio' and 'Insurance and other receivables' assets in the credit risk rating table are not held at fair value or managed on a fair value basis. The cash-flows for all of these assets consist solely of payments of principal and interest. These assets are not considered to have a low credit rating as defined by IFRS 9 as at 31 December 2018.

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 £72.0m as at 31 December 2018 (31 December 2017: £98.0m) to ReAssure, which does not have a published credit rating. Of this amount £48.0m (31 December 2017: £71.0m) 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 2018 and 31 December 2017.

**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 2018, further interim distributions totalling £2,718 (2017: £13,590) 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.

## 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 2018 comprise:

**CA:** This segment represents 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 Save & Prosper Insurance Limited (S&P) which was acquired on 20 December 2010 and its then subsidiary Save & Prosper Pensions Limited. The S&P business was transferred to CA during 2011. This segment also contains the business of Protection Life, which was purchased on 28 November 2013 and the business of which was transferred to CA effective from 1 January 2015. CA is responsible for conducting 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'.

**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 comprised the three insurance companies Waard Leven N.V., Hollands Welvaren Leven N.V. and Waard Schade N.V., and a servicing company, Waard Verzekering. During 2017, the book of policies held within Hollands Welvaren Leven N.V. was successfully integrated into Waard Leven and consequently Hollands Welvaren Leven N.V. was deregistered on 19 December 2018. 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.

**Scildon:** This segment represents the group's latest Dutch life insurance business, which was acquired on 5 April 2017. Scildon's policy base is predominantly made up of individual protection and savings contracts. It is open to new business and sells protection, individual savings and group pension contracts via a broker-led distribution model.

**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 2018.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 7 Operating segments (continued)

### (i) Segmental income statement for the year ended 31 December 2018

| | CA £000 | Movestic £000 | Waard Group £000 | Scildon £000 | Other group activities £000 | Total £000 |
|---|---|---|---|---|---|---|
| Net insurance premium revenue | 34,028 | 13,663 | 1,698 | 169,991 | – | 219,380 |
| Fee and commission income | 28,143 | 23,567 | 19 | 50,054 | – | 101,783 |
| Net investment return | (112,960) | (165,091) | 629 | (57,870) | 257 | (335,035) |
| **Total revenue (net of reinsurance payable)** | **(50,789)** | **(127,861)** | **2,346** | **162,175** | **257** | **(13,872)** |
| Other operating income | 12,792 | 28,444 | – | – | – | 41,236 |
| **Segmental (expense)/income** | **(37,997)** | **(99,417)** | **2,346** | **162,175** | **257** | **27,364** |
| Net insurance contract claims and benefits incurred | 59,945 | (5,018) | 4,419 | (135,091) | – | (75,745) |
| Net change in investment contract liabilities | 30,321 | 165,008 | – | – | – | 195,329 |
| Fees, commission and other acquisition costs | (1,215) | (29,563) | (293) | (1,907) | – | (32,978) |
| Administrative expenses: | | | | | | |
| Amortisation charge on software assets | – | (1,463) | – | (208) | – | (1,671) |
| Depreciation charge on property and equipment | – | (126) | (52) | (468) | – | (646) |
| Other | (22,034) | (13,578) | (2,903) | (25,607) | (3,356) | (67,478) |
| Operating expenses | (838) | (3,991) | – | – | (11) | (4,840) |
| Financing costs | (4) | (1,953) | – | – | (2,394) | (4,351) |
| Share of loss from associates | – | (616) | – | – | – | (616) |
| **Profit before tax and consolidation adjustments** | **28,178** | **9,283** | **3,517** | **(1,106)** | **(5,504)** | **34,368** |
| Other operating expenses: | | | | | | |
| Charge for amortisation of acquired value of in-force business | (4,497) | (3,106) | (669) | (3,821) | – | (12,093) |
| Charge for amortisation of acquired value of customer relationships | – | (83) | – | – | – | (83) |
| Fees, commission and other acquisition costs | – | 1,137 | – | 3,683 | – | 4,820 |
| **Segmental income less expenses** | **23,681** | **7,231** | **2,848** | **(1,244)** | **(5,504)** | **27,012** |
| **Profit before tax** | **23,681** | **7,231** | **2,848** | **(1,244)** | **(5,504)** | **27,012** |
| Income tax (expense)/credit | (3,125) | (944) | (642) | 779 | 1,044 | (2,888) |
| **Profit/(loss) after tax** | **20,556** | **6,287** | **2,206** | **(465)** | **(4,460)** | **24,124** |

Further analysis of the segmental profit before tax and consolidation adjustments can be found on page 36 of the Financial Review section.

### (ii) Segmental balance sheet as at 31 December 2018

| | CA £000 | Movestic £000 | Waard Group £000 | Scildon £000 | Other group activities £000 | Total £000 |
|---|---|---|---|---|---|---|
| Total assets | 2,636,499 | 3,033,654 | 137,640 | 1,948,490 | 60,817 | 7,817,100 |
| Total liabilities | (2,476,949) | (2,942,300) | (90,585) | (1,789,841) | (71,809) | (7,371,484) |
| **Net assets** | **159,550** | **91,354** | **47,055** | **158,649** | **(10,992)** | **445,616** |
| Investment in associates | – | 5,840 | – | – | – | 5,840 |
| Additions to non-current assets | – | 14,480 | 21 | 6,140 | – | 20,641 |

**(iii) Segmental income statement for the year ended 31 December 2017**

| | CA £000 | Movestic £000 | Waard Group £000 | Scildon £000 | Other group activities £000 | Total £000 |
|---|---|---|---|---|---|---|
| Net insurance premium revenue | 39,036 | 15,438 | 2,227 | 120,623 | – | 177,324 |
| Fee and commission income | 29,009 | 25,608 | 20 | 35,664 | – | 90,301 |
| Net investment return | 251,041 | 223,310 | 7,349 | 50,016 | 101 | 531,817 |
| **Total revenue (net of reinsurance payable)** | **319,086** | **264,356** | **9,596** | **206,303** | **101** | **799,442** |
| Other operating income | 13,985 | 26,762 | 42 | – | – | 40,789 |
| **Segmental income** | **333,071** | **291,118** | **9,638** | **206,303** | **101** | **840,231** |
| Net insurance contract claims and benefits incurred | (191,524) | (5,447) | (1,051) | (167,225) | – | (365,247) |
| Net change in investment contract liabilities | (66,969) | (222,953) | – | – | – | (289,922) |
| Fees, commission and other acquisition costs | (1,368) | (31,959) | (331) | (1,494) | – | (35,152) |
| Administrative expenses: | | | | | | |
| Amortisation charge on software assets | – | (2,052) | – | (124) | – | (2,176) |
| Depreciation charge on property and equipment | – | (292) | (52) | (229) | – | (573) |
| Other | (21,678) | (13,485) | (3,015) | (18,813) | (10,528) | (67,520) |
| Operating expenses | (952) | (3,302) | – | 1 | 14 | (4,239) |
| Financing costs | (4) | (2,756) | – | – | (1,683) | (4,443) |
| Share of profit from associates | – | 949 | – | – | – | 949 |
| **Profit before tax and consolidation adjustments** | **50,576** | **9,821** | **5,189** | **18,419** | **(12,096)** | **71,908** |
| Other operating expenses: | | | | | | |
| Charge for amortisation of acquired value of in-force business | (6,224) | (3,527) | (662) | (2,858) | – | (13,271) |
| Charge for amortisation of acquired value of customer relationships | – | (101) | – | – | – | (101) |
| Fees, commission and other acquisition costs | – | 6,601 | – | 4,146 | – | 10,747 |
| **Segmental income less expenses** | **44,352** | **12,794** | **4,527** | **19,707** | **(12,096)** | **69,283** |
| Profit arising on business combination | – | – | – | – | 20,319 | 20,319 |
| **Profit before tax** | **44,352** | **12,794** | **4,527** | **19,707** | **8,223** | **89,602** |
| Income tax (expense)/credit | (7,085) | 71 | (1,068) | (4,946) | 1,860 | (11,168) |
| **Profit after tax** | **37,267** | **12,865** | **3,459** | **14,761** | **10,083** | **78,434** |

**(iv) Segmental balance sheet as at 31 December 2017**

| | CA £000 | Movestic £000 | Waard Group £000 | Scildon £000 | Other group activities £000 | Total £000 |
|---|---|---|---|---|---|---|
| Total assets | 3,020,489 | 3,148,135 | 166,803 | 2,060,569 | 47,388 | 8,443,384 |
| Total liabilities | (2,849,557) | (3,057,934) | (109,421) | (1,881,301) | (93,515) | (7,991,728) |
| **Net assets** | **170,932** | **90,201** | **57,382** | **179,268** | **(46,127)** | **451,656** |
| Investment in associates | – | 6,407 | – | – | – | 6,407 |
| Additions to non-current assets | – | 23,836 | 313 | 3,719 | – | 27,868 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 8 Fees and commission income

| Year ended 31 December<br>Fee income | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Policy-based fees | 44,823 | 32,295 |
| Fund management-based fees | 36,398 | 36,717 |
| Benefit-based fees | 13,614 | 14,585 |
| Change in deferred income – gross | 753 | 737 |
| Change in deferred income – reinsurers' share | (54) | (64) |
| Total fee income | 95,534 | 84,270 |
| Commission income | 6,249 | 6,031 |
| **Total fee and commission income** | **101,783** | **90,301** |

## 9 Net investment return

| Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Dividend income | 47,285 | 39,855 |
| Interest income | 31,643 | 34,189 |
| Rental income from investment properties | 7 | 15 |
| Net fair value gains and losses | | |
| Equity securities designated as at fair value through income on initial recognition | (365,159) | 442,445 |
| Debt securities designated as at fair value through income on initial recognition | (46,882) | 6,306 |
| Derivative financial instruments | (2,017) | 9,007 |
| Investment properties | 88 | – |
| **Net investment return** | **(335,035)** | **531,817** |

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 2017: £nil).

## 10 Other operating income

| Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Investment management fee rebate | 37,023 | 37,538 |
| Charges to policyholder funds for yield tax | 3,971 | 2,963 |
| Other | 242 | 288 |
| **Total other operating income** | **41,236** | **40,789** |

## 11 Insurance contract claims and benefits

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Claims and benefits paid to insurance contract holders | 471,205 | 465,729 |
| Decrease in insurance contract provisions | (351,812) | (51,033) |
| **Total insurance contract claims and benefits** | **119,393** | **414,696** |
| Reinsurer's share of claims and benefits | (43,648) | (49,449) |
| **Net insurance contract claims and benefits incurred** | **75,745** | **365,247** |

## 12 Change in investment contract liabilities

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Changes in the fair value of investment contracts designated on initial recognition as fair value through income | (182,053) | 266,344 |
| Changes in the fair value of policyholders' funds held by the group designated on initial recognition as fair value through income | (14,887) | 27,259 |
| **Total (decrease)/increase in investment contract liabilities** | **(196,940)** | **293,603** |
| Reinsurers' share of investment contract liabilities | 1,611 | (3,681) |
| **Net (decrease)/increase in investment contract liabilities** | **(195,329)** | **289,922** |

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 | 2018 £000 | 2017 £000 |
|---|---|---|
| **Directly expensed costs:** | | |
| Insurance contracts | | |
| Commission, new business and renewal costs | 14,654 | 12,904 |
| Deferred amount | (6,055) | (12,167) |
| | **8,599** | **737** |
| Investment contracts | | |
| Commission, new business and renewal costs | 18,362 | 24,836 |
| Deferred amount | (12,401) | (15,644) |
| | **5,961** | **9,192** |
| **Amortisation of deferred acquisition costs:** | | |
| Insurance contracts | 2,400 | 8,177 |
| Investment contracts | 11,229 | 6,329 |
| Investment contracts-reinsurance | (31) | (30) |
| **Total** | **28,158** | **24,405** |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 14 Administrative expenses

| Year ended 31 December | Note | 2018 £000 | 2017 £000 |
|---|---|---|---|
| Personnel-related costs | 44 | 34,395 | 30,919 |
| Investment management fees | | 5,718 | 7,580 |
| Amortisation charge on software assets | | 1,671 | 2,218 |
| Depreciation charge on property and equipment | | 647 | 698 |
| Costs paid to third-party administrators | | 12,549 | 13,295 |
| Other goods and services | | 14,815 | 15,559 |
| **Total** | | **69,795** | **70,269** |

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 | 2018 £000 | 2017 £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* | 758 | 743 |
| Audit-related assurance services** | 235 | 462 |
| **Total** | **1,043** | **1,255** |

*Includes Ernst & Young audit fees in respect of the Scildon audit in 2017.

**Includes the audit of regulatory returns submitted to the UK regulator for 2017. The group is now exempt from audit for the regulatory returns following PRA legislation introduced in 2018.

## 15 Other operating expenses

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Charge for amortisation of acquired value of in-force business** | **12,093** | **13,271** |
| **Charge for amortisation of acquired value of customer relationships (AVCR)** | **83** | **101** |
| **Other** | | |
| Direct operating expenses of investment properties | | |
| Revenue-generating properties | (3) | – |
| Non revenue-generating properties | – | 2 |
| Recovery of cash deposit | (3) | (14) |
| Payment of yield tax relating to policyholder funds | 3,971 | 3,286 |
| Other | 875 | 965 |
| **Total** | **4,840** | **4,239** |

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.

