Registered Number: 4096141

FRIENDS LIFE LIMITED

COMPANY INCORPORATED IN ENGLAND AND WALES
REGISTRATION NUMBER 4096141

REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2017

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Registered Number: 4096141

FRIENDS LIFE LIMITED

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

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FRIENDS LIFE LIMITED

COMPANY INFORMATION

DIRECTORS

A. D. Briggs
M. G. Carvill (non-executive director)
V. F. Gooding (non-executive director)
R. W. A. Howe (non-executive director)
J. B. O'Roarke (non-executive director)
H. R. Patel (non-executive director)
S. P. Trickett (non-executive director)
J. M. Windsor

COMPANY SECRETARY

Aviva Company Secretarial Services Limited
St Helens
1 Undershaft
London
EC3P 3DQ

REGISTERED OFFICE

Pixham End
Dorking
Surrey
RH4 1QA

INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
7 More London Riverside
London
SE1 2RT

OTHER INFORMATION

Friends Life Limited ("the Company") is a member of the Association of British Insurers and covered by the Financial Ombudsman Service and is authorised and regulated by the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA").

The Company is a member of the Aviva plc group of companies ("the Group").

FRIENDS LIFE LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2017

The directors present their Strategic Report for the Company for the year ended 31 December 2017.

PRINCIPAL ACTIVITIES

The Company is a wholly owned subsidiary of Friends Life FPL Limited ("FPL") a company incorporated in the United Kingdom ("UK"). The Company's ultimate parent and controlling company is Aviva plc.

The Company's principal activities previously comprised manufacturing and administering life and pensions products in the UK.

On 1 October 2017, the long-term business of the Company, along with the majority of shareholder fund assets, was transferred to a fellow subsidiary of Aviva plc, Aviva Life & Pensions UK Limited ("UKLAP"), via a Business Transfer Scheme ("the Scheme") under Part VII of the Financial Services and Markets Act 2000. The Company subsequently ceased to underwrite long-term insurance business.

Following the completion of the Scheme transfer, the Company applied to the FCA and PRA for de-authorisation. As at the date of this Report & Financial Statements the Company has yet to receive approval for this application.

TRANSFER OF BUSINESS

On 1 October 2017, all of the long-term business of the Company was transferred to UKLAP via the Scheme. The purpose of the Scheme was to simplify the structure of the Aviva UK Life businesses and to generate capital efficiencies within the Aviva Group.

The long-term business transferred out of the Company comprised:

- All With-profits funds assets and liabilities to separate With-profit funds within UKLAP.
- All Non-profit fund assets and liabilities to the UKLAP Non-profit fund.
- £249m of Shareholder fund net liabilities to the UKLAP Shareholder fund.

The Scheme was implemented on 1 October 2017 and resulted in a £68,308m of assets and £67,328m of liabilities being transferred from the Company. No consideration was paid by UKLAP to the Company in respect of this transfer of assets and liabilities and as a result the transfer generated a loss of £980m which has been reported in the Statement of changes in equity. The assets and liabilities transferred are set out in note 37 of this Report & Financial Statements.

In addition the Scheme resulted in the transfer of the £495m Step-Up Tier One Insurance Capital Securities ("STICS") which were previously disclosed as Other equity reserves of the Company. No consideration was paid in respect of the transfer of the STICS resulting in the recognition of a £495m gain which has been reported directly in the Statement of changes in equity. This gain offsets the impact of the de-recognition of the STICS balance from Other equity reserves which has also been reported directly in the Statement of changes in equity.

The Company has also incurred an unrealised loss of £61m and a realised loss of £1,903m in respect of the write down in the value of its investment in the subsidiary, Friends Life and Pensions Limited ("FLP"). The assets and liabilities of FLP were also transferred to UKLAP via the Scheme which has resulted in this reduction in the value of the Company's investment in FLP from £1,969m to £5m.

The Company's shareholder fund retained £10m of assets to cover the Company's minimum capital requirements until receipt of permission for de-authorisation. When permission for de-authorisation is received it is intended that the remaining £10m of assets will be transferred to UKLAP under the terms of the Scheme.

RESULTS AND BUSINESS REVIEW

Operational structure

Prior to the Scheme the Company largely operated in the UK individual and group protection, savings and investment, and annuity markets.

Business Performance	**2017** **£m**	**2016** **£m**
(Loss)/Profit after tax	(1,442)	316
Total equity	10	3,304

(Loss)/Profit after tax

The 2017 loss after tax includes dividends received from the subsidiaries of the Company of £440m, offset by £1,964m of negative fair value adjustments in respect of these subsidiaries giving a profit after tax excluding these items of £82m. The £82m reflects the nine months of trading before the Scheme was implemented.

The 2016 profit after tax includes dividends received from the subsidiaries of the Company of £269m, offset by £64m of negative fair value adjustments in respect of these subsidiaries, giving a profit after tax excluding these items of £111m.

Total equity

The movement in total equity during the year reflects the loss after tax for the year of £1,442m, the £854m dividends paid, the £980m loss arising from the Scheme and the £18m of interest paid on STICS less tax relief.

FUTURE OUTLOOK

Following the Scheme transfer described above, the Company has ceased to write insurance business and has applied for de-authorisation. On receipt of permission for de-authorisation it is intended that the £10m assets retained to cover minimum capital requirements until de-authorisation will be transferred to UKLAP, leaving the Company with £nil of net assets. There are no plans in place to liquidate the Company.

PRINCIPAL RISKS AND UNCERTAINTIES

As a result of the Scheme all assets and liabilities aside from the £10m of assets retained until de-authorisation have been transferred to UKLAP and the Company has ceased to underwrite long-term business. The Company is therefore no longer considered to be exposed to significant risk or uncertainties.

The risks and uncertainties of UKLAP are disclosed in the 2017 Report and Financial statements of UKLAP.

Approved by the Board on 27 March 2018 and signed on its behalf by

Aviva Company Secretarial Services Limited
COMPANY SECRETARY

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2017

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2017.

DIRECTORS

The directors of the Company at the date of this report are shown on page 1.

M. J. Hawker was appointed as a director on 1 January 2017 and resigned as a director on 31 March 2017.

B. J. Richards (also known as B. J. Carew-Jones) resigned as a director on 28 September 2017.

A.E. Hutchinson resigned as a director on 31 October 2017.

J. R. F. Walls resigned as a director on 28 February 2018. V. F. Gooding was appointed as a director on the same date.
J B O'Roarke was appointed as a non-executive director of the Company on 8 March 2018.

COMPANY SECRETARY

M. Risam acted as the Company Secretary until 31 August 2017 after which Aviva Company Secretarial Services Limited acted as the Company Secretary.