## 16 Financing costs

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Interest expense on bank borrowings | 2,398 | 1,687 |
| Interest expense on financial reinsurance | 1,899 | 2,674 |
| Other interest | 54 | 82 |
| **Total financing costs** | **4,351** | **4,443** |

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 | 2018 £000 | 2017 £000 |
|---|---|---|
| CA and other group activities – net expense | (2,081) | (5,225) |
| Movestic – net (expense)/credit | (944) | 71 |
| Waard Group – net expense | (642) | (1,068) |
| Scildon – net credit/(expense) | 779 | (4,946) |
| **Total net expense** | **(2,888)** | **(11,168)** |

*UK business*

| CA and other group activities Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Current tax** | | |
| Current year | (2,369) | (6,220) |
| Overseas tax | (616) | (480) |
| Adjustment to prior years | (76) | – |
| Net expense | (3,061) | (6,700) |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | 980 | 1,475 |
| **Total income tax expense** | **(2,081)** | **(5,225)** |

| Reconciliation of effective tax rate on profit before tax Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Profit before tax** | **18,177** | **32,256** |
| Income tax using the domestic corporation tax rate of 19.0% (2017: 19.25%) | (3,453) | (6,209) |
| Other permanent differences | (2) | (468) |
| Effect of UK tax bases on insurance profits | | |
| Offset of franked investment income | 1,998 | 1,753 |
| Variation in rate of tax on amortisation of acquired in-force value | (71) | (6) |
| Foreign tax | (498) | (390) |
| Effect of change in tax rate | 22 | 48 |
| Other | (1) | 47 |
| Over provided in previous years | (76) | – |
| **Total income tax expense** | **(2,081)** | **(5,255)** |

There has been no change in tax rate during the year (tax rate 19%).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 17 Income tax (continued)

*Movestic*

**Movestic**
**Year ended 31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Current tax** | | |
| Current year expense | (599) | (6) |
| Adjustments for prior years | (384) | (9) |
| Net expense | (983) | (15) |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | 39 | 86 |
| **Total income tax (expense)/credit** | **(944)** | **71** |

**Reconciliation of effective tax rate on profit before tax**
**Year ended 31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Profit before tax** | **7,231** | **12,794** |
| Income tax using the domestic corporation tax rate of 22% | (1,591) | (2,815) |
| Non-taxable income in relation to unit-linked business | 1,505 | 2,242 |
| Impact of different tax rate for subsidiaries | 2 | (578) |
| Non-taxable fair value adjustment | (412) | 698 |
| Temporary differences | – | 41 |
| Permanent differences | (12) | 461 |
| Unrecognised tax recoverable | – | 72 |
| Non-deductible expenses | (52) | (41) |
| Under provided in prior years | (384) | (9) |
| **Total income tax (expense)/credit** | **(944)** | **71** |

*Waard Group*

**Waard Group**
**Year ended 31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Current tax** | | |
| Current year expense | (924) | (1,243) |
| Adjustment to prior years | 1 | 55 |
| Net expenses | (923) | (1,188) |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | 281 | (120) |
| **Total income tax expense** | **(642)** | **(1,068)** |

| Reconciliation of effective tax rate on profit before tax<br>Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **Profit before tax** | **2,848** | **4,527** |
| Income tax using the domestic corporation tax rate of 25% | (712) | (1,132) |
| Impact of different tax rate for subsidiaries | 69 | 9 |
| Over provided in prior years | 1 | 55 |
| **Total income tax expense** | **(642)** | **(1,068)** |

*Scildon*

| Scildon<br>Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **Current tax** | **(1,490)** | **(3,014)** |
| Adjustments for prior year | (14) | – |
| Net expense | (1,504) | (3,014) |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | 1,785 | (1,932) |
| Impact to changes in tax rates | 498 | – |
| **Total income tax credit/(expense)** | **779** | **(4,946)** |

| Reconciliation of effective tax rate on profit before tax<br>Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **(Loss)/profit before tax** | **(1,244)** | **19,707** |
| Income tax using the domestic corporation tax rate of 25% | 311 | (4,927) |
| Non-deductible expenses | 498 | (28) |
| (Over)/under provided in prior years | (30) | 9 |
| **Total income tax credit/(expense)** | **779** | **(4,946)** |

## 18 Deferred acquisition costs

| Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **Balance at 1 January** | **61,858** | **48,318** |
| Additions arising from new business | 18,541 | 27,685 |
| Amortisation charged to income | (13,629) | (14,506) |
| Foreign exchange translation difference | (1,731) | 361 |
| **Balance at 31 December** | **65,039** | **61,858** |
| Current | 7,822 | 6,191 |
| Non-current | 57,217 | 55,667 |
| **Total** | **65,039** | **61,858** |

The amortisation charged to income is recognised in fees, commission and other acquisition costs (see Note 13).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 19 Acquired value of in-force business (AVIF)

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Cost:** | | |
| **Balance at 1 January** | **221,201** | **151,617** |
| Additions – acquisition of subsidiary | – | 66,296 |
| Foreign exchange translation difference | (1,245) | 3,288 |
| **Balance at 31 December** | **219,956** | **221,201** |
| **Amortisation and impairment losses:** | | |
| **Balance at 1 January** | **102,162** | **88,674** |
| Amortisation for the year | 12,093 | 13,271 |
| Foreign exchange translation difference | (908) | 217 |
| **Balance at 31 December** | **113,347** | **102,162** |
| **Carrying amounts at 1 January** | **119,039** | **62,943** |
| **At 31 December** | **106,609** | **119,039** |
| Current | 15,286 | 13,428 |
| Non-current | 91,323 | 105,611 |
| **Total** | **106,609** | **119,039** |

The amortisation charged to the Consolidated Statement of Comprehensive Income is recognised in Other Operating Expenses (see Note 15).

## 20 Goodwill

The goodwill is arising from the purchase of Sparplatsen, a Sweden based software developer by the Movestic business, in order to gain access to the use of an automated investment advisory tool, including risk assessment, asset allocation model and investment guidance tool, for use by the company's customers and IFA network.

## 21 Software assets

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Cost:** | | |
| **Balance at 1 January** | **23,218** | **21,061** |
| Additions – acquisition of subsidiary | – | 1,069 |
| Additions | 1,839 | 928 |
| Foreign exchange translation difference | 12 | 160 |
| **Balance at 31 December** | **25,069** | **23,218** |
| **Amortisation and impairment losses:** | | |
| **Balance at 1 January** | **16,860** | **14,501** |
| Additions – acquisition of subsidiary | – | 67 |
| Amortisation charge for the year | 1,671 | 2,218 |
| Impairment charge | 650 | – |
| Foreign exchange translation difference | 177 | 74 |
| **Balance at 31 December** | **19,358** | **16,860** |
| **Carrying amounts at 31 December** | **5,711** | **6,358** |
| Current | 1,579 | 2,260 |
| Non-current | 4,132 | 4,098 |
| **Total** | **5,711** | **6,358** |

## 22 Property and equipment

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Cost:** | | |
| **Balance at 1 January** | **11,803** | **2,303** |
| Additions – acquisitions of subsidiary | – | 8,825 |
| Additions | 262 | 211 |
| Disposals | (102) | (36) |
| Foreign exchange translation difference | 385 | 500 |
| **Balance at 31 December** | **12,348** | **11,803** |
| **Amortisation and impairment losses:** | | |
| **Balance at 1 January** | **7,476** | **1,784** |
| Additions – acquisitions of subsidiary | – | 4,803 |
| Depreciation charge for the year | 647 | 698 |
| Disposals | (80) | (19) |
| Foreign exchange translation difference | 12 | 210 |
| **Balance at 31 December** | **8,055** | **7,476** |
| **Carrying amounts at 31 December** | **4,293** | **4,327** |
| Current | 186 | 723 |
| Non-current | 4,107 | 3,604 |
| **Total** | **4,293** | **4,327** |

## 23 Investment in associate

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Balance at 1 January** | **6,407** | **5,433** |
| Share of profit | (616) | 949 |
| Foreign exchange translation difference | 49 | 25 |
| **Balance at 31 December** | **5,840** | **6,407** |

| Associates at 100% | Assets £000 | Liabilities £000 | Revenues £000 | Loss £000 |
|---|---|---|---|---|
| Modernac S.A. | 39,045 | 27,126 | 9,472 | (1,258) |
| **Total at 31 December 2018** | **39,045** | **27,126** | **9,472** | **(1,258)** |

| Associates at 49% | Equity at 100% £000 | Equity at 49% £000 | 49% share of loss £000 |
|---|---|---|---|
| Modernac S.A | 11,919 | 5,840 | (616) |
| **Total at 31 December 2018** | **11,919** | **5,840** | **(616)** |

## 24 Financial instruments

### Group

**Financial assets by measurement category at 31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Fair value through income | | |
| Designated at fair-value through income on initial recognition | 7,030,924 | 7,610,042 |
| Derivative financial instruments | 446 | 1,682 |
| Mortgage loan portfolio | 41,191 | 48,106 |
| Insurance and other receivables | 55,849 | 59,448 |
| Prepayments | 7,309 | 7,325 |
| **Total** | **7,135,719** | **7,726,603** |

Financial assets that are not held at fair value or managed on a fair value basis, consist of the 'Mortgage Loan Portfolio', 'Insurance and other receivables' and 'Prepayments'. The cash flows for all of these assets are solely of payments of principal and interest. The fair value of the mortgage loan portfolio as at 31 December 2018 was £42.7m and the change in fair value in the year was an increase of £0.1m. For the 'Insurance and other receivables' and 'Prepayments' assets, the carrying value is considered to be a reasonable approximation of fair value. All other financial assets are held on a fair value basis and have a value of £7,031.4m as at 31 December 2018 with a change in fair value in the year which was a decrease of £414.1m.

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).

**Fair value measurement at 31 December 2018**

| **Financial assets** | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
|---|---|---|---|---|
| Equities – listed | 413,851 | – | – | 413,851 |
| Holdings in collective investment schemes | 4,835,621 | – | – | 4,835,621 |
| Debt securities – fixed rate | | | | |
| Government bonds | 806,019 | 30,668 | – | 836,687 |
| Listed | 678,942 | – | – | 678,942 |
| Debt securities – floating rate listed | 5,987 | – | – | 5,987 |
| Total debt securities | 1,490,948 | 30,668 | – | 1,521,616 |
| Policyholders' funds held by the group | 259,836 | – | – | 259,836 |
| Derivative financial instruments | – | 446 | – | 446 |
| **Total** | **7,000,256** | **31,114** | **–** | **7,031,370** |
| Current | | | | 4,858,901 |
| Non-current | | | | 2,172,469 |
| **Total** | | | | **7,031,370** |
| **Financial liabilities** | | | | |
| Investment contracts at fair value through income | – | 3,235,519 | – | 3,235,519 |
| Liabilities related to policyholders' funds held by the group | 259,836 | – | – | 259,836 |
| Derivative financial instruments | – | 22,714 | – | 22,714 |
| **Total** | **259,836** | **3,258,233** | **–** | **3,518,069** |

| **Fair value measurement at 31 December 2017** | | | | |
|---|---|---|---|---|
| **Financial assets** | **Level 1 £000** | **Level 2 £000** | **Level 3 £000** | **Total £000** |
| Equities – listed | 512,724 | – | – | 512,724 |
| Holdings in collective investment schemes | 5,202,772 | – | – | 5,202,772 |
| Debt securities – fixed rate | | | | |
| Government bonds | 961,194 | 30,202 | – | 991,396 |
| Listed | 631,416 | – | – | 631,416 |
| Debt securities – floating rate listed | 6,005 | – | – | 6,005 |
| Total debt securities | 1,598,615 | 30,202 | – | 1,628,817 |
| Policyholders' funds held by the group | 265,729 | – | – | 265,729 |
| Derivative financial instruments | – | 1,682 | – | 1,682 |
| **Total** | **7,579,840** | **31,884** | **–** | **7,611,724** |
| Current | | | | 5,048,130 |
| Non-current | | | | 2,563,594 |
| **Total** | | | | **7,611,724** |
| **Financial liabilities** | | | | |
| Investment contracts at fair value through income | – | 3,420,272 | – | 3,420,272 |
| Liabilities related to policyholders' funds held by the group | 265,729 | – | – | 265,729 |
| Derivative financial instruments | – | 22,494 | – | 22,494 |
| **Total** | **265,729** | **3,442,766** | **–** | **3,708,495** |

The debt securities classified as Level 2, at 2017 and 2018 are traded in active markets with less depth or wider-bid ask spreads. This does 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.

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.

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** | |
|---|---|---|---|---|
| | **2018 £000** | **2017 £000** | **2018 £000** | **2017 £000** |
| **Financial liabilities** | | | | |
| Borrowings | 109,202 | 129,202 | 111,456 | 132,204 |

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.

## 24 Financial instruments (continued)

**Company**

| Fair value measurement at 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Holdings in collective investment schemes | 47,288 | 29,091 |
| **Total** | **47,288** | **29,091** |
| Current | 47,288 | 29,091 |
| Non-current | – | – |
| **Total** | **47,288** | **29,091** |

There were no Level 2 and Level 3 assets.

**Investment in subsidiaries**
**Company**

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Balance at 1 January** | **354,720** | **249,234** |
| Capital contribution to Chesnara Holdings B.V.* | – | 105,486 |
| **Balance at 31 December** | **354,720** | **354,720** |
| Current | | – |
| Non-current | 354,720 | 354,720 |
| **Total** | **354,720** | **354,720** |

*Chesnara plc provided a capital contribution to Chesnara Holding B.V of £105.5m to part fund the acquisition of Scildon, in 2017. The remainder of the acquisition cost of £137.5m was funded by Chesnara Holdings B.V, upon receipt of a dividend payment from Waard Leven.

A list of investments in subsidiaries held by the group is disclosed in Note 51.

## 25 Mortgage loan portfolio

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Loans and receivables at amortised cost** | **41,191** | **48,106** |
| Current | 9,950 | 18,476 |
| Non-current | 31,241 | 29,630 |
| **Total** | **41,191** | **48,106** |

The mortgage loan portfolio was acquired in 2016 by the Waard Group and is stated at amortised cost.

## 26 Insurance and other receivables

**Group**

| **Insurance and other receivables 31 December** | **2018 £000** | **2017 £000** |
|---|---|---|
| **Receivables arising from insurance contracts** | | |
| Brokers | 726 | 711 |
| Policyholders | 2,543 | 4,260 |
| **Receivables arising from investment contracts** | | |
| Other | 11,695 | 10,042 |
| **Other receivables** | | |
| Loan to associated companies | 705 | 697 |
| Accrued interest income | 12,803 | 15,898 |
| Receivables from fund management companies | 7,273 | 7,711 |
| Initial margin payments on derivatives | 4,644 | 3,621 |
| Other | 15,460 | 16,508 |
| **Total** | **55,849** | **59,448** |
| Current | 55,084 | 57,941 |
| Non-current | 765 | 1,507 |
| **Total** | **55,849** | **59,448** |

The carrying amount is a reasonable approximation of fair value.

## 27 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 and interest rate swap within the Scildon business.

| **31 December** | **2018** | | **2017** | |
|---|---|---|---|---|
| | **Asset £000** | **Liability £000** | **Asset £000** | **Liability £000** |
| Interest rate swaps | – | (21,191) | – | (22,170) |
| Exchange-traded futures | 210 | (1,523) | 635 | (324) |
| Financial reinsurance embedded derivative | 236 | – | 1,047 | – |
| **Total** | **446** | **(22,714)** | **1,682** | **(22,494)** |
| Current | 269 | (22,714) | 898 | (22,494) |
| Non-current | 177 | – | 784 | – |
| **Total** | **446** | **(22,714)** | **1,682** | **(22,494)** |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 27 Derivative financial instruments (continued)

**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 futures, with their fair value being based on market observable inputs at the balance sheet date. They are, accordingly, determined at Level 2 in the three-level fair value determination hierarchy set out in Note 24.

**Exchange-traded futures (by geographical investment market)**
**31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Asset £000** | **Liability £000** | **Asset £000** | **Liability £000** |
| Australia | 15 | (19) | 2 | (23) |
| Canada | – | (66) | 6 | – |
| Switzerland | – | (3) | – | (3) |
| Europe | 4 | (192) | 5 | (73) |
| UK | 65 | (34) | 62 | (197) |
| Hong Kong | 32 | (28) | 28 | – |
| Japan | 4 | (293) | 154 | (16) |
| USA | 90 | (882) | 378 | (11) |
| Denmark | – | (6) | – | (1) |
| **Total** | **210** | **(1,523)** | **635** | **(324)** |

**Financial reinsurance embedded derivative**

In respect of Movestic, the group has a reinsurance contract with a third party that has an element that is deemed to transfer significant insurance risk and an element 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 24.

**Derivatives within the CA (S&P with-profits funds)**

As part of its investment management strategy, CA enters into a limited range of derivative instruments to manage its exposure to various risks.

CA 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. CA 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.

CA also purchases exchange rate futures to mitigate exchange rate risk within its with-profits funds.

These contracts are fair valued using market observable inputs at the balance sheet date. They are, accordingly, determined at Level 2 in the three-level fair value determination hierarchy set out in Note 24.

**Derivatives within Scildon**

Scildon uses various interest rate derivatives to hedge some of the risk of changes in value of its obligations under insurance contracts in non-linked funds.

## 28 Cash and cash equivalents

**Group**

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Bank and cash balances | 104,015 | 86,545 |
| Call deposits due within 1 month | 46,465 | 40,011 |
| Call deposits due after 1 month | 64,732 | 84,091 |
| **Total cash and cash equivalents** | **215,212** | **210,647** |
| Bank overdrafts | (958) | (1,091) |
| **Cash and cash equivalents in the statement of cash flows** | **214,254** | **209,556** |

The effective interest rate on short-term bank deposits was 0.29% (2017: 0.20%), with an average maturity of 24 days (2017: 31 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 £92.8m (2017: £89.8m) held in unit-linked policyholders' funds.

**Company**

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Bank and cash balances | 2,808 | 1,259 |
| Cash deposits due within 1 month | 97 | 546 |
| Cash deposits maturing between greater than 1 month and less than 1 year | 5,085 | 10,062 |
| **Total** | **7,990** | **11,867** |

## 29 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 an EU insurance legislation that aims to unify the 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 formulae 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 the 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)

## 29 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 | CA | Movestic | Waard Group | Scildon | Group |
|---|---|---|---|---|---|
| Dividend paying limit: Own Funds stated as % of SCR | 120% | 120% | 200% | 200% | 110% |
| Management actions limit: Own Funds stated as % of SCR | 110% | 110% | 175% | 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:

- *Internal solvency reporting:* 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 2018 and at 31 December 2017, which is unaudited, has been shown in the tables below. They present a view of the solvency position which may differ to the position of the individual insurance company(ies) within that division.

**31 December 2018 (unaudited)**

| Region | CA £m | Movestic £m | Waard Group £m | Scildon £m | Other group and consolidation adjustments £m | Group £m |
|---|---|---|---|---|---|---|
| Own Funds (pre dividends) | 184.7 | 210.0 | 51.7 | 166.0 | (39.6) | 572.8 |
| Proposed dividend | (59.0) | (2.9) | (3.2) | (5.2) | 50.1 | (20.2) |
| **Own Funds (post dividends)** | **125.7** | **207.1** | **48.5** | **160.8** | **10.5** | **552.6** |
| SCR | 96.6 | 119.1 | 7.8 | 79.2 | 46.9 | 349.6 |
| **Solvency surplus** | **29.1** | **88.0** | **40.7** | **81.6** | **n/a** | **203.0** |
| **Solvency ratio** | **130%** | **174%** | **624%** | **203%** | **n/a** | **158%** |
| Dividend paying limit (% of SCR) | 120% | 120% | 200% | 200% | n/a | 110% |
| Dividend paying limit (£) | 115.9 | 142.9 | 15.6 | 158.4 | n/a | 384.6 |
| Surplus over dividend paying limit | 9.8 | 64.2 | 32.9 | 2.4 | n/a | 168.0 |

**31 December 2017 (unaudited)**

| Region | CA £m | Movestic £m | Waard Group £m | Scildon £m | Other group and consolidation adjustments £m | Group £m |
|---|---|---|---|---|---|---|
| Own Funds (pre dividends) | 198.7 | 230.7 | 61.2 | 210.0 | (65.8) | 634.8 |
| Proposed dividend | (32.0) | (2.8) | (13.0) | (22.2) | 50.5 | (19.6) |
| **Own Funds (post dividends)** | **166.7** | **227.8** | **48.2** | **187.8** | **(15.3)** | **615.2** |
| SCR | 128.1 | 149.0 | 10.0 | 81.4 | 53.3 | 421.8 |
| **Solvency surplus** | **38.6** | **78.8** | **38.2** | **106.4** | **n/a** | **193.4** |
| **Solvency ratio** | **130%** | **153%** | **483%** | **231%** | **n/a** | **146%** |
| Dividend paying limit (% of SCR) | 120% | 120% | 200% | 200% | n/a | 110% |
| Dividend paying limit (£) | 153.7 | 178.9 | 20.0 | 162.8 | n/a | 464.0 |
| Surplus over dividend paying limit | 13.0 | 49.0 | 28.2 | 25.0 | n/a | 151.2 |

***(ii) Reconciliation between Solvency II Own Funds and IFRS net assets (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 2018 (unaudited)**

| Region | CA £m | Movestic £m | Waard Group £m | Scildon £m | Other group and consolidation adjustments £m | Group £m |
|---|---|---|---|---|---|---|
| **Solvency II Own Funds (post dividends)** | **125.7** | **207.1** | **48.5** | **160.8** | **10.5** | **552.6** |
| Add Back: Ring-fenced fund surplus restrictions | 5.7 | – | – | – | – | 5.7 |
| Add Back: Intangible assets | 7.7 | 89.2 | 4.4 | 70.9 | 1.3 | 173.5 |
| Add Back: Foreseeable dividends | 59.0 | 2.9 | 3.2 | 5.2 | (50.1) | 20.2 |
| Add Back: Difference in valuation of technical provisions | (46.3) | (205.7) | (11.8) | (77.5) | 34.4 | (306.9) |
| Add Back: Difference in deferred tax | 7.5 | 0.5 | 4.1 | (0.7) | (7.0) | 4.4 |
| Add Back: Other valuation differences | 0.3 | (2.6) | (1.3) | (0.1) | (0.1) | (3.9) |
| **IFRS Net Assets** | **159.6** | **91.4** | **47.1** | **158.6** | **(11.1)** | **445.6** |

**31 December 2017 (unaudited)**

| Region | CA £m | Movestic £m | Waard Group £m | Scildon £m | Other group and consolidation adjustments £m | Group £m |
|---|---|---|---|---|---|---|
| **Solvency II Own Funds (post dividends)** | **166.7** | **227.8** | **48.2** | **187.8** | **(15.3)** | **615.2** |
| Add Back: Ring-fenced fund surplus restrictions | 26.6 | – | – | – | – | 26.5 |
| Add Back: Intangible assets | 11.5 | 94.1 | 5.0 | 70.3 | 1.7 | 182.6 |
| Add Back: Foreseeable dividends | 32.0 | 2.8 | 13.0 | 22.2 | (50.4) | 19.6 |
| Add Back: Difference in valuation of technical provisions | (78.5) | (233.6) | (10.7) | (111.2) | 24.0 | (410.0) |
| Add Back: Difference in deferred tax | 12.4 | – | 3.8 | 10.5 | (6.4) | 20.3 |
| Add Back: Other valuation differences | 0.2 | (0.9) | (2.1) | – | 0.2 | (2.5) |
| **IFRS Net Assets** | **170.9** | **90.2** | **57.4** | **179.6** | **(46.2)** | **451.7** |

*The prior year comparatives have been re-stated to align with presentation in Note 7 – operating segments.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 30 Insurance contract provisions

### (a) Analysis of insurance contract provisions by operating segment

| 31 December | 2018 Gross £000 | 2018 Reinsurance £000 | 2018 Net £000 | 2017 Gross £000 | 2017 Reinsurance £000 | 2017 Net £000 |
|---|---|---|---|---|---|---|
| CA | 1,702,207 | 156,309 | 1,545,898 | 1,992,705 | 173,718 | 1,818,987 |
| Movestic | 84,296 | 53,174 | 31,122 | 86,271 | 54,149 | 32,122 |
| Waard Group | 83,801 | 3,827 | 79,974 | 100,329 | 4,413 | 95,916 |
| Scildon | 1,698,710 | 59 | 1,698,651 | 1,782,974 | 874 | 1,782,100 |
| **Total insurance contract provisions** | **3,569,014** | **213,369** | **3,355,645** | **3,962,279** | **233,154** | **3,729,125** |
| Current | 209,910 | 23,198 | 186,712 | 243,326 | 39,087 | 204,239 |
| Non-current | 3,359,104 | 190,171 | 3,168,933 | 3,718,953 | 194,067 | 3,524,886 |
| **Total** | **3,569,014** | **213,369** | **3,355,645** | **3,962,279** | **233,154** | **3,729,125** |

### (b) Analysis of movement in insurance contract provisions

| Year ended 31 December | 2018 Gross £000 | 2018 Reinsurance £000 | 2018 Net £000 | 2017 Gross £000 | 2017 Reinsurance £000 | 2017 Net £000 |
|---|---|---|---|---|---|---|
| **Balance at 1 January** | **3,962,279** | **233,154** | **3,729,125** | **2,242,446** | **254,859** | **1,987,587** |
| Arising on business combination | – | – | – | 1,736,389 | 1,314 | 1,735,075 |
| Premiums received | 215,417 | 12,119 | 203,298 | 186,260 | 15,053 | 171,207 |
| Fees deducted | (67,666) | (1,457) | (66,209) | (59,961) | (1,555) | (58,406) |
| Reserves released in respect of benefits paid | (432,529) | (44,819) | (387,710) | (410,873) | (55,286) | (355,587) |
| Movements in provisions for contracts sold – Movestic | | | | | | |
| in current year | 26,263 | 16,424 | 9,839 | 30,304 | 17,856 | 12,448 |
| in prior years | (21,030) | (13,520) | (7,510) | (26,070) | (17,128) | (8,942) |
| Investment return | (122,557) | (1,969) | (120,588) | 170,646 | 3,273 | 167,373 |
| Other movements | 8,837 | 13,437 | (4,600) | 93,138 | 14,768 | 78,370 |
| **Balance at 31 December** | **3,569,014** | **213,369** | **3,335,645** | **3,962,279** | **233,154** | **3,729,125** |

### (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 CA (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 CA (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** | **2018** | | **2017** | |
|---|---|---|---|---|
| | **SPI** | **SPP** | **SPI** | **SPP** |
| Assurances: | | | | |
| Regular premium plans | 2.625% | 3.000% | 2.625% | 2.625% |
| Single premium contracts | 3.000% | 4.125% | 3.000% | 3.750% |
| Linked TIC* | – | 5.000% | – | 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 2018 for the material product types, these lay between 0.50% and 2.10% (31 December 2017: between 0.20% and 2.05%).