FUTURE OUTLOOK

The future outlook of the Company is discussed in the Strategic Report.

DIVIDEND

During May 2017 a cash interim dividend of £414m and an in-specie interim dividend of £440m were paid (2016: £nil). The in-specie dividend comprised an intercompany receivable from Aviva Group Holdings Limited. This intercompany receivable had previously been paid to the Company as a dividend in-specie from FLP. No final dividend is proposed in respect of the financial year ending 31 December 2017.

It is expected that the £10m of assets retained in the Company will be transferred to UKLAP under the terms of the Scheme once the Company has been de-authorised.

STATEMENT OF GOING CONCERN

The financial statements have been prepared on a going concern basis. In assessing whether the going concern basis is appropriate the directors have considered the information contained in the financial statements. There are no plans in place to liquidate the Company. Key information in respect of the Company's business activities, financial performance (including financial strength), and risks is set out on pages 2 and 3 of the financial statements.

POST BALANCE SHEET EVENTS

There are no adjusting or non-adjusting post balance sheet events.

FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Further information on the Company's risk management process and the policies for mitigating certain risks are set out within Note 27. Details of the financial instruments used for these purposes are also disclosed in Note 27.

EMPLOYEES

The Company receives services and administration from Aviva Administration Limited ("AAL") and Aviva Management Services UK Limited ("AMSUKL"). During 2016 staff previously employed by AAL and AMSUKL entered into new employment contracts with Aviva Employment Services Limited ("AES"), another Group service company. The Company has no direct employees. The average number of employees of AES is disclosed in the AES financial statements.

STATEMENT OF DISCLOSURE OF INFORMATION TO THE AUDITORS

Each person who was a director of the Company on the date that this report was approved confirms that:

(a) so far as the director is aware there is no relevant audit information, being information needed by the auditors in connection with preparing their report, of which the auditors are unaware; and

(b) each director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

INDEPENDENT AUDITORS

It is the intention of the directors to reappoint the auditors, PricewaterhouseCoopers LLP, under the deemed appointment rules of section 487 of the Companies Act 2006.

QUALIFYING INDEMNITY PROVISIONS

Aviva plc, the Company's ultimate parent, granted in 2004 an indemnity to the directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985 (which continue to apply in relation to any provision made before 1 October 2007). This indemnity is a 'qualifying third party indemnity' for the purposes of section 309A to 309C of the Companies Act 1985. These qualifying third party indemnity provisions remain in force as at the date of approving the Directors' Report by virtue of paragraph 15, Schedule 3 of the Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007.

The directors also have the benefit of the indemnity provision contained in the Company's articles of association subject to the conditions set out in the Companies Act 2006. This is a "qualifying third party indemnity" provision as defined by section 234 of the Companies Act 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Strategic Report, the Report of the Directors 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 have prepared the financial statements in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), comprising Financial Reporting Standards 101 *Reduced Disclosure Framework* ("FRS 101"), and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and the profit or loss of the Company for that period.

In preparing these financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards, including FRS 101, have been followed subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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.

Pixham End
Dorking
Surrey
RH4 1QA

27 March 2018

BY ORDER OF THE BOARD

Aviva Company Secretarial Services Limited
COMPANY SECRETARY

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF FRIENDS LIFE LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion, Friends Life Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2017; the profit and loss account, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

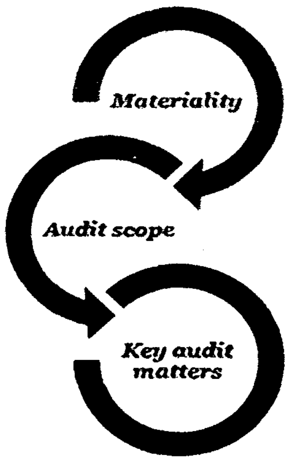
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We have provided no non-audit services to the company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview



- Overall materiality: £86 million, based on 4% of loss before tax, adjusted for the loss on the Scheme transfer.

- Friends Life Limited is a standalone life insurance entity and a wholly owned subsidiary of Aviva plc.
- We performed a full scope audit of the complete financial information in accordance with our materiality and risk assessment.

- Valuation of the long term business provision.
  - Annuitant mortality assumptions.
  - Expense assumptions.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the company and the industry in which it operates, and considered the risk of acts by the company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the company's financial statements, including, but not limited to, the Companies Act 2006, the Prudential Regulation Authority's regulations and UK tax legislation. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with the regulators, review of correspondence with legal advisors, enquiries of management and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the 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) identified by the auditors, including 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, and any comments we make on the results of our procedures thereon, 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. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Valuation of the long term business provision The long term business provision forms part of the Loss on Scheme transfer of business as set out in note 37. For the long term business provision, the Directors' valuation of the provisions for the settlement of future claims, involves complex and subjective judgements about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts to the valuation of these liabilities.	The work to address the valuation of the long term business provision included the following procedures: • We understood the governance process in place to determine the insurance contract liabilities, including testing the associated financial reporting control framework. • We tested the design and operating effectiveness of controls over the accuracy and completeness of the data used. • Using our actuarial specialist team members, we applied our industry knowledge and experience and we compared the methodology, models and assumptions used against recognised actuarial practices. • We tested the key judgements and controls over the preparation of the liabilities, including the manually calculated components. We focused on the consistency in treatment and methodology period-on-period and with reference to recognised

Key audit matter	How our audit addressed the key audit matter
	actuarial practice. • We used the results of an independent PwC annual benchmarking survey of assumptions to further challenge the assumption setting process by comparing certain assumptions used relative to the company's industry peers. • We assessed the disclosures in the financial statements. As part of our consideration of the entire set of assumptions, we focussed particularly on the annuitant mortality and expense assumptions given their significance to the result and the level of judgement involved. These have been considered in greater detail below.
Annuitant mortality assumptions Annuitant mortality assumptions, as described in note 25, require a high degree of judgement due to the number of factors which may influence mortality experience. The differing factors which affect the assumptions are underlying mortality experience (in the portfolio), industry and management views on the future rate of mortality improvements and external factors arising from developments in the annuity market. There are two main components to the annuitant mortality assumptions: • Mortality base assumption: this component is typically less subjective as it is derived using the external Continuous Mortality Investigation (CMI) tables, adjusted for internal experience. However, judgement is required in choosing the appropriate table and fitting internal experience to this table. • Rate of mortality improvements: this component is more subjective given the lack of data and the uncertainty over how life expectancy will change in the future. Management has made specific adjustments to reflect the profile of their portfolio and their views on the rate of mortality improvement. In addition, a margin for prudence is applied to the annuitant mortality assumptions.	In addition to the procedures above, in respect of the annuitant mortality assumptions: • We tested the methodology used by management to derive the assumptions with reference to relevant rules and actuarial guidance and by applying our industry knowledge and experience. This included evaluating management's choice of, and fitting to, the CMI base tables, dataset for improvements and the margin for prudence. • We assessed the results of the experience investigations carried out by management for the annuity business to determine whether they provided support for the assumptions used. • We compared the mortality assumptions selected by management against those used by their peers. Based on the work performed and the evidence obtained, we consider the assumptions used for annuitant mortality to be appropriate.
Expense assumptions Future maintenance expenses and expense inflation assumptions are used in the measurement of the long term business provision, as described in note 25. The assumptions reflect the expected future expenses that will be required to maintain the in-force policies, including an allowance for project costs and a margin for prudence. The assumptions used require	In addition to the procedures above, in respect of the expense assumptions: • We tested the methodology used by management to derive the assumptions with reference to relevant rules and actuarial guidance and by applying our industry knowledge and experience. This included testing the split of expenses between