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)

## 30 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 CA (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 CA (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** | **2018 £000** | **2017 £000** |
|---|---|---|
| **At beginning of the year** | **19,235** | **35,746** |
| Charge/(credit) to income | 3,862 | (16,511) |
| **At the end of year** | **23,097** | **19,235** |

*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 £1,124,000 as at 31 December 2018 (31 December 2017: £696,000).

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 20% and allowing for future investment returns, including presumed future equity investment return of 3.6% 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 2018 was £3.9m (31 December 2017: £4.2m). 459 policies invested in the fund (31 December 2017: 485), of which 30 (31 December 2017: 36) were paying premiums (for a total of approximately £9,000 per annum (31 December 2017: £10,000)).

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 | 2.16% pa |
| Rate of return on cash | 0.67% pa |
| Discount rate | 0.80% pa |
| Retirement age | 90% of business with policyholders retiring at age 65<br>10% of business with policyholders retiring at age 70 |
| Terminations before retirement | 3% pa |

The reserve for the guarantee as at 31 December 2018 was £0.1m (31 December 2017: £0.2m).

*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 70. The reserve for this option as at 31 December 2018 was £9.7m (31 December 2017: £10.0m).

*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 2018 was £0.1m (31 December 2017: £0.1m).

*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 2018 was £0.3m (31 December 2017: £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 2018 is £0.1m (31 December 2017: £0.1m).

***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)

### 30 Insurance contract provisions (continued)

**(c) Basis and assumptions for calculating insurance contract provisions (continued)**

***Sweden (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**

| | 2013 £000 | 2014 £000 | 2015 £000 | 2016 £000 | 2017 £000 | 2018 £000 |
|---|---|---|---|---|---|---|
| Estimate of ultimates | | | | | | |
| End of accident year | 28,346 | 27,917 | 28,041 | 33,650 | 31,315 | 28,670 |
| 1 year later | 22,775 | 21,299 | 21,373 | 24,566 | 23,236 | |
| 2 years later | 20,139 | 18,099 | 19,016 | 21,494 | | |
| 3 years later | 18,357 | 15,177 | 16,329 | | | |
| 4 years later | 16,567 | 14,182 | | | | |
| 5 years later | 15,416 | | | | | |
| Current estimate of ultimate claims | 15,416 | 14,182 | 16,329 | 21,494 | 23,236 | 28,670 |
| Cumulative payments | (13,169) | (9,263) | (9,542) | (11,343) | (9,824) | (5,900) |
| In balance sheet | 2,247 | 4,919 | 6,787 | 10,151 | 13,412 | 22,770 |
| Provision for prior years | | | | | | 20,132 |
| Liability in balance sheet | | | | | | 80,418 |

**Analysis of claims development – net**

| | 2013 £000 | 2014 £000 | 2015 £000 | 2016 £000 | 2017 £000 | 2018 £000 |
|---|---|---|---|---|---|---|
| Estimate of ultimates | | | | | | |
| End of accident year | 11,288 | 13,470 | 10,739 | 10,787 | 11,057 | 9,422 |
| 1 year later | 7,451 | 7,192 | 5,810 | 6,748 | 2,002 | |
| 2 years later | 6,663 | 4,577 | 5,022 | 5,694 | | |
| 3 years later | 3,946 | 3,517 | 4,322 | | | |
| 4 years later | 3,310 | 3,372 | | | | |
| 5 years later | 2,994 | | | | | |
| Current estimate of ultimate claims | 2,994 | 3,372 | 4,322 | 5,694 | 6,351 | 9,422 |
| Cumulative payments | (2,313) | (1,604) | (1,961) | (2,251) | (2,002) | (1,126) |
| In balance sheet | 681 | 1,768 | 2,361 | 3,443 | 4,339 | 8,296 |
| Provision for prior years | | | | | | 8,032 |
| Liability in balance sheet | | | | | | 28,931 |

**Netherlands (Waard Group)**

**(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 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.

**Netherlands (Scildon)**

**(i) Basis**

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.

For other policies, a discounted value of claims/benefits is used.

**(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.

For the annuity portfolio mark to market interest assumptions are used. Term policies written after 2015 are reserved on best estimate market value reserves.

**(d) Sensitivity to changes in assumptions**

Impact on reported profits and equity to changes in key variables:

| | CA Change in net of tax profits and equity | | Scildon Change in net of tax profits and equity | | Movestic Change in net of tax profits and equity | |
|---|---|---|---|---|---|---|
| | 2018 £m | 2017 £m | 2018 £m | 2017 £m | 2018 £m | 2017 £m |
| **Change in variable** | | | | | | |
| 100 basis point increase credit spreads* | (2.2) | n/a | (37.5) | (19.2) | n/a | n/a |
| 100 basis point increase in Investment return | 0.9 | (1.1) | (26.9) | (30.5) | 0.4 | n/a |
| 100 basis point decrease in Investment return | (1.9) | (1.7) | 29.5 | 33.1 | (0.6) | n/a |
| 10% increase in mortality/morbidity | 2.0 | 1.5 | (0.3) | (0.1) | n/a | n/a |
| 10% increase in mortality alone | 2.6 | 2.9 | (0.3) | (0.1) | n/a | n/a |
| 10% increase in morbidity alone | (0.6) | (0.6) | – | – | n/a | n/a |
| 10% increase in policy maintenance expenses | (4.5) | (4.4) | 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) |
| Net after reinsurance | n/a | n/a | n/a | n/a | (1.1) | (1.2) |
| 5% decrease in loss ratio | | | | | | |
| Gross before reinsurance | n/a | n/a | n/a | n/a | 3.1 | 3.2 |
| Net after reinsurance | n/a | n/a | n/a | n/a | 1.1 | 1.2 |

*The 2018 stress includes corporate bonds and non-local government bonds (i.e. excludes Dutch and German government bonds, but includes other government bonds). The 2017 stress only includes corporate bonds. The stress approach has been updated for 2018, given there is a known exposure to these bonds and changes in spreads.

## 30 Insurance contract provisions (continued)

### UK businesses (CA)

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 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 sensitivities overleaf 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 overleaf 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 overleaf quantifies a 10% increase in those expenses.

### Swedish business (Movestic)

The key sensitivities in the measurement of the group and individual contracts insurance claim reserves within Movestic are a movement in the loss ratio applied to earned premium and the foreign exchange risk arising on business written in Norway. In addition, for the income protection and the waiver of premium benefits within the individual contracts, the claims reserves are impacted by the discount rate used. The impact of these sensitivities is shown overleaf.

### Dutch business (Waard Group)

The most material sensitivity within Waard Group is interest rates. Due to the fact that Waard measures its insurance contract liabilities using historical rates of interest, a rise in interest rates results in a fall in the value of fixed-interest assets with no change in the value of liabilities. The impact on net of tax profits and equity at 2018 is negative £2.3m.

### Dutch business (Scildon)

The key sensitivity within Scildon is interest rates. Similarly to Waard Group, Scildon measures the majority of its insurance contract liabilities using historical rates of interest. This means that a rise in interest rates results in a fall in the value of fixed-interest assets with only a small reduction in the value of liabilities. The impact on net of tax profits and equity at 2018 is negative £26.9m.

## 31 Investment contracts at fair value through income and amounts deposited with reinsurer

### Analysis by operating segment

| 31 December | | 2018 | | | 2017 | |
|---|---|---|---|---|---|---|
| | Investment contract liability £000 | Amount deposited with reinsurer £000 | Net £000 | Investment contract liability £000 | Amount deposited with reinsurer £000 | Net £000 |
| CA | 692,318 | 34,349 | 657,969 | 776,551 | 38,776 | 737,775 |
| Movestic | 2,543,201 | – | 2,543,201 | 2,643,722 | – | 2,643,722 |
| **Total** | **3,235,519** | **34,349** | **3,201,170** | **3,420,273** | **38,776** | **3,381,497** |
| Current | 98,788 | 34,349 | 64,439 | 797,615 | 38,776 | 758,839 |
| Non-current | 3,136,731 | – | 3,136,731 | 2,622,658 | – | 2,622,658 |
| **Total** | **3,235,519** | **34,349** | **3,201,170** | **3,420,273** | **38,776** | **3,381,497** |

The fair values of the groups' investment contract liabilities have been disclosed according to a three-level valuation hierarchy in Note 24.

## 32 Liabilities relating to policyholders' funds held by the group

**Unit-linked**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Balance at I January** | **265,729** | **229,397** |
| Deposits received | 64,093 | 52,449 |
| Fees deducted from account balances | (2,941) | (2,095) |
| Investment yield | (14,887) | 10,453 |
| Foreign exchange translation difference | (8,098) | 1,093 |
| Other movements | (44,060) | (25,568) |
| **Balance at 31 December** | **259,836** | **265,729** |
| Current | 10,243 | 16,210 |
| Non-current | 249,593 | 249,519 |
| **Total** | **259,836** | **265,729** |

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 24.

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 24.

## 33 Borrowings

**Group**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Bank loan | 69,580 | 89,457 |
| Amount due in relation to financial reinsurance | 39,622 | 39,745 |
| **Total** | **109,202** | **129,202** |
| Current | 25,785 | 32,379 |
| Non-current | 83,417 | 96,823 |
| **Total** | **109,202** | **129,202** |

**Company**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Bank loan** | **69,580** | **89,457** |
| Current | 15,306 | 22,029 |
| Non-current | 54,274 | 67,428 |
| **Total** | **69,580** | **89,457** |

The bank loan as at 31 December 2018 comprises the following:

- on 3 April 2017 tranche one of a new facility was drawn down, amounting to £40.0m. This facility is unsecured and is repayable in ten 6-monthly instalments on the anniversary of the draw down date. The outstanding principal on the loan bears interest at a rate of 2.00 percentage points above the London Inter-Bank Offer Rate and is repayable over a period which varies between 1 and 6 months at the option of the borrower. The proceeds of this loan facility were utilised, together with existing group cash, to repay in full, the pre-existing loan facilities totalling £52.8m.
- on 3 April 2017 tranche two of the new loan facility was drawn down, amounting to €71.0m. As with tranche one, this facility is unsecured and is repayable in ten 6-monthly instalments on the anniversary of the draw down date. The outstanding principal on the loan bears interest at a rate of 2.00 percentage points above the European Inter-Bank Offer Rate and is repayable over a period which varies between 1 and 6 months at the option of the borrower.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 33 Borrowings (continued)

– in April 2018 we converted our existing debt arrangement with RBS into a syndicated facility. This will provide access to higher levels of debt financing from a wider panel of lenders, which in turn will enable us to fulfil our appetite of financing future deals up to the maximum levels of gearing set out in our debt and leverage policy, without being restricted by the lending capacity of one individual institution. This facility enables Chesnara to access an increased level of funds efficiently, which in turn supports our acquisition strategy.

The fair value of the sterling denominated bank loan at 31 December 2018 was £27.0m (31 December 2017: £35.0m).

The fair value of the euro denominated bank loan at 31 December 2018 was £42.8m (31 December 2017: £55.0m).

The fair value of amounts due in relation to financial reinsurance was £41.6m (31 December 2017: £42.2m).

Bank loans are presented net of unamortised arrangement fees. Arrangement fees are recognised in profit or loss using the effective interest rate method.

## 34 Defined benefit obligations

Scildon operates a defined benefit pension scheme for the benefit of its present and past employees. A summary of the scheme assets and liabilities as at the balance sheet date and the movements in the post-acquisition period are provided below.

The amount included in the balance sheet arising from the obligations in respect of the scheme is as follows:

| As at period ended | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Present value of defined benefit obligations | 50,781 | 47,459 |
| Fair value of plan assets | (50,886) | (48,354) |
| Surplus | (105) | (895) |
| Effect of asset ceiling test | 105 | 895 |
| **Net liability arising from defined benefit obligation** | **–** | **–** |

As at 31 December 2018, there was a surplus in the Pension Fund of £0.1m. The Scildon defined benefit scheme is accounted for under the provisions of IAS 19. As such, pension surplus assets are not recognisable on the face of the balance sheet and as a consequence are subject to an asset ceiling test, which effectively reduces the asset value to nil. The company is unable to recognise the surplus position in terms of potential refunds of past contributions made or through lower future contributions to the scheme.

Amounts recognised in income in respect of the scheme are as follows:

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Service cost: | | |
| Current service cost | 1,780 | 1,413 |
| Past service cost | – | (438) |
| Net interest income | (20) | (3) |
| **Components of defined benefit costs recognised in profit or loss** | **1,760** | **972** |

The costs charged to the profit and loss account are recorded under operating expenses as personnel costs.