Key audit matter	How our audit addressed the key audit matter
significant judgement.	acquisition and maintenance by agreeing a sample to supporting evidence. • We validated significant assumptions used by management, including the margin for prudence and the rate of inflation against past experience, market observable data (to the extent available and relevant) and our experience of market practices. • We have tested that the assumptions appropriately reflect the expected future expenses for maintaining policies in force, which includes consideration of the allowance for project costs. Based on the work performed and the evidence obtained, we consider the assumptions for expense risk to be appropriate.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

The company is a standalone life insurance entity and a wholly owned subsidiary of Aviva plc. We performed a full scope audit of the complete financial information in accordance with our materiality and risk assessment. We conducted our audit at the offices of the company and the offices of their outsourcers who operate certain policy administration and investment functions.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

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

Overall materiality	£86 million.
How we determined it	4% of loss before tax, adjusted for the loss on Scheme transfer.
Rationale for benchmark applied	We believe that loss before tax is the primary measure used by the shareholders in assessing the performance of the entity, and is a generally accepted auditing benchmark. We have adjusted the loss before tax for the loss on Scheme transfer, given the focus and significance of this transaction.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £4.3 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

CONCLUSIONS RELATING TO GOING CONCERN

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

REPORTING ON OTHER INFORMATION

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance 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 an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of 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. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Report of the directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic report and report of the directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the directors for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Report of the directors.

RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS AND THE AUDIT

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 6, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they 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 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 company or to cease operations, or have no realistic alternative but to do so.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF FRIENDS LIFE LIMITED (continued)

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

OTHER REQUIRED REPORTING

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 28 May 2015 to audit the financial statements for the year ended 31 December 2015 and subsequent financial periods. The period of total uninterrupted engagement is 3 years, covering the years ended 31 December 2015 to 31 December 2017.

Gail Tucker

Gail Tucker (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 March 2018

Registered Number: 4096141

FRIENDS LIFE LIMITED

PROFIT AND LOSS ACCOUNT
TECHNICAL ACCOUNT - LONG-TERM BUSINESS
FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	2017 £m	2016 £m
Earned premiums, net of reinsurance			
Gross premiums written	4	942	1,345
Outward reinsurance premiums	5	(537)	(690)
		405	655
Investment income	6	8,372	4,597
Unrealised gains on investments	6	-	2,920
Other technical income, net of reinsurance	7	225	267
Total technical income		9,002	8,439
Claims incurred, net of reinsurance			
Claims paid			
- gross amount		(3,254)	(4,378)
- reinsurers' share	5	476	686
		(2,778)	(3,692)
Change in the provision for claims			
- gross amount		(25)	(40)
- reinsurers' share	5	5	7
		(20)	(33)
Net claims incurred		(2,798)	(3,725)
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance			
- gross amount		1,261	(966)
- reinsurers' share	5	32	125
		1,293	(841)
Technical provisions for linked liabilities, net of reinsurance			
- gross amount		(1,264)	(3,362)
- reinsurers' share	5	166	825
		(1,098)	(2,537)
Change in other technical provisions, net of reinsurance		195	(3,378)
Net operating expenses	8	(265)	(446)
Investment expenses and charges	6	(59)	(209)
Unrealised losses on investments	6	(5,761)	-
Other technical charges, net of reinsurance	9	(6)	(9)
Tax attributable to the long-term business	10	(175)	(329)
Transfer to or from the fund for future appropriations		27	(13)
		(6,239)	(1,006)
Total technical charges		(8,842)	(8,109)
Balance on the technical account – long-term business		160	330

Note:

All amounts above are in respect of discontinued operations.

The Notes on pages 18 to 85 form an integral part of these financial statements.

FRIENDS LIFE LIMITED

PROFIT AND LOSS ACCOUNT
NON-TECHNICAL ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	2017 £m	2016 £m
Balance on the long-term business technical account		160	330
Tax attributable to balance on long-term business technical account	10	53	38
(Loss)/profit before tax from long-term business		213	368
Investment income	6	443	34
Unrealised (losses)/gains on investments	6	(50)	194
Investment expenses and charges	6	(1,999)	(258)
Other Technical Income, Net of Reinsurance		(9)	-
(Loss)/profit on ordinary activities before tax		(1,402)	338
Tax (charge) on (loss)/profit on ordinary activities	10	(40)	(22)
(Loss)/profit on ordinary activities after tax		(1,442)	316

Note:

All of the amounts above are in respect of discontinued operations.

The Notes on pages 18 to 85 form an integral part of these financial statements.

Registered Number: 4096141

FRIENDS LIFE LIMITED

BALANCE SHEET AS AT 31 DECEMBER 2017

ASSETS	Note	2017 £m	2016 £m
Present value of acquired in-force business	12	-	15
Investments			
Land and buildings	14	-	1,021
Investments in Group undertakings and participating interests	17	5	4,111
Other financial investments	14	-	24,330
		5	29,462
Assets held to cover linked liabilities	14	-	27,761
Reinsurers' share of technical provisions			
Long-term business provision	18	-	1,227
Claims outstanding	18	-	56
Technical provisions for linked liabilities	18	-	6,849
		-	8,132
Debtors			
Debtors arising out of direct insurance operations			
- Policyholders		-	43
- Intermediaries		-	5
Debtors arising out of reinsurance operations		-	12
Other debtors	19	5	171
		5	231
Other assets			
Cash at bank and in hand		-	6,491
Prepayments and accrued income			
Accrued interest and rent		-	268
Deferred acquisition costs	20	-	491
Other prepayments and accrued income		-	7
		-	766
TOTAL ASSETS		10	72,858

The Notes on pages 18 to 85 form an integral part of these financial statements.

Registered Number: 4096141

FRIENDS LIFE LIMITED

BALANCE SHEET AS AT 31 DECEMBER 2017

LIABILITIES	Note	2017 £m	2016 £m
Capital and reserves			
Called up share capital	21	702	702
Profit and loss account		(692)	2,107
Other equity	23	-	495
Total equity		10	3,304
Subordinated liabilities	24	-	856
Fund for future appropriations		-	692
Technical provisions			
Long-term business provision	25	-	31,128
Claims outstanding		-	399
		-	31,527
Technical provisions for linked liabilities	25	-	34,610
Provisions for other risks			
Provisions for taxation	10	-	352
Other provisions	28	-	95
		-	447
Creditors			
Creditors arising out of direct insurance operations		-	30
Creditors arising out of reinsurance operations		-	32
Other creditors including taxation and social security	29	-	1,244
		-	1,306
Accruals and deferred income		-	116
TOTAL LIABILITIES AND EQUITY		10	72,858

Approved by the Board on 27 March 2018 and signed on its behalf by

J.M. Windsor

J.M. WINDSOR
DIRECTOR

The Notes on pages 18 to 85 form an integral part of these financial statements.

FRIENDS LIFE LIMITED

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	Called up share capital £m	Profit and loss account £m	Other equity £m	Total equity £m
At 1 January 2017		702	2,107	495	3,304
Loss on ordinary activities after tax		-	(1,442)	-	(1,442)
Dividends paid		-	(854)	-	(854)
Scheme transfer of net assets	37	-	(980)	-	(980)
Scheme transfer of STICS		-	495	(495)	-
Interest paid on STICS		-	(22)	-	(22)
Tax relief on STICS interest		-	4	-	4
At 31 December 2017		702	(692)	-	10

Prior Year

	Called up share capital £m	Profit and loss account £m	Other equity £m	Total equity £m
At 1 January 2016	702	1,809	495	3,006
Profit on ordinary activities after tax	-	316	-	316
Interest paid on STICS	-	(22)	-	(22)
Tax relief on STICS interest	-	4	-	4
At 31 December 2016	702	2,107	495	3,304

The Notes on pages 18 to 85 form an integral part of these financial statements.

1. ACCOUNTING POLICIES

The principal accounting policies are set out below. Following the Scheme transfer on 1 October 2017 the majority of the accounting policies are no longer relevant to the 31 December 2017 balance sheet. However, the accounting policies previously used continue to be shown in this note so that users of the financial statements are able to understand the accounting policies under which the year ended 31 December 2017 profit and loss account has been prepared and the accounting policies under which the 31 December 2016 profit and loss account and balance sheet were prepared.

(a) Basis of preparation

These financial statements have been prepared in accordance with The Companies Act 2006 as applicable to companies using Financial Reporting Standard 101 *Reduced Disclosure Framework* (FRS 101) and in accordance with applicable accounting standards. The financial statements have been prepared under the historical cost convention as modified by the revaluation of land and buildings, investment in group undertakings, and derivatives and financial assets and liabilities at fair value through profit and loss as set out in Note 1(o). No depreciation is provided in respect of freehold investment properties or amortisation in respect of leasehold properties with over 20 years to expire in order to comply with the requirements of IAS 40 *Investment Properties*. This is a departure from the requirement of the Companies Act 2006 which requires all properties to be depreciated.

As explained in the Report of the Directors these financial statements have been prepared on a going concern basis. In considering whether the Company's financial statements should be prepared under the going concern basis, the directors have considered the information contained in these financial statements. The directors are confident that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing these financial statements.

The Company is exempt under section 400 of the Companies Act 2006 from the obligation to prepare group financial statements as the Company is a wholly owned subsidiary of Aviva plc in whose consolidated financial statements the Company is included. Accordingly, the financial statements present information about the Company as an individual entity and not about its group.

The financial statements are stated in sterling which is the Company's functional and presentational currency. Unless otherwise noted the amounts shown in the financial statements are in millions of pounds Sterling (£m).

The accounting policies which follow set out those policies which applied in preparing the financial statements for the year ended 31 December 2017.

The Company has taken advantage of the following disclosure exemptions under FRS 101:

i. the requirement in paragraph 38 of IAS 1 *Presentation of Financial Statements* to present comparative information in respect of:

   a. Paragraph 118(e) of IAS 38 *Intangible Assets* to show a reconciliation of the carrying amount at the beginning and end of the period in respect of the present value of acquired in-force business (Note 12);
   b. Paragraph 76 of IAS 40 *Investment Property* to show a reconciliation between the carrying amounts of investment property at the beginning and end of the period (Note 15);

ii. the requirements of paragraphs 10(d) and 111 of IAS 1 to include a statement of cash flows and the requirements of IAS 7 *Statement of Cash Flows;*
iii. the requirements of paragraph 16 of IAS 1 to make a statement of compliance with the international accounting standards;

1. ACCOUNTING POLICIES (continued)

(a) Basis of preparation (continued)

iv. the requirements of paragraphs 30 and 31 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to disclose when an entity has not applied a new accounting standard that has been issued but is not yet effective;

v. the requirements of paragraph 17 of IAS 24 *Related Party Disclosure* to disclose key management personnel compensation;

vi. the requirements of paragraph 18A of IAS 24 to disclose amounts incurred by the Company for the provision of key management personnel services that are provided by a separate management entity; and

vii. the requirements in IAS 24 to disclose related party transactions entered into between two or more members of a group.

Minor clarifications to existing guidance on a number of standards became effective for the reporting period beginning on 1 January 2017. The principle clarifications are to IAS 12 *Income Taxes* which clarifies the accounting for deferred tax assets on unrealised losses, IAS 7 *Statement of Cash Flows* which requires disclosure of movements in liabilities arising from financing activities with cash and non-cash changes presented separately, and IFRS 12 *Disclosure of Interests in Other Entities* which clarifies existing guidance. The amendments do not have any impact on the Company's financial statements.

(b) Product classification

(i) Insurance contracts

Contracts under which the Company accepts significant insurance risk from another party (the policyholder), by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder, are classified as insurance contracts. Insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of: a specified interest rate, security price, commodity price, foreign exchange rate, index of price or rates, a credit rating or credit index or other variable. Insurance contracts may transfer some financial risk.

Once a contract has been classified as an insurance contract it remains an insurance contract for the remainder of its lifetime even if the insurance risk reduces significantly during the period. As a general guideline the Company defines a significant insurance risk as the possibility of having to pay benefits, on the occurrence of an insured event, that are more than 5% greater than the benefits payable if the insured event did not occur.