Amounts recognised in the statement of comprehensive income are as follows:

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| The return on plan assets (excluding amounts included in net interest expense) | (598) | (365) |
| Actuarial gains and losses arising from changes in assumptions | (423) | 626 |
| Actuarial gains and losses arising from experience adjustments | 302 | 794 |
| Adjustment for the effect of asset ceiling test | 789 | (895) |
| Foreign exchange translation | 5 | 5 |
| Tax effect | (19) | (41) |
| **Total profit for the year not recognised in income** | **56** | **124** |

Movements in the present value of defined benefit obligations in the period since acquisition were as follows:

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Balance 1 January | 47,459 | 44,864 |
| Current service cost | 1,790 | 1,413 |
| Interest cost | 895 | 648 |
| Contributions from the plan participants | 359 | 270 |
| Actuarial gains and losses arising from changes in assumptions | 423 | (626) |
| Actuarial gains and losses arising from experience adjustments | (302) | (794) |
| Benefits paid | (480) | (329) |
| Individual settlements | 83 | 640 |
| Past service pension costs | – | (438) |
| Foreign exchange translation | 554 | 1,811 |
| **Balance at 31 December** | **50,781** | **47,459** |

Movements in the fair value of plan assets in the period since acquisition were as follows:

| | 2018<br>£000 | 2018<br>£000 |
|---|---|---|
| Balance 1 January/6 April | 48,354 | 45,813 |
| Benefits paid | (480) | (329) |
| Contributions from the employer | 1,701 | (176) |
| Contributions from the plan participants | 359 | 270 |
| Assets distributed on settlements | 83 | 640 |
| Interest income | 915 | 651 |
| The return on plan assets (excluding amounts included in net interest expense) | (598) | (365) |
| Foreign exchange translation | 552 | 1,850 |
| **Balance at 31 December** | **50,886** | **48,354** |

The cost of defined benefit pension amounts:

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **Pension costs** | | |
| Current service pension costs | 1,780 | 1,413 |
| **Total pension costs** | **1,780** | **1,413** |
| **Net interest** | | |
| Interest cost on the present value of promised retirement benefits | 895 | 648 |
| Interest income on assets | (915) | (651) |
| Net interest on the net liability defined benefit | (20) | (3) |
| Past service cost | – | (438) |
| **Total charged to profit and loss account** | **1,760** | **972** |

## 34 Defined benefit obligations (continued)

The principal actuarial assumptions applied to the scheme valuation are as follows:

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Discount rate | 2.00% | 1.90% |
| Interest income on assets | 2.00% | 1.90% |
| General salary increases | 2.00% | 2.00% |
| Deferred pension increases | 0.80% | 0.60% |
| Inflation | 2.00% | 2.00% |

Distribution of plan assets:

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Equity type instruments | 7,587 | 8,253 |
| Fixed interest instruments – Government bonds | 42,871 | 39,527 |
| Cash | 46 | 196 |
| Other | 382 | 378 |
| **Total** | **50,886** | **48,354** |

| Period ended 31 December | 2018 £000 | Not quoted | Quoted market price in an active market 2018 £000 | 2017 £000 | Not quoted | Quoted market price in an active market 2017 £000 |
|---|---|---|---|---|---|---|
| Equity type instruments | 7,587 | – | 7,587 | 8,253 | – | 8,253 |
| Fixed interest instruments – Government bonds | 42,871 | – | 42,871 | 39,527 | – | 39,527 |
| Cash | 46 | 46 | – | 196 | 196 | – |
| Other | 382 | 382 | – | 378 | 378 | – |
| **Total** | **50,886** | **428** | **50,458** | **48,354** | **574** | **47,780** |

The plan assets do not include investments that are issued by the company and do not include assets used by the company.

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Actual return on plan assets | 317 | 286 |

The risks faced by the company in connection with the pension commitments are determined by the duration of these obligations. The table below shows how these obligations are distributed among active and non-active participants.

| As at 31 December 2018 | Cash value of defined benefit number | Duration years |
|---|---|---|
| Active members | 32,095 | 28.6 |
| Deferred members | 12,549 | 24.0 |
| Wholly or partially disabled members | 2,186 | 18.5 |
| Pensioners | 9,783 | 11.1 |
| **Total** | **56,613** | **32.4** |

The present value of the defined benefit obligations is sensitive to a change in the assumptions used. The table below shows the sensitivity of the value of pension rights and service costs, to changes in the underlying assumptions used:

| As at 31 December 2018 | Change | Defined benefit obligation change | Funding cost change |
|---|---|---|---|
| **Discount rate** | | | |
| Plus | 0.50% | (5,503) | (320) |
| Minus | 0.50% | 6,661 | 385 |
| **Salary increase** | | | |
| Plus | 0.50% | 802 | 89 |
| Minus | 0.50% | (802) | (89) |
| **Mortality** | | | |
| Age set back | 1 year | 1,761 | 74 |

The pension fund holds investments which take account of the risk profile of the underlying scheme liabilities, as part of the asset and liability management employed by the scheme.

The employer contribution expected to be paid in respect of 2019 is £1.9m (2018: £1.9m).

Risks associated with the Scildon defined benefit scheme are not considered by the group to be material.

## 35 Deferred tax assets and liabilities

**Deferred tax liabilities comprise:**

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Net deferred tax liabilities: | | |
| CA and other group activities | (1,996) | (2,976) |
| Movestic | (253) | (302) |
| Waard Group | (175) | (455) |
| Scildon | (17,039) | (19,061) |
| **Total** | **(19,463)** | **(22,794)** |
| Current | (904) | (1,184) |
| Non-current | (18,559) | (21,610) |
| **Total** | **(19,463)** | **(22,794)** |

## 35 Deferred tax assets and liabilities (continued)

### CA and other group activities

### (a) Recognised deferred tax assets and liabilities

| 31 December | 2017 Assets/ (liabilities) £000 | (Charge) /credit in year £000 | 2018 Assets/ (liabilities) £000 |
|---|---|---|---|
| Profit arising on transition to new tax regime | (1,008) | 202 | (806) |
| Deferred acquisition costs | (388) | 66 | (322) |
| Deferred income | 739 | (123) | 616 |
| Acquired value in force | (2,657) | 785 | (1,872) |
| Unrealised and deferred investment gains | (23,062) | 11,585 | (11,477) |
| Excess expenses of management | 23,062 | (11,585) | 11,477 |
| Share-based payments | 338 | 50 | 388 |
| **Total** | **(2,976)** | **980** | **(1,996)** |
| Comprising: | | | |
| Net deferred tax liabilities | (2,976) | 980 | (1,996) |
| **Total** | **(2,976)** | **980** | **(1,996)** |

| 31 December | 2016 Assets/ (liabilities) £000 | (Charge) /credit in year £000 | 2017 Assets/ (liabilities) £000 |
|---|---|---|---|
| Profit arising on transition to new tax regime | (1,237) | 229 | (1,008) |
| Deferred acquisition costs | (469) | 81 | (388) |
| Deferred income | 877 | (138) | 739 |
| Acquired value in force | (3,849) | 1,192 | (2,657) |
| Unrealised and deferred investment gains | (23,042) | (20) | (23,062) |
| Excess expenses of management | 23,042 | 20 | 23,062 |
| Share-based payments | 202 | 136 | 338 |
| **Total** | **(4,476)** | **1,500** | **(2,976)** |
| Comprising: | | | |
| Net deferred tax liabilities | (4,476) | 1,500 | (2,976) |
| **Total** | **(4,476)** | **1,500** | **(2,976)** |

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 | 2018 £000 | 2017 £000 |
|---|---|---|
| **Income tax credit** | **992** | **1,500** |

**(b) Items for which no deferred tax asset is recognised**

| 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| BLAGAB transitional amounts | 1,906 | 2,382 |
| Unrelieved expenses | 132,241 | 87,136 |
| **Total** | **134,147** | **89,518** |

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**

**(c) Recognised deferred tax assets and liabilities**

As at the balance sheet date, Movestic had a recognised deferred tax liability of £0.3m (31 December 2017: £0.3m), in respect of fair value adjustments arising upon acquisition. Unrecognised deferred tax assets was nil at the balance sheet date in respect of corporation tax recoverable (31 December 2017: £0.2m).

**Waard Group**

**(d) Recognised deferred tax assets and liabilities**

| 31 December | 2017 Assets/ (liabilities) £000 | (Charge) /credit in year £000 | Foreign exchange translation difference £000 | 2018 Assets/ (liabilities) £000 |
|---|---|---|---|---|
| Intangible assets | | | | |
| Fair value adjustment on acquisition | (1,258) | 319 | (8) | (947) |
| Valuation differences | 803 | (38) | 7 | 772 |
| **Total** | **(455)** | **281** | **(1)** | **(175)** |
| Comprising: | | | | |
| Net deferred tax liabilities | (455) | 281 | (1) | (175) |
| **Total** | **(455)** | **281** | **(1)** | **(175)** |

**Scildon**

**(e) Recognised deferred tax assets and liabilities**

| 31 December | 2017 Assets/ (liabilities) £000 | (Charge) /credit in year £000 | Recognised through equity £000 | Foreign exchange translation difference £000 | 2018 Assets/ (liabilities) £000 |
|---|---|---|---|---|---|
| Fair value adjustment on acquisition | (14,511) | 34 | – | (153) | (14,630) |
| Deferred acquisition costs | 6,141 | (1,672) | – | 39 | 4,508 |
| Defined benefit pension scheme obligations | – | – | (14) | – | (14) |
| Revaluation of buildings and investment properties | – | 105 | – | 2 | 107 |
| Valuation differences on technical provisions | (6,163) | 1,258 | – | (46) | (4,951) |
| Valuation differences on Investments at fair value through profit and loss | 760 | 2,560 | – | 37 | 3,357 |
| Untaxed reserves | (4,705) | – | – | (51) | (4,756) |
| Property and equipment | (583) | – | (70) | (7) | (660) |
| **Total** | **(19,061)** | **2,285** | **(84)** | **(179)** | **(17,039)** |
| Comprising: | | | | | |
| Net deferred tax liabilities | (19,061) | 2,285 | (84) | (179) | (17,039) |
| **Total** | **(19,061)** | **2,285** | **(84)** | **(179)** | **(17,039)** |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 36 Reinsurance payables

**Payable to reinsurers**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Payables in respect of insurance contracts | 10,299 | 10,746 |
| Payables in respect of investment contracts | 14 | 14 |
| Reinsurers' share of deferred acquisition costs and claims deposits | 222 | 646 |
| **Total** | **10,535** | **11,406** |
| Current | 10,535 | 11,406 |
| Non-current | – | – |
| **Total** | **10,535** | **11,406** |

The carrying value of payables to reinsurers is a reasonable approximation of fair value.

## 37 Payables related to direct insurance and investment contracts

**31 December**

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Gross £000 | Reinsurance £000 | Net £000 | Gross £000 | Reinsurance £000 | Net £000 |
| Accrued claims | 65,216 | 17,640 | 47,576 | 66,785 | 25,888 | 40,897 |
| Intermediaries' liabilities | 1,140 | – | 1,140 | 3,650 | – | 3,650 |
| Policyholder premium liabilities | 23,388 | – | 23,388 | 23,378 | – | 23,378 |
| Other | 1,485 | – | 1,485 | 3,350 | – | 3,350 |
| **Total** | **91,229** | **17,640** | **73,589** | **97,163** | **25,888** | **71,275** |
| Current | 91,229 | 17,640 | 73,589 | 97,163 | 25,888 | 71,275 |
| Non-current | – | – | – | – | – | – |
| **Total** | **91,229** | **17,640** | **73,589** | **97,163** | **25,888** | **71,275** |

The carrying value of payables related to the direct insurance and investment contracts is a reasonable approximation of fair value.

## 38 Deferred income

**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Balance at 1 January** | **4,701** | **5,438** |
| Release to income | (753) | (737) |
| **Balance at 31 December** | **3,948** | **4,701** |
| Current | 476 | 634 |
| Non-current | 3,472 | 4,067 |
| **Total** | **3,948** | **4,701** |

The release to income is included in fees and commission income (see Note 8).

### 39 Other payables

**Group**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Accrued expenses | 14,374 | 13,876 |
| VAT | 48 | 53 |
| Employee tax | 3,115 | 3,240 |
| Other | 27,219 | 27,815 |
| **Total** | **44,756** | **44,984** |
| Current | 44,756 | 44,984 |
| Non-current | – | – |
| **Total** | **44,756** | **44,984** |

**Company**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Accrued expenses | 2,156 | 2,274 |
| Other | 655 | 2,377 |
| **Total** | **2,811** | **4,651** |
| Current | 2,811 | 4,651 |
| Non-current | – | – |
| **Total** | **2,811** | **4,651** |

The carrying value of other payables is a reasonable approximation of fair value.

### 40 Share capital and share premium

**Group**
**31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Number of shares issued | Share capital £000 | Number of shares issued | Share capital £000 |
| **Share capital** | **149,847,736** | **43,767** | **149,885,761** | **43,766** |
| | | Share premium £000 | | Share premium £000 |
| | | **142,053** | | **141,983** |

The number of shares in issue at the balance sheet date included nil shares held in treasury (31 December 2017: 86,040).

## 40 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 £41.5m, 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, 23.3m new shares were issued to new and existing shareholders, as part of a fund raising exercise in respect of the proposed acquisition of Legal & General Nederland. The gross amount of new equity raised was £70.0m. Transaction costs of £3.3m were incurred in respect of the fund raising and have been deduced from equity.

**Company**
**31 December**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Number of shares** | **Share capital £000** | **Number of shares** | **Share capital £000** |
| **Authorised:** | | | | |
| Ordinary shares of 5p each | 201,000,000 | 10,050 | 201,000,000 | 10,050 |
| **Issued:** | | | | |
| Ordinary shares of 5p each | 149,908,956 | 7,495 | 149,885,761 | 7,494 |
| | | **Share premium £000** | | **Share premium £000** |
| | | **142,053** | | **141,983** |

The number of shares in issue at the balance sheet date included nil shares held in treasury (31 December 2017: 86,040).

## 41 Treasury shares

| Group and company 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| **Balance at 31 December** | – | **98** |

## 42 Other reserves

**Group**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Capital redemption reserve | 50 | 50 |
| Foreign exchange translation reserve | 27,108 | 27,614 |
| **Balance at 31 December** | **27,158** | **27,664** |

**Company**
**31 December**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Capital redemption reserve** | **50** | **50** |

## 43 Retained earnings

| Group<br>31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Retained earnings attributable to equity holders of the parent company comprise: | | |
| **Balance at 1 January** | **238,341** | **188,598** |
| Profit for the year | 24,124 | 78,434 |
| Revaluation of pension obligations | 56 | 124 |
| Share based payment | 501 | 669 |
| Dividends | | |
| Final approved and paid for 2016 | – | (19,002) |
| Interim approved and paid for 2017 | – | (10,482) |
| Final approved and paid for 2017 | (19,578) | – |
| Interim approved and paid for 2018 | (10,806) | – |
| **Balance at 31 December** | **232,638** | **238,341** |

The interim dividend in respect of 2016, approved and paid in 2017 was paid at the rate of 7.00p per share. The final dividend in respect of 2017, approved and paid in 2018, was paid at the rate of 13.07p per share so that the total dividend paid to the equity shareholders of the parent company in respect of the year ended 31 December 2017 was made at the rate of 20.07p per share.