(ii) Investment contracts

Policyholder contracts not considered insurance contracts are classified as investment contracts. Contracts currently classified as investment contracts are either unit-linked or contracts with Discretionary Participation Features ("DPF") with no significant insurance risk. The latter are mainly unitised with-profits contracts and are also known as participating investment contracts. A contract with DPF is a contractual right held by a policyholder to receive, as a supplement to a guaranteed minimum payment, additional payments that are likely to be a significant portion of the total contractual payments and whose amount or timing is contractually at the discretion of the issuer and that are contractually based on:

- the performance of a specified pool of contracts, or a specified type of contract; or
- realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
- the profit or loss of the company that issues the contracts.

1. ACCOUNTING POLICIES (continued)

(c) **Foreign currencies**

Transactions in foreign currencies are translated to Sterling at the foreign exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Sterling at the exchange rate ruling at the balance sheet date, and any exchange differences arising are taken to the profit and loss account. Non-monetary assets and liabilities measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not subsequently restated. Non-monetary assets and liabilities stated at fair value in a foreign currency are translated at the rate on the date the fair value was determined. When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in the profit and loss account any exchange component of that gain or loss is recognised in the profit and loss account.

(d) **Premiums**

Premium income is accounted for in the year in which it falls due in respect of insurance contracts. Further details relating to the classification of new business premiums are included in Note 4(a).

Deposits collected/paid in respect of non-participating investment contracts are not accounted for as premiums/claims through the profit and loss account. Fee and investment income in respect of these contracts are recognised through the profit and loss account, together with the associated change in technical provisions backing linked liabilities.

(e) **Reinsurance**

The Company accepts and cedes reinsurance in the normal course of business with retention limits varying by line of business. Premiums on reinsurance accepted are recognised as revenue in the same manner they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies using assumptions consistent with those used to account for these policies.

Reinsurers' share of technical provisions includes balances due from both insurance and reinsurance companies for ceded liabilities in respect of insurance and investment contracts written by the Company. This includes balances in respect of contracts which are legally reinsurance contracts but do not meet the definition of a reinsurance contract under IFRS 4 *Insurance Contracts* because they do not transfer insurance risk. These typically relate to fund access reinsurance agreements in respect of unit-linked contracts where unit-linked funds of the Company are accessing funds in other insurance companies for investment purposes only. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract.

Financial reinsurance contracts are accounted for directly through the balance sheet and are not included in technical provisions. A liability is recognised in creditors arising out of reinsurance operations based on the amounts expected to be repaid to the reinsurer.

If a reinsurance asset is impaired the Company reduces the carrying amount accordingly and recognises that impairment loss in the income statement. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Company may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

1. ACCOUNTING POLICIES (continued)

(f) **Fee and commission income**
Investment contract policyholders are charged for policy administration services, investment management services, and for surrenders. Investment management services comprise primarily fees and charges from unit-linked investments. These fees and charges are recognised as revenue in the period in which the services are rendered. In respect of surrenders the revenue is recognised when the surrender takes place.

Front-end fees charged at the inception of certain investment contracts are recognised as income over the expected term of the contract on a straight line basis with the unrecognised amount at the end of the year presented as a liability. Regular fees charged to the policyholder periodically (monthly, quarterly or annually) are recognised on a straight-line basis over the period in which the service is rendered.

Fee and commission income is included in the long-term business technical account as part of 'other technical income'.

(g) **Investment income**
All income received from investments is recognised in the profit and loss account and includes dividends, interest, rental income, and realised gains on financial assets.

Dividend income from listed and unlisted securities is recognised as income when the right to receive payment is established. For listed securities this is the date the security is listed as ex-dividend. For unlisted securities this is the due date of payment. Interest income is recognised as income as it accrues taking into account the relevant coupon rate, an applicable floating rate, and the effective yield of the asset. Under the effective interest rate method, interest income includes the amortisation of any discount or premium and capitalised issue costs.

Realised gains and losses on investments are calculated as the difference between the net sales proceeds and the book cost or amortised cost of the investment as appropriate.

(h) **Unrealised gains and losses on investments**
Unrealised gains and losses on investments represent the difference between the valuation of investments designated as fair value through the profit and loss, derivatives, and land and buildings at the balance sheet date and their original cost, or (if they have been previously fair valued) the valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the period also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Unrealised gains and losses relating to investments, which are directly connected with the carrying on of long-term business, are recorded in the long-term business technical account. Non long-term business unrealised gains and losses are recorded in the non-technical account.

(i) **Claims and surrenders**
Insurance claims reflect the cost of all claims incurred during the year on insurance contracts, including claims handling costs. Death claims and surrenders are recognised on the basis of notifications received. Maturities and annuity payments are recorded when due. Claims and benefits recorded are accrued to the policyholder and included within the long term business provision and the technical provision backing linked liabilities.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any general administrative costs directly attributable to the claims function. Reinsurance recoveries are accounted for in the same period as the related claim.

1. **ACCOUNTING POLICIES (continued)**

(j) **Transaction costs**
Transaction costs in respect of brokers fees, stamp duty, fees and other expenses on investments are charged to profit and loss in the period in which they are payable.

(k) **Bonuses**
Bonuses charged to the long-term business technical account in a given period comprise reversionary bonuses declared in respect of that period which are provided within the calculation of the long-term business provision, and terminal bonuses paid which are included within claims paid.

(l) **Loss on Scheme transfer of business**
The carrying value of assets and liabilities which are transferred via the Scheme transfer to UKLAP are accounted for as a loss within the Statement of changes in equity.

(m) **Taxation**
Taxation is based on the profits and income for the period as determined in accordance with the relevant tax legislation together with adjustments to provisions for prior periods. Tax payable is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Current taxation is recognised in the profit and loss account for the period, except to the extent that it is attributable to a gain or loss recognised outside the profit and loss account in which case the current taxation is recognised in the statement of comprehensive income, or equity, as applicable.

The balance transferred from the long-term business technical account is grossed up by the related shareholder tax charged to the long-term business technical account.

(n) **Deferred tax**
Deferred tax is recognised on temporary differences arising between tax bases of assets and liabilities and their carrying amounts in the financial statements. The tax rates used are the rates that have been enacted or substantively enacted by the balance sheet date.

Full provision is made for deferred tax liabilities. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which temporary differences can be utilised.

Deferred taxation is recognised in the profit and loss account for the period except to the extent that it is attributable to a gain or loss recognised outside the profit and loss account, in which case the deferred taxation is recognised in the statement of comprehensive income, or equity, as applicable.

(o) **Investments**
Investments are shown in the balance sheet as follows:

(i) **Land and buildings**
Investment properties are measured at fair value at least annually at the balance sheet date. The movement in fair value is recorded in the profit and loss account. Fair values are measured by external independent valuers on the basis of open market value using methods set out in the Royal Institution of Chartered Surveyors ("RICS") Red Book. The valuations used are based on valuation techniques using multiples of future rental incomes. The rental multiples are based on multiples observed in recent similar transactions in the market. Key assumptions include occupancy and rental income.

No depreciation is provided in respect of freehold investment properties or amortisation in respect of leasehold properties with over 20 years to expire. This is a departure from the requirements of the Companies Act 2006 which requires all properties to be depreciated. However, these properties are held solely for investment purposes and the directors consider that systematic annual depreciation

1. ACCOUNTING POLICIES (continued)

(o) Investments (continued)

(i) Land and buildings (continued)

would be inappropriate. Depreciation or amortisation is only one of the factors reflected in the annual valuations of properties, and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified. The accounting policy adopted is therefore necessary for the financial statements to give a true and fair view.

(ii) Other financial investments

The Company classifies its financial investments into the following two categories: financial investments at fair value through profit and loss, and loans receivable. The classification depends on the purpose for which the investments were acquired or originated.

Purchases and sales of financial investments are recognised on the date the Company commits to purchase or sell the investment, generally the trade date.

A transfer of a financial asset is accounted for as a de-recognition only if substantially all of the asset's risks and rewards of ownership are transferred or control is transferred to a party external to the Company. Control is transferred if the transferee has the practical ability to sell the asset unilaterally without needing to impose additional restrictions on any subsequent transfer.

(iii) Financial assets at fair value through profit and loss

Financial assets at fair value through profit or loss comprise assets which are designated as such on initial recognition, and derivatives which are classified as held for trading.

Financial assets are designated upon initial recognition at fair value through profit or loss as they are managed individually or together on a fair value basis.

All financial assets at fair value through profit or loss are measured at fair value. The fair value on initial recognition is generally the consideration given, excluding any transaction costs directly attributable to their acquisition, which are expensed. Movements in fair value are taken to the profit and loss account as investment return in the period in which they arise. Financial assets carried at fair value are initially recognised at fair value and subsequently remeasured at fair value based on quoted bid prices where such prices are available from a third party in a liquid market. If quoted bid prices are unavailable the fair value of the financial asset is estimated using the valuation approaches outlined in Note 2(b) of these financial statements.

The Company has not applied hedge accounting for any financial assets.

(iv) Loans receivable

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans are measured on initial recognition at the fair value of the consideration given plus incremental costs that are incurred on the acquisition of the investment. Subsequent to initial recognition loans are either measured at amortised cost using the effective interest rate method, with any difference between cost and redemption value being amortised through the profit and loss account over the period of the borrowings, or if they meet the criteria for designation at fair value through profit or loss, and are so designated on initial recognition, they are measured at fair value.

The amortised cost is the present value of estimated future cash flows discounted at the effective interest rate at the date of acquisition or origination of the loan.

The carrying value of a loan is reviewed for impairment at each reporting date. If there is objective evidence of impairment, for example there is a default or delinquency in payment, the impairment

1. ACCOUNTING POLICIES (continued)

(o) Investments (continued)

(iv) Loans receivable (continued)

loss is calculated and recognised in accordance with IAS 39 *Financial instruments – recognition and measurement.*

(v) Investments in Group undertakings and participating interests

Shares in Group undertakings are stated at their fair values estimated using applicable valuation models. Investments managed on a fair value basis are classified as held at fair value through profit or loss, with movements recognised in the profit and loss account.

(p) Present value of acquired in-force business ("PVIF")

On acquisition of an external portfolio of insurance contracts or investment contracts the net present value of the Company's interest in the expected pre-tax cash flows of the in-force business is capitalised in the balance sheet as an intangible asset. PVIF is amortised over the anticipated lives of the related contracts.

The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen compared to the amortised acquired value based on assumptions made at the time of the acquisition. Any amortisation or impairment charge is recorded in the long-term business technical account within 'other technical charges'.

(q) Other financial assets

Other financial assets primarily include insurance and other debtors, including amounts due from Group undertakings and cash at bank.

Insurance and other receivables are recognised when due and measured on initial recognition at the fair value of the amount receivable plus incremental costs. Subsequent to initial recognition these receivables are measured at amortised cost using the effective interest method which is considered a reasonable approximation to fair value.

(r) Cash at bank and in hand

Included within cash at bank and in hand are cash equivalents. Cash equivalents consist of short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand with only an insignificant change in their fair values.

(s) Deferred acquisition costs

The costs directly attributable to the acquisition of new business for non-participating insurance contracts are deferred to the extent that they are expected to be recoverable out of future margins in revenues on these contracts. For participating contracts, acquisition costs are generally not deferred, as the liability for these contracts is calculated on a realistic basis. For non-participating investment contracts, incremental acquisition costs and sales enhancements that are directly attributable to securing an investment management service are also deferred.

Where such business is reinsured, the deferred acquisition costs are tested for recoverability against the present value of future profits, net of reinsurance, and impaired where this value does not support recoverability of the costs.

Deferred acquisition costs are amortised systematically over a period no longer than that in which they are expected to be recoverable out of future margins. Deferred acquisition costs for non-participating investment contracts are amortised over the period in which the service is provided.

1. ACCOUNTING POLICIES (continued)

(s) Deferred acquisition costs (continued)

Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written off where they are no longer considered to be recoverable.

(t) Funds for future appropriations ("FFA")

The FFA in the with-profits funds is presented as a liability and comprises all funds available for allocation, either to policyholders or to shareholders, the allocation of which has not been determined at the balance sheet date.

All liabilities in respect of insurance and participating investment contracts within the with-profits funds are valued on a realistic basis and therefore included amounts attributable in respect of future bonuses. Such amounts are estimated in accordance with the published Principles and Practices of Financial Management ("PPFM") and represent a constructive obligation. The realistic liabilities include an estimate of the fair value of policyholder options and guarantees. The unallocated surplus within the with-profits funds represents the excess of assets of the fund relative to the realistic liabilities and other current liabilities not included within realistic liability measurement. The unallocated surplus can be considered to represent the appropriate percentage of working capital of the funds combined with the value of future transfers to shareholders from the with-profits funds.

(u) Financial liabilities

The Company classifies financial liabilities as either financial liabilities at fair value through profit and loss or financial liabilities carried at amortised cost. The amortised cost of a financial liability is the amount at which the financial liability is measured at initial recognition minus principal repayments plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount.

Financial liabilities at fair value through profit and loss, such as investment contracts, are designated on initial recognition when one of the following criteria is satisfied:

- it eliminates or significantly reduces an accounting mismatch caused by financial assets and financial liabilities being measured on a different basis; or
- the financial liability contains or may contain an embedded derivative.