A final dividend of 13.46p per share in respect of the year ended 31 December 2018 payable on 24 May 2019 to equity shareholders of the parent company registered at the close of business on 12 April 2019, the dividend record date, was approved by the directors after the balance sheet date. The resulting total final dividend of £20.2m has not been provided for in these financial statements and there are no income tax consequences.

The interim dividend in respect of 2018, approved and paid in 2018, was paid at the rate of 7.21p per share to equity shareholders of the parent company registered at the close of business on 5 September 2018, the dividend record date.

The following summarises dividends per share in respect of the year ended 31 December 2017 and 31 December 2018:

| Year ended 31 December | 2018<br>P | 2017<br>P |
|---|---|---|
| Interim – approved and paid | 7.21 | 7.00 |
| Final – proposed/paid | 13.46 | 13.07 |
| **Total** | **20.67** | **20.07** |

| Company<br>Year ended 31 December | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| **Balance at 1 January** | **158,571** | **164,921** |
| Profit for the year | 64,860 | 22,465 |
| Share based payment | 501 | 669 |
| Dividends paid | | |
| Final approved and paid for 2016 | – | (19,002) |
| Interim approved and paid for 2017 | – | (10,482) |
| Final approved and paid for 2017 | (19,578) | – |
| Interim approved and paid for 2018 | (10,806) | – |
| **Balance at 31 December** | **193,548** | **158,571** |

Details of dividends, approved and paid, are set out in the 'group' section above.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 44 Employee benefit expense, including directors

| Year ended 31 December | CA £000 | Movestic £000 | Waard Group £000 | Scildon £000 | Other group activities £000 | 2018 £000 | 2017 £000 |
|---|---|---|---|---|---|---|---|
| Wages and salaries | 2,670 | 8,614 | 1,161 | 10,256 | 2,487 | 25,188 | 22,782 |
| Social security costs | 330 | 2,819 | 162 | 1,390 | 308 | 5,009 | 5,076 |
| Pension costs-defined contribution plans | 181 | 1,925 | 114 | – | 169 | 2,389 | 2,255 |
| Pension costs-defined benefit plans | – | – | – | 1,809 | – | 1,809 | 806 |
| **Total** | **3,181** | **13,358** | **1,437** | **13,455** | **2,964** | **34,395** | **30,919** |
| Monthly average number of employees | | | | | | | |
| Company | | | | | | 37 | 34 |
| Subsidiaries | | | | | | 326 | 295 |
| **Total** | | | | | | **363** | **329** |

*Directors*
Note 45 provides detail of compensation to directors of the company.

*UK*
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 45 – share based payments on page 169.

*Waard*
The Waard business participates in a defined contribution scheme.

*Scildon*
Scildon has a defined benefit plan. The pension scheme is an indexed average pay scheme with a pension of 1.75% per year of service. Indexation is conditional since 1 January 2013. The pension scheme is administered by Stichting Pensionfonds Legal & General Nederland. The company has agreed to contribute to the premium for the unconditional part of the pension. Apart from the obligations which may arise from the collective agreement provisions, the company is not obliged to make additional contributions to the claims brought under the pension fund. The company is not entitled to refunds or discounts.

Part of the plan consists a defined contribution scheme. The company pays a contribution to the scheme and subsequently has no further financial obligations with respect to this part of the scheme. This contribution is recognised as an expense when paid.

The costs of the defined benefit plan are calculated using the projected unit credit method. This means that the cost of providing pensions charged to the income statement are placed over the service lives of employees, according to actuarial calculations. The obligations are calculated as the difference between the present value of pension obligations, net of the fair value of the existing plan assets.

The present value of pension liabilities is determined by discounting the expected future retirement benefits at the rate of return on high quality corporate bonds in euros, which have a similar remaining period to when the pension payments are expected to be incurred. Any deficiency is recognised as a liability in the consolidated balance sheet. Any surplus is recognised as a receivable. A claim however, will only be considered if the company can enforce law in the form of refunds or reductions in future contributions.

Actuarial gains and losses arising from deviations from expected outcomes are recognised as revaluations under IFRS through other comprehensive income and recognised directly in equity.

The company commissions Milliman to produce an annual scheme valuation report. The last available valuation report was as at 31 December 2018.

Further information is shown in Note 34 net liability benefit obligations.

*Movestic*
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 2017, totalled £3.6m.

During 2018 further contributions of £0.7m 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 2017.

The Annual Report states that the Scheme's surplus is £193.9m as at 31 December 2018 (£162.5m as at 31 December 2017).

As at 31 December 2018, the fund had assets under management of £1.3bn (£1.3bn as at 31 December 2017). During 2018 there have been 121 (31 December 2017: 126) employer insurance companies participating in the Scheme and 26,000 (31 December 2017: 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.

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.

## 45 Share-based payments

The group issues equity-settled share based payments to the two 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)

(b) Long-Term Incentive Scheme (LTI)

The STI Scheme is based upon a 1 year performance period measured against IFRS, EcV operating profit and strategic group objectives. In relation to 2018, 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 3 years. Therefore the award was 65% settled in cash and 35% settled by a share option award, which cannot be exercised for 3 years.

Under the LTI Scheme, options are granted with a vesting period of 3 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 invest 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'.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 45 Share-based payments (continued)

### (a) 2018 award under the Short-Term Incentive Scheme (STI)

Details of the short-term incentive awards made in the year are as follows:

**2018 Short-Term Incentive Scheme Awards made in year**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Amount paid as cash bonus through the income statement (65%) | 140 | 376 |
| Amount deferred into shares for 3 years and subject to forfeiture (35%) | 76 | 203 |
| Total bonus award for the year | 216 | 579 |
| Amount of deferred expense recorded in the current year | 18 | 48 |

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) 2018 award made under the Long-Term Incentive Scheme (LTI)

In April 2018, the group granted 167,000 nil priced share options with a vesting period of 3 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 410.00p, which was the share price as at 28 April 2018, the grant date of the options.

Details of the share options outstanding during the year are as follows:

**2018 Long-Term Incentive Scheme**

| | 2018 | |
|---|---|---|
| | Options number 000 | Weighted average exercise price £ |
| Outstanding at the beginning of the year | – | – |
| Granted during the year | 168 | – |
| Outstanding at the end of the year | 168 | – |
| 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) | 410.00 |
| Weighted average exercise price (pence) | Nil |
| Weighted average fair value of options granted (pence) | 229.78 |
| Expected volatility | 25.77 |
| Expected life | 3 years |
| Risk free rate | 1.190% |
| 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 £81,000 related to equity-settled share based payments transactions in 2018.

**(c) 2017 award made under the Short-Term Incentive Scheme (STI)**
The group has recorded an expense of £48,000 with regards to the 35% element that has been deferred over the vesting period.

**(d) 2017 award made under the Long-Term Incentive Scheme (LTI)**
In April 2017, the group granted 174,000 nil priced share options with a vesting period of 3 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 382.75p, which was the share price as at 28 April 2017, the grant date of the options.

Details of the share options outstanding during the year are as follows:

| 2017 Long-Term Incentive Scheme | 2018 Options number 000 | 2018 Weighted average exercise price £ | 2017 Options number 000 | 2017 Weighted average exercise price £ |
|---|---|---|---|---|
| Outstanding at the beginning of the year | 174 | – | – | – |
| Granted during the year | – | – | 174 | – |
| Outstanding at the end of the year | 174 | – | 174 | – |
| 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) | 382.75 |
| Weighted average exercise price (pence) | Nil |
| Weighted average fair value of options granted (pence) | 211.73 |
| Expected volatility | 26.97 |
| Expected life | 3 years |
| Risk free rate | 0.70% |
| 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 £89,000 related to equity-settled share based payments transactions in 2018.

**(e) 2016 award under the Short-Term Incentive Scheme (STI)**
The group has recorded an expense of £66,000 with regards to the 35% element that has been deferred over the vesting period.

## 45 Share-based payments (continued)

### (f) 2016 award made under the Long-Term Incentive Scheme (LTI)

In April 2016, the group granted 255,000 nil priced share options with a vesting period of 3 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:

**2016 Long-Term Incentive Scheme**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Options number 000 | Weighted average exercise price £ | Options number 000 | Weighted average exercise price £ |
| Outstanding at the beginning of the year | 221 | – | 255 | – |
| Granted during the year | – | – | (34) | – |
| Outstanding at the end of the year | 221 | – | 221 | – |

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) | 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 £141,000 related to equity-settled share based payments transactions in 2018.

### (g) 2015 award under the Short-Term Incentive Scheme (STI)

The group has recorded an expense of £40,000 with regards to the 35% element that has been deferred over the vesting period.

**(h) 2015 award made under the Long-Term Incentive Scheme (LTI)**

In April 2015, the group granted 181,000 nil priced share options with a vesting period of 3 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:

**2015 Long-Term Incentive Scheme**

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Options number 000 | Weighted average exercise price £ | Options number 000 | Weighted average exercise price £ |
| Outstanding at the beginning of the year | 165 | – | 181 | – |
| Forfeited during the year | – | – | (16) | – |
| Outstanding at the end of the year | 165 | – | 165 | – |

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 £10,000 related to equity-settled share based payments transactions in 2018.

**(i) 2014 award under the Short-Term Incentive Scheme (STI)**

The group has recorded an expense of £5,000 with regards to the 35% element that has been deferred over the vesting period.

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

In May 2014, the group granted 169,000 nil priced share options with a vesting period of 3 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**

| | 2018 Options number 000 | 2018 Weighted average exercise price £ | 2017 Options number 000 | 2017 Weighted average exercise price £ |
|---|---|---|---|---|
| Outstanding at the beginning of the year | – | – | 91 | – |
| Forfeited during the year | – | – | (33) | 396.74 |
| Exercised during the year | – | – | 58) | – |
| Outstanding at the end of the year | – | – | – | – |
| 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 £nil related to equity-settled share based payments transactions in 2018.

## 46 Earnings per share

Earnings per share are based on the following:

| Year ended 31 December | 2018 | 2017 |
|---|---|---|
| Profit for the year attributable to shareholders (£000) | 24,124 | 78,434 |
| Weighted average number of ordinary shares | 149,847,736 | 149,749,517 |
| Basic earnings per share | 16.10p | 52.38p |
| Diluted earnings per share | 16.01p | 52.13p |

The weighted average number of ordinary shares in respect of the year ended 31 December 2018 is based upon 149,908,956 shares. The weighted average number of ordinary shares in respect of the year ended 31 December 2018 was based upon 149,908,956 shares in issue. No shares were held in treasury.

There were 845,346 share options outstanding at 31 December 2018 (2017: 877,000). Accordingly, there is dilution of the average number of ordinary shares in issue in respect of 2017.

## 47 Operating leases

*Leases as lessee*

Non-cancellable operating lease rentals are payable as follows:

| Operating lease rentals<br>Year ended 31 December | 2018<br>Non-investment properties<br>£000 | 2018<br>Motor vehicles<br>£000 | 2018<br>Total<br>£000 | 2017<br>Non-investment properties<br>£000 | 2017<br>Motor vehicles<br>£000 | 2017<br>Total<br>£000 |
|---|---|---|---|---|---|---|
| Less than 1 year | 85 | 21 | 106 | 922 | 139 | 1,061 |
| Between 1 and 2 years | 3,027 | 25 | 3,052 | 815 | 142 | 957 |
| Between 2 and 5 years | 328 | – | 328 | 60 | 99 | 159 |
| More than 5 years | – | – | – | – | – | – |
| **Expenses recognised in the year in respect of operating leases** | **3,441** | **65** | **3,506** | **1,071** | **188** | **1,259** |

*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.

## 48 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.

## 49 Capital commitments

There were no capital commitments as at 31 December 2018 or as at 31 December 2017.

## 50 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;

(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. Key management compensation is as follows:

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Short-term employee benefits | 988 | 1,324 |
| Post-employment benefits | 68 | 66 |
| **Total** | **1,056** | **1,390** |

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.

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

## 50 Related parties (continued)

### (b) Related party transactions (continued)

The following amounts were payable to directors in respect of bonuses and incentives:

| | 2018 £000 | 2017 £000 |
|---|---|---|
| **Annual bonus scheme (included in the short-term employee benefits above)** | **216** | **588** |

These amounts have been included in accrued expenses as disclosed in Note 39. The amounts payable under the annual bonus scheme were payable within 1 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 | 2018 £000 | 2017 £000 |
|---|---|---|
| **Recovery of expenses** | **3,976** | **3,272** |

*(iii) Transactions with associate*

Movestic Livförsäkring AB and its associate Modernac SA

| Year ended 31 December | 2018 £000 | 2017 £000 |
|---|---|---|
| Reinsurance premiums paid | (8,253) | (9,667) |
| Reinsurance recoveries received | 5,460 | 5,820 |
| Reinsurance commission received | (1,561) | (2,843) |
| | (4,354) | (6,690) |
| **Amounts outstanding as at balance sheet date** | **(2,700)** | **(2,442)** |

Movestic Livförsäkring AB had the following amounts outstanding at the balance sheet date:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Amounts owed by associate £000 | Amounts owed to associate £000 | Amounts owed by associate £000 | Amounts owed to associate £000 |
| **Modernac S.A.** | – | **2,700** | – | **2,442** |

These amounts have been included in other payables as disclosed in Note 39 and other receivables as disclosed in Note 26.