A financial liability is recognised when, and only when, the Company becomes a party to the contractual provisions of a financial instrument. A financial liability is derecognised when, and only when, the obligation specified in the contract is discharged or cancelled or expires.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a currently enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

(v) Technical provisions – long-term business provisions

Under IFRS 4, insurance and participating investment contract liabilities are measured using accounting policies consistent with those adopted previously under existing accounting practices, with the exception of those relating to with-profit contracts. The Company has adopted FRS 27, Insurance Contracts, for liabilities relating to such contracts, which adds to the requirements of IFRS but does not vary them in any way.

Calculation of the long-term business provisions are based on regulatory requirements prior to the adoption of Solvency II and represent a determination within a range of possible outcomes, where the assumptions used in the calculations depend on the prevailing circumstances. The principal assumptions are disclosed in note 25.

1. **ACCOUNTING POLICIES (continued)**

(v) **Technical provisions – long-term business provisions (continued)**

For non-profit contracts the liabilities are based upon the relevant PRA Pillar 1 rules contained in the Prudential Sourcebook for Insurers which were used until 31 December 2015 for regulatory capital reporting (after this date regulatory capital reporting has been prepared under the Solvency II regime which has a different basis for measurement of technical provisions). The reserves calculated on a PRA Pillar 1 bases are adjusted to remove certain regulatory reserves and margins in assumptions, notably for annuity business. The calculation of liabilities to policyholders for non-profit contracts includes explicit allowance for future expenses and allow for lapses where appropriate.

For with-profit funds FRS 27 requires liabilities to be calculated as the realistic basis liabilities, which are grandfathered from the PRA Pillar 1 realistic balance sheet requirements in-force prior to the adoption of Solvency II, adjusted to remove the shareholders' share of future bonuses. On 1 January 2016 the Pillar 1 regulatory regime was replaced with Solvency II, under which realistic liabilities were replaced with Best Estimate Liabilities ("BEL"). Key differences between the two are that BEL excludes the shareholder's share of future bonuses, excludes planned and approved enhancements to benefits, and uses an adjusted yield for discounting.

Consequently, for periods subsequent to 31 December 2015, the realistic liabilities are determined using a yield adjusted Solvency II assessment allowing for both declared bonus and constructive obligations for future bonuses not yet declared (excluding the shareholders' share of future bonuses) and include the cost of options and guarantees measured on a market-consistent basis. The basis of calculation does not recognise deferred acquisition costs, but does allow for future profits of non-profit and unit-linked business written in the with-profits funds to be recognised. The realistic liabilities calculated reflect the fact that the with-profits funds are closed to new business.

(w) **Technical provisions for linked liabilities**
Technical provisions for linked liabilities include the liabilities in respect of all linked contracts. The measurement approach applied in respect of these contracts depends on their product classification.

Investment
Unit-linked contracts which are classified as investment contracts are recognised at fair value through the profit and loss account. The fair value is based on the current unit value plus additional non-unit reserves if required based on a discounted cash flow analysis.

Insurance / participating investment
Under IFRS 4 long-term business provisions for insurance and participating investment contracts are measured using accounting policies consistent with those adopted previously under existing accounting practices.

Unit-linked contracts which are classified as insurance or investment with DPF are calculated using the relevant PRA Pillar 1 rules contained in the Prudential Sourcebook for Insurers which were used until 31 December 2015 for regulatory capital reporting. After this date regulatory capital reporting will be prepared under the Solvency II regime which has a different basis for measurement of technical provisions.

(x) **Classification of financial instruments between debt and equity**
The classification of financial instruments between debt and equity is based on the principles in IAS 32 *Financial instruments: Presentation* rather than the instruments' legal form or their commercial intent. The Company applies these principles when classifying its financial instruments. In order to be classified as debt the financial instrument, in situations where the contract will not be settled by the Company's own shares, must have a contractual obligation to:

(i) deliver cash or another financial asset to another entity, or

1. ACCOUNTING POLICIES (continued)

(x) **Classification of financial instruments between debt and equity (continued)**

(ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company.

For some instruments the contractual obligation to pay cash or another financial asset is dependent on the occurrence or non-occurrence of some future event. If this event is out of the control of the Company then this usually means that the instrument still meets its definition of debt. However, if the Company is only required to settle the obligation in the event of liquidation, or if the likelihood of the event occurring (or not occurring) is so remote that it is extremely unlikely that the obligation will be triggered, then the Company treats the instruments as equity as required by IAS 32. Payments on instruments classified as equity are not treated as expenses but as an appropriation of profit.

(y) **Creditors**

Creditors include creditors arising out of insurance and reinsurance operations and other obligations due to Group undertakings or third parties. Other financial liabilities are initially recognised at cost, being fair value. Subsequent to initial measurement they are measured at amortised cost which, given the short term nature of these items, is considered a reasonable approximation to fair value. Financial guarantee contracts are classified as fair value through profit and loss.

(z) **Dividends**

Final dividends approved by ordinary shareholders are recognised as a liability on the date of approval, and interim dividends declared by directors are recognised on the date of payment. All dividends are charged directly to equity.

(aa) **Provisions**

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is more probable than not that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligations can be made.

When the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

(bb) **Collateral**

The Company receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, as well as certain derivative contracts and loans, in order to reduce the credit risk of these transactions. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, which is not legally segregated from the Company, is recognised as an asset in the statement of financial position with a corresponding liability for the repayment. Non-cash collateral received is not recognised in the statement of financial position unless the Company either (a) sells or re-pledges these assets in the absence of default, at which point the obligation to return this collateral is recognised as a liability; or (b) the counterparty to the arrangement defaults, at which point the collateral is seized and recognised as an asset.

Collateral pledged in the form of cash, which is legally segregated from the Company, is derecognised from the statement of financial position with a corresponding receivable recognised for its return. Non-cash collateral pledged is not derecognised from the statement of financial position unless the Company defaults on its obligations under the relevant agreement, and therefore continues to be recognised in the statement of financial position within the appropriate asset classification.

2. USE OF JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

Prior to the Scheme transfer the Company made significant judgements in the application of critical accounting policies that affected the reported amounts of assets and liabilities. The Company also made key assumptions about the future and other sources of uncertainty. These were continually evaluated based on historical experience and other factors, including expectations of future events that are considered to be reasonable under the circumstances.

Following the Scheme transfer on 1 October 2017 the Company is not required to make significant judgements, estimates or assumptions to determine the amount of assets and liabilities which are recognised in the financial statements.