*(iv) Transactions with persons related to key management personnel*

During the year, there were no transactions with persons related to key management personnel.

## 52 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 2018 | Ownership interest 31 December 2017 | 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 |
| **Registered address**<br>2nd Floor, Building 4, West Strand Business Park,<br>West Strand Road, Preston, Lancashire PR1 8UY | | | | |
| Movestic Livförsäkring AB | Sweden | 100% of all share capital | 100% of all share capital | Swedish krona |
| Movestic Kapitalforvältning AB | Sweden | 100% of all share capital (2) | 100% of all share capital (2) | Swedish krona |
| **Registered address**<br>Box 7853, S-103 99 Stockholm, Sweden | | | | |
| Movestic Fund Management S.A. | Luxembourg | 100% of all share capital (6) | 100% of all share capital (6) | Swedish krona |
| **Registered address**<br>12 Rue Gabriel Lippmann, L-5365 Munsbach, Luxembourg | | | | |
| Modernac S.A. | Luxembourg | 49% of all share capital (2) | 49% of all share capital (2) | Swedish krona |
| **Registered address**<br>BP 593 L-2015 Luxemburg, 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 |
| Waard Verzekering | Netherlands | 100% of all share capital (4) | 100% of all share capital (4) | Euro |
| Hollands Welvaren Leven N.V. (7) | Netherlands | n/a | 100% of all share capital (5) | Euro |
| **Registered address**<br>Geert Scholtenslaan II 1687 CL Wognum, Netherlands | | | | |
| Scildon N.V | Netherlands | 100% of all share capital (4) | 100% of all share capital (4) | Euro |
| **Registered address**<br>Laapersveld 68 Hilversum, 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.
(6) Company formed on 6 March 2017.
(7) Company deregistered on 19 December 2018.

SECTION E:

# ADDITIONAL INFORMATION



Preston Riversway Docks, Sunrise

# FINANCIAL CALENDAR

**29 March 2019**
Results for the year ended
31 December 2018 announced

**11 April 2019**
Ex dividend date

**12 April 2019**
Dividend record date

**17 April 2019**
Published Report and Accounts issued
to shareholders

**01 May 2019**
Last date for dividend reinvestment
plan elections

**14 May 2019**
Annual General Meeting

**24 May 2019**
Dividend payment date

**29 August 2019**
Half year results for the 6 months
ending 30 June 2018 announced

# KEY CONTACTS

**Registered and Head Office**
2nd Floor, Building 4
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West Strand Road
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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
Statutory Auditor
Saltire Court
2 Hardman Street
Manchester
M3 3HF

**Registrars**
Link 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 advisor.

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 2019 Annual General Meeting of Chesnara plc will be held at the offices of Panmure Gordon (UK) Limited, One New Change, London EC4M 9AF on 14 May 2019 at 11am. For the business set out below. Resolutions 1 to 14 inclusive will be proposed as ordinary resolutions and resolutions 15 to 18 inclusive will be proposed as special resolutions.

**1.** To receive and adopt the audited accounts for the financial year ended 31 December 2018, together with the reports of the directors and auditor thereon.

**2.** To approve the Directors' Remuneration Report (other than the part of it which contains the Directors' Remuneration Policy) for the year ended 31 December 2018.

**3.** To declare a final dividend of 13.46 pence per ordinary share for the financial year ended 31 December 2018.

**4.** To re-elect John Deane as a director.

**5.** To re-elect David Rimmington as a director.

**6.** To re-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 elect Mark Hesketh 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 the close of business on 28 June 2020 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 £50,000, with the individual amount authorised for each of (a) to (c) above being limited to £50,000. 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 exercise all the powers of the company, 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) up to an aggregate nominal amount of £2,498,483 such amount to be reduced by the aggregate nominal amount of any equity securities allotted pursuant to the authority in paragraph (b) below in excess of £2,498,483; and

(b) up to an aggregate nominal amount of £4,996,965 (such amount to be reduced by the nominal aggregate amount of any shares allotted or rights granted pursuant to the authority in paragraph (a) above) 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, provided that this authority shall, unless renewed, varied or revoked by the company, expire at the conclusion of the company's next Annual General Meeting (or, if earlier, at the close of business on 30 June 2020) save that the company may, before such expiry, make offers or agreements which would or might require securities to be allotted or Allotment Rights to be granted after such expiry and the directors may allot securities or grant Allotment Rights in pursuance of such offer or agreement notwithstanding the expiry of 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 £374,772

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 £374,772; and

(b) used only for the purposes of financing (or refinancing, if the power is to be exercised within 6 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 in the capital of the company, provided that:

(a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 14,990,896;

(b) the minimum price (exclusive of expenses) which may be paid for such ordinary shares is its nominal value;

(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 5 business days immediately preceding the date on which the terms of the tender offer are announced;

(d) the authority hereby conferred shall expire at the conclusion of the company's next Annual General Meeting (or, if earlier, at the close of business on 30 June 2020); and

(e) 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 a general meeting of the company (other than an Annual General Meeting) may be called on not less than 14 clear days' notice.

By order of the board

**Alastair Lonie**
Company Secretary

2nd Floor, Building 4
West Strand Business Park,
West Strand Road,
Preston
Lancashire
PR1 8UY

28 March 2019

# 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. You will not receive a form of proxy for the AGM in the post. Instead, you will receive instructions to enable you to vote electronically and how to register to do so. You will still be able to vote in person at the AGM, and may request a physical copy proxy form directly from the registrars, Link Asset Services, 34 Beckenham Road, Beckenham, BR3 4TU (telephone number: 0371 664 0300). If you request a physical copy proxy form, it must be completed in accordance with the instructions that accompany it and then delivered (together with any power of attorney or other authority under which it is signed, or a certified copy of such item) to [Link Asset Services, PXS1, 34 Beckenham Road, Beckenham, Kent BR3 4TU so as to be received by 11am on Friday 10 May 2019]. The return of the form of proxy will not, however, prevent you from attending the Meeting and voting, in person, should you wish to do so.

3. 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. Members may appoint a proxy online by following the instructions for the electronic appointment of a proxy at **www.signalshares.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 11am on Friday 10 May 2019. 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.

4. 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 Link Asset Services (ID RA10), by 11am on Friday 10 May 2019, which is acting as the company's 'issuer's agent'. After this time, any change of instruction to a proxy appointed through the CREST system should be communicated to the appointee through other means. The time of the message's receipt will be taken to be when (as determined by the timestamp applied by the CREST Applications Host) the issuer's agent is first able to retrieve it by enquiry through the CREST system in the prescribed manner. Euroclear does not make available special procedures in the CREST system for transmitting any particular message. Normal system timings and limitations apply in relation to the input of CREST proxy appointment instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or a CREST sponsored member or has appointed any voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as is necessary to ensure that a message is transmitted by means of the CREST system by any particular time. CREST members and, where applicable, their CREST sponsors or voting service providers should take into account the provisions of the CREST Manual concerning timings as well as its section on 'Practical limitations of the system'. In certain circumstances, the company may, in accordance with the Uncertificated Securities Regulations 2001 or the CREST Manual, treat a CREST proxy appointment instruction as invalid.

# EXPLANATORY NOTES TO THE NOTICE OF THE ANNUAL GENERAL MEETING (CONTINUED)

**5.** 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.

**6.** 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 close of business on Friday 10 May 2019. 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.

**7.** 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.

**8.** As at 23 March 2019 (being the last practicable date prior to the publication of this document), the company's issued share capital consisted of 149,908,956 ordinary shares, carrying one vote each. No shares were held by the company in treasury. Therefore, the total voting rights in the company as at 23 March 2019 (being the last practicable date prior to the publication of this document) were 149,908,956.

**9.** Information regarding this Annual General Meeting, including information required by Section 311A of the Companies Act 2006, is available at **www.chesnara.co.uk** Any electronic address provided either in this notice or any related documents may not be used to communicate with the company for any purposes other than those expressly stated.

**10.** 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.

**11.** 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.

**12.** Members meeting the threshold requirements in Sections 338 and 338A of the Companies Act 2006 have the right to require the company (i) to give to members entitled to receive notice of the meeting notice of a resolution which may properly be moved and is intended to be moved at the meeting and/or (ii) to include in the business to be dealt with at the meeting any matter (other than a proposed resolution) which may be properly included in the business. A resolution may properly be moved or a matter may properly be included in the business unless (a) (in the case of a resolution only) it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the company's constitution or otherwise), (b) it is defamatory of any person, or (c) it is frivolous or vexatious. Such a request may be in hard copy form or in electronic form, must identify the resolution of which notice is to be given or (as applicable) the matter to be included in the business, must be authenticated by the person or persons making it, must be received by the company not later than 11am on 2nd April 2019, and (in the case of a matter to be included in the business only) must be accompanied by a statement setting out the grounds for the request.

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.

### Resolution 2

**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 2018. The Directors' Remuneration Report can be found on pages 62 to 79 of the 2018 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 set out on pages 73 to 79. The vote on this resolution is advisory only and the directors' entitlement to remuneration is not conditional on it being passed. The Companies Act 2006 requires the Directors' Remuneration Policy to be put to shareholders for approval annually unless the approved policy remains unchanged, in which case it need only be put to shareholders for approval at least every 3 years. The company is not proposing any changes to the Directors' Remuneration Policy approved at the annual general meeting in 2017.

### Resolution 3

**Final dividend**
The declaration of the final dividend requires the approval of shareholders in general meeting. If the 2019 Annual General Meeting approves resolution 3, the final dividend of 13.46 pence per share will be paid on 24 May 2019 to ordinary shareholders who are on the register of members at the close of business on 12 April 2019 in respect of each ordinary share.

### Resolutions 4 – 10 inclusive

**Election and Re-election of directors**
The company's Articles of Association provide that any director who has not been elected or re-elected by the shareholders at either of the two preceding annual general meetings is required to retire at the next Annual General Meeting. Additionally, the Articles of Association require such further directors to retire at the annual general meeting as would bring the total number of directors retiring up to one-third of their number.

Notwithstanding the provisions of the company's Articles of Association, the board of directors has determined that all the directors shall retire from office at this year's annual general meeting in line with the best practice recommendations of the UK Corporate Governance Code 2018 (the 'Code'). Each of the directors intends to stand for re-election by the shareholders. Biographical details of each director can be found on pages 50 and 51 of this document. The Chairman confirms that each of the directors proposed 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 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 company notes that the guidance within the Corporate Governance Code is that the Chairman should not normally remain in place after serving 9 years. However, with the experienced SID Mike Evans stepping down in October 2018, the board feel that the interests of the shareholders and other stakeholders are best served by Peter Mason continuing 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. The Audit & Risk Committee has recommended the re-appointment of Deloitte LLP and has confirmed that such recommendation is free from influence by a third party and that no restrictive contractual terms have been imposed on the company. Deloitte LLP has indicated that it is willing to continue to act as the company's auditor.

Resolution 11, therefore, proposes Deloitte's reappointment as auditor to hold office until the next general meeting at which the company's accounts are laid before shareholders. Resolution 12 authorises the directors to determine the auditor's 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.

### 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. The directors' current allotment authority is due to lapse at the 2019 Annual General Meeting. The board is, therefore, seeking to renew its authority over shares having an aggregate nominal amount of £2,498,483, representing approximately one-third of the issued ordinary share capital of the company (excluding treasury shares) as at 23 March 2019 (being the latest practicable date prior to the publication of this document). The board is also seeking authority to allot shares having an aggregate nominal amount of £4,996,965, representing approximately two-thirds of the issued share capital of the company (excluding treasury shares) as at 23 March 2019 by way of a rights issue.

The allotment authority sought is in line with the Share Capital Management guidelines issued by the Investment Association. For the avoidance of doubt, the authority sought pursuant to this resolution will give the directors the ability to allot shares (or grant rights to shares) up to a maximum aggregate nominal amount of £4,996,965.

As at 23 March 2019, the company held no treasury shares.

The authority will expire at the earlier of the conclusion of the company's next Annual General Meeting and the close of business on 30 June 2020.

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.

# EXPLANATORY NOTES TO THE NOTICE OF THE ANNUAL GENERAL MEETING (CONTINUED)

**Resolutions 15 and 16**

**Disapplication of statutory pre-emption rights**
The directors are currently authorised, subject to certain limitations, to issue shares for cash without first offering them to existing shareholders in proportion to their existing shareholdings. That authority will expire at the conclusion of the 2019 Annual General Meeting and, in accordance with the Statement of Principles issued by the Pre-Emption Group, 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.

Resolution 15, if passed, will allow the directors to (a) allot shares in the company for cash in connection with a rights issue or other pre-emptive offer; and (b) otherwise allot shares in the company for cash up to a maximum aggregate nominal value of £374,772, in each case as if the pre-emption rights of Section 561 of the Companies Act 2006 did not apply. This aggregate nominal amount equates to approximately 5% of the issued ordinary share capital of the company (excluding treasury shares) as at 23 March 2019 (being the latest practicable date prior to the publication of this notice of annual general meeting).

Resolution 16 is proposed as a separate special resolution. In line with the Pre-Emption Group's Statement of Principles, the company is seeking authority, to issue up to an additional 5% of its issued ordinary share capital for cash without pre-emption rights applying. In accordance with the Statement of Principles, the company will only allot shares under this additional authority in connection with an acquisition or specific 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 6 month period and is disclosed in the announcement of the allotment.

The board also confirms its intention to follow the provisions of the Statement of Principles regarding cumulative usage of authorities within a rolling 3 year period. Those provisions provide that no more than 7.5% of the issued share capital will be issued for cash on a non pre-emptive basis during any rolling 3 year period, other than to existing shareholders, without prior consultation with shareholders. This limit excludes any ordinary shares issued pursuant to a general disapplication of pre-emption rights in connection with an acquisition or specified capital investment.

**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 (excluding treasury shares) as at 23 March 2019, 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 the conclusion of the company's next Annual General Meeting and the close of business on 30 June 2020.

The company has options and awards outstanding under existing share schemes over an aggregate of 845,346 ordinary 5p shares, representing 0.56% of the company's issued ordinary share capital (excluding treasury shares) as at 23 March 2019 (the latest practicable date prior to the publication of this document). This would represent approximately 0.63% of the company's issued share capital (excluding treasury shares) if the proposed authority being sought at the Annual General Meeting to buy back 14,990,896 ordinary shares was exercised in full (and all of the repurchased ordinary shares were cancelled).

**Resolution 18**

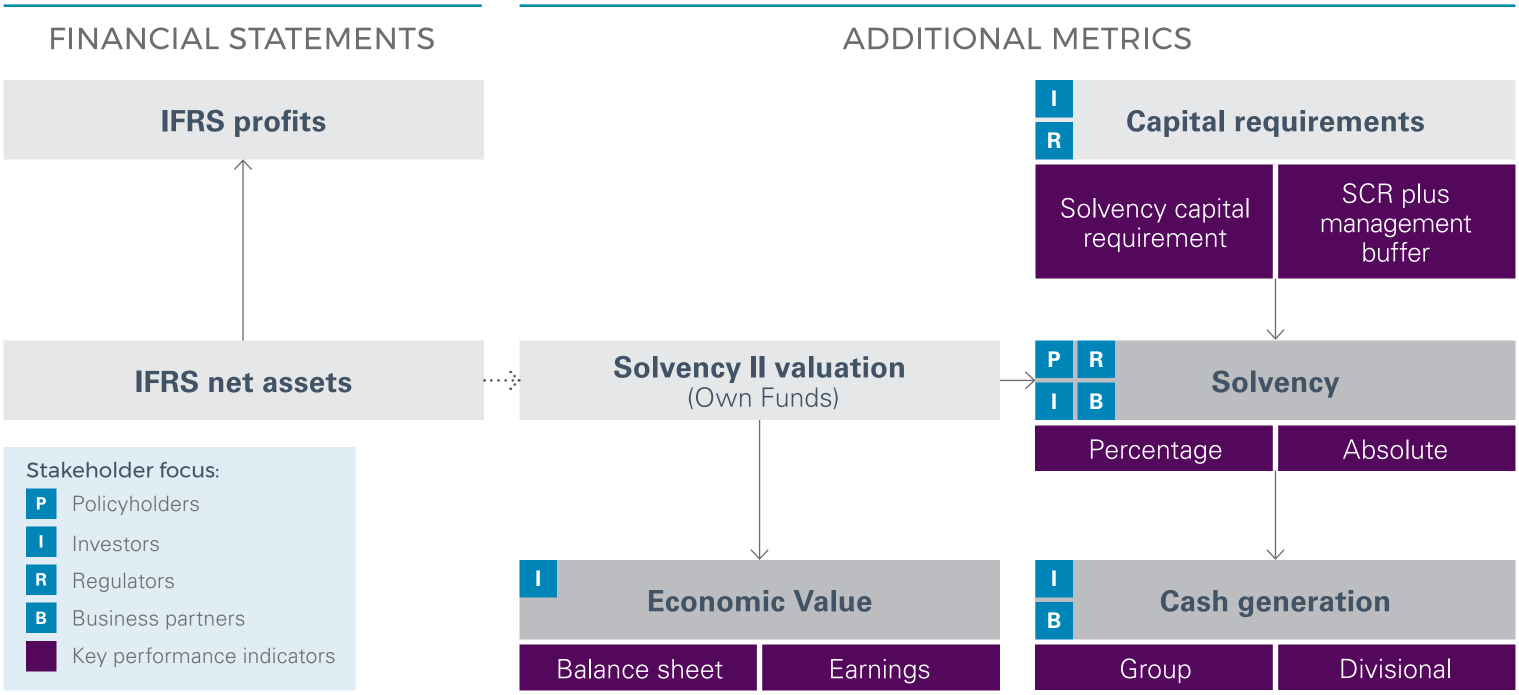
**Notice of general meetings**
The Companies Act 2006 requires the notice period for general meetings of the company to be at least 21 days, but, as a result of a resolution which was passed by the company's shareholders at last year's Annual General Meeting, the company is currently able to call general meetings (other than an Annual General Meeting) on not less than 14 clear days' notice. In order to preserve this ability, shareholders must once again approve the calling of meetings on not less than 14 clear days' notice. Resolution 18 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 statutory requirements for electronic voting 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.

**Directors' recommendation**
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 (save in respect of those matters in which they are interested), and consider that all resolutions are in the best interests of the company and its shareholders as a whole.

# RECONCILIATION OF METRICS

Within these Report and Accounts and as described on page 10, we use alternative performance measures to detail the position and performance of the group and its divisions. We believe that these measures are of greater commercial relevance than IFRS to the users of the Report and Accounts. The diagram below shows the interaction between the measures:




As shown above, the key interaction between our statutory reporting rules under IFRS and the alternative performance measures is with the Solvency II valuation and the Own Funds balance. A reconciliation from IFRS net assets to Solvency II Own Funds is shown below:

| £m | 31 Dec 2018 | 31 Dec 2017 | Rationale |
|---|---|---|---|
| **Group IFRS net assets** | **445.6** | **451.7** | |
| Removal of intangible assets; AVIF, DAC and DIL | (173.5) | (182.6) | Intangible assets that cannot be sold separately have no intrinsic value under Solvency II rules. |
| Removal of IFRS reserves, net of reinsurance | 6,817.6 | 7,378.9 | Actuarial reserves are calculated differently between the two methodologies and hence IFRS reserves are replaced with Solvency II technical provisions. The main differences in methodology are discussed further below. |
| Inclusion of SII technical provisions, net of reinsurance | (6,510.7) | (6,968.9) | |
| Other valuation differences | 3.9 | 2.5 | Other immaterial valuation differences. |
| Deferred tax valuation differences | (4.4) | (20.3) | These are the deferred tax impacts as a result of the adjustments above. |
| Foreseeable dividends | (20.2) | (19.6) | Under Solvency II rules, future 'foreseeable dividends' are required to be recognised within Own Funds. Under IFRS rules, dividends are recognised when paid. |
| Ring-fenced surpluses | (5.7) | (26.5) | Solvency II requires that Own Funds are reduced by any surpluses that are restricted. For Chesnara this relates to surpluses within the two S&P with-profits funds, which are temporarily restricted. These restrictions are removed through periodic capital transfers. |
| **Group Solvency II Own Funds** | **552.6** | **615.2** | |

The main differences between the two methodologies for calculating actuarial reserves are as follows:

- IFRS reserves continue to be largely based on the Solvency I regimes in place in each of the divisions. The main difference between IFRS and Solvency I is the inclusion of an additional cost of guarantee reserve in each of the with-profits funds in CA plc.
- IFRS assumptions contain prudence margins, whereas the Solvency II assumptions are best estimate.
- Solvency II requires the establishment of contract boundaries to determine whether an insurance obligation or reinsurance obligation is to be treated as existing or future business, with only existing business considered in scope for the calculation of technical provisions.
- Solvency II requires the inclusion of a risk margin to reflect inherent uncertainties within the estimated liabilities.
- Other valuation differences, such as IFRS future liability cash flows are discounted using a valuation rate of interest based on the risk-adjusted yield on held assets, whereas Solvency II uses a swaps-based risk-free discount curve, as prescribed by EIOPA.

# GLOSSARY

| | |
|---|---|
| **AGM** | Annual General Meeting. |
| **ALM** | Asset Liability Management – management of risks that arise due to mismatches between assets and liabilities. |
| **APE** | Annual Premium Equivalent – an industry wide measure that is used for measuring the annual equivalent of regular and single premium policies. |
| **CA** | Countrywide Assured plc. |
| **CALH** | Countrywide Assured Life Holdings Limited and its subsidiary companies. |
| **BAU cash generation** | This represents divisional cash generation plus the impact of non-exceptional group activity. |
| **Cash generation** | 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. Cash generation is reported at a group level and also at an underlying divisional level reflective of the collective performance of each of the divisions prior to any group level activity. |
| **Divisional cash generation** | This represents the cash generated by the three operating divisions of Chesnara (UK, Sweden and the Netherlands), exclusive of group level activity. |
| **DNB** | De Nederlandsche Bank is the central bank of the Netherlands and is the regulator of our Dutch subsidiaries. |
| **DPF** | 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. |
| **Dutch business** | Scildon and the Waard Group, consisting of Waard Leven N.V., Hollands Welvaren Leven N.V., Waard Schade N.V. and Waard Verzekeringen B.V. |
| **Economic Profit** | A measure of pre-tax profit earned from investment market conditions in the period and any economic assumption changes in the future (alternative performance metrice – APM). |
| **EcV** | Economic Value is a financial metric that is derived from Solvency II Own Funds that is broadly similar in concept to European Embedded Value. It provides a market consistent assessment of the value of existing insurance businesses, plus adjusted net asset value of the non-insurance business within the group. |
| **FCA** | Financial Conduct Authority. |
| **FI** | Finansinspektionen, being the Swedish Financial Supervisory Authority. |
| **Form of proxy** | The form of proxy relating to the General Meeting being sent to shareholders with this document. |
| **FSMA** | The Financial Services and Markets Act 2000 of England and Wales, as amended. |
| **Group** | The company and its existing subsidiary undertakings. |
| **Group cash generation** | This represents the absolute cash generation for the period at total group level, comprising divisional cash generation as well as both exceptional and non-exceptional group activity. |
| **Group 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 group in those capital resources. |
| **Group SCR** | 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. |
| **Group solvency** | Group solvency is a measure of how much the value of the company exceeds the level of capital it is required to hold in accordance with Solvency II regulations. |
| **HCL** | HCL Insurance BPO Services Limited. |
| **IFRS** | International Financial Reporting Standards. |
| **IFA** | Independent Financial Adviser. |
| **KPI** | Key performance indicator. |
| **LGN** | LGN or Legal & General Nederland refers to the legal entity Legal & General Nederland Levensverzekering Maatschappij N.V acquired by Chesnara in April 2017. |
| **London Stock Exchange** | London Stock Exchange plc. |
| **LTI** | Long-Term Incentive Scheme – A reward system designed to incentivise executive directors' long-term performance. |
| **Movestic** | Movestic Livförsäkring AB. |
| **Modernac** | Modernac SA, an associated company which is 49% owned by Movestic. |
| **New business** | The present value of the expected future cash inflows arising from business written in the reporting period. |
| **Official List** | The Official List of the Financial Conduct Authority. |
| **Operating Profit** | A measure of the pre-tax profit earned from a company's ongoing core business operations, excluding any profit earned from investment market conditions in the perSSiod and any economic assumption changes in the future (alternative performance metric – APM). |
| **Ordinary shares** | Ordinary shares of five pence each in the capital of the company. |
| **Own Funds** | 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. |
| **ORSA** | Own Risk and Solvency Assessment. |
| **PRA** | Prudential Regulation Authority. |
| **QRT** | Quantitative Reporting Template. |
| **ReAssure** | ReAssure Limited. |
| **Resolution** | The resolution set out in the notice of General Meeting set out in this document. |
| **RMF** | Risk Management Framework. |
| **Scildon** | Scildon. |
| **Shareholder(s)** | Holder(s) of Ordinary Shares. |
| **Solvency II** | 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. |
| **SICAV** | A type of open-ended investment fund in which the amount of capital in the fund varies according to the number of investors. Shares in the fund are bought and sold based on the fund's current net asset value. |
| **STI** | Short-Term Incentive Scheme – A reward system designed to incentivise executive directors' short-term performance. |
| **SCR** | 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. |
| **Swedish business** | Movestic and its subsidiaries and associated companies. |
| **S&P** | Save & Prosper Insurance Limited and Save & Prosper Pensions Limited. |
| **TCF** | Treating Customers Fairly – a central PRA principle that aims to ensure an efficient and effective market and thereby help policyholders achieve fair outcomes. |
| **TSR** | Total Shareholder Return, measured with reference to both dividends and capital growth. |
| **UK or United Kingdom** | The United Kingdom of Great Britain and Northern Ireland. |
| **UK business** | CA and S&P. |

# NOTE ON TERMINOLOGY

As explained in Note 7 to the IFRS financial statements, the principal reporting segments of the group are:

| | |
|---|---|
| **CA** | 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; S&P 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; 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; |
| **Movestic** | which was purchased on 23 July 2009 and comprises the group's Swedish business, Movestic Livförsäkring AB and its subsidiary and associated companies; |
| **The Waard Group** | which was acquired on 19 May 2015 and comprises of two insurance companies; Waard Leven N.V., and Waard Schade N.V.; and a service company, Tadas Verzekering; and |
| **Scildon** | which was acquired on 5 April 2017; and |
| **Other group activities** | which represents the functions performed by the parent company, Chesnara plc. Also included in this segment are consolidation adjustments. |

# NOTES

# NOTES

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