(a) **Liabilities arising from insurance contracts and participating investment contracts**
Determination of the ultimate liabilities of insurance contracts or participating investment contracts is a critical accounting estimate. There are several sources of uncertainty that need to be considered in determining the key assumptions made in estimating the liabilities that the Company will ultimately pay on claims made and on maturity of the policies.

The most significant assumptions which are deemed to have the greatest effect on the measurement of liabilities are:

- mortality, morbidity, and persistency assumptions;
- for with-profits policies the stochastic model used to value liabilities is sensitive to risk-free rates, assumed asset volatilities, and the assumed correlation between asset volatilities. Risk-free rates are set in accordance with current swap rates;
- the valuation interest rates for annuities in payment. Fixed interest assets, predominantly corporate bonds, are held to match the expected benefit outgoings of the annuity portfolio. The excess yields on corporate bonds over that on gilts are called bond spreads and these reflect compensation for the higher risk of default (credit risk premium) and lower liquidity (illiquidity premium) compared to gilts. One of the key judgements is the assessment of how much of the spread is attributable to illiquidity premium. The illiquidity premium is derived by deducting an allowance for defaults (based on an analysis of historical defaults) from the total bond spread. This approach is consistent with current industry practice;
- other valuation interest rates have been calculated by reference to consistent economic indices. The impact of these liability changes on surplus is generally to offset some or all of the corresponding impact on the value of fixed-interest assets backing the liabilities;
- for guaranteed annuity options the cost depends on assumptions such as the level of policy discontinuance and the option take-up rate;
- changes in assumptions behind the valuation techniques for assets that are not quoted in active markets could have a significant impact on the value of assets that are backing the liabilities in respect of insurance and investment contracts; and
- maintenance expense assumptions.

The impact of changing the significant assumptions during the year has been disclosed within note 3.

(b) **Fair value determination of financial instruments at fair value through the profit and loss account**
Financial assets are designated at fair value as they are managed on a fair value basis. Financial liabilities such as investment contracts are designated at fair value to eliminate mismatch with corresponding assets that are managed on a fair value basis.

The majority of the Company's assets held at fair value are valued on the basis of quoted market information or market observable data. Where significant observable market data is not available, or the price is not observable from current market transactions, fair value is based on valuation techniques. Where valuation techniques are used the fair value measurement objective of these remains the same, namely the calculation of an exit price from the perspective of the Company.

2. USE OF JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

(b) Fair value determination of financial instruments at fair value through the profit and loss account (continued)

The fair values of financial assets are generally provided by external parties. The Company has performed independent pricing reviews of pricing models to ensure that appropriate methodologies have been applied. The approach taken for each specific class of unlisted investment is as follows:

- Corporate bond valuations are generally obtained from brokers and pricing services. Bond prices provided by pricing services are based on the best estimate of market price determined by market makers based on a variety of factors and are considered to be observable prices. In determining fair value market makers will take into account transactions they have observed in identical or similar assets as well as movements in market indices and any other factors they regard as relevant.

- Investment properties are measured at fair value at the reporting date. Fair values are measured by external independent valuers using methods set out in the Royal Institute of Chartered Surveyors' guidelines ("RICS Red Book"). The valuations used are based on valuation techniques using multiples of future rental incomes. The rental multiples are based on multiples observed in recent similar transactions in the market.

- Methods considered when determining fair values of unlisted shares and other variable yield securities include discounted cash flow techniques and net asset valuation. Regular checks are performed of tolerance levels for changes such as percentage movements in prices, excess movements, and inter vendor price comparisons where tolerance levels are pre-defined for security types.

- The valuation of the holdings in private equity limited partnerships and companies is based on the most recent underlying valuations available at the reporting date as adjusted for contributions, distributions and known diminutions in value of individual underlying investments in the period since valuations were performed. The valuation technique is not supported by observable market values. Valuations of private equity holdings are prepared in accordance with International Private Equity and Venture Capital Board ("IPEV") guidelines.

- Exchange-traded derivatives are valued using active market prices. The values of over-the-counter derivative financial instruments are estimated by applying valuation techniques using pricing models or discounted cash flow methods.

- The fair value of investments in property limited partnerships is taken as the Company's share of the net asset value of the partnerships. This value is based on the latest market valuation of the underlying property investments which is updated at least every six months. The valuation would be adjusted in the event of a significant market movement in the period between the last market valuation and the reporting date.

- Loans are valued using a discounted cash flow methodology with the discount rates derived from the relevant risk-free curve and a credit spread curve. The valuation process is carried out by the investment manager and reviewed by management. All spreads are reviewed on a regular basis and will be recalibrated if they appear to be outliers relative to factors such as available market proxies and spreads of underlying securities.

(c) Provisions

The amounts recognised as provision liabilities are the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. All estimates are based on management's knowledge of current circumstances and predictions of future events. Actual experience may differ from these estimates.

3. CHANGES IN ACCOUNTING ESTIMATES

2017: The total impact of key changes in accounting estimates amounted to a £22m decrease in profit before tax as follows:

- **Basis changes: Credit default allowance**
  The credit default allowance has been updated to reflect economic conditions. This has resulted in a decrease in profit before tax of £22m due to an increase in the long term business provision.

2016: The total impact of key changes in accounting estimates amounted to a £119m increase in profit before tax as follows:

- **Basis changes: Mortality/Morbidity**
  Longevity assumptions have been updated to reflect recent experience with minor changes made to base mortality tables. The latest version of the continuous mortality investigation, CMI_15, has also been adopted. This has resulted in an increase in profit before tax of £111m due to a decrease in liabilities to policyholders. Other mortality/morbidity assumptions have not been changed.

- **Basis changes: Expense Assumptions**
  Expense assumptions have been updated to reflect recent experience and the long term rate of inflation used on internal expenses has been reduced from RPI+1% to RPI. This has resulted in a decrease in profit before tax of £10m.

- **Basis changes: Persistency**
  Lapse assumptions have been updated to reflect recent experience. This has resulted in an increase in profit before tax of £5m.

- **Basis changes: Credit default allowance**
  The credit default allowance has been updated to reflect economic conditions. This has resulted in an increase in profit before tax of £90m due to a decrease in the long term business provision.

- **Technical provisions : Long term business provision**
  During the year additional technical provisions were established in the long term business provision reflecting the best estimate of additional policyholder liabilities which will arise on completion of a review of the principles and practices applied to certain unit-linked policyholder funds. This has resulted in a decrease in profit before tax of £77m.

4. SEGMENTAL INFORMATION

	2017 £m	Restated 2016 £m
Gross written premiums on insurance contracts and investment contract deposits	1,137	1,613
Less: investment contract deposits written	(195)	(268)
Gross written premiums per the long-term business technical account	942	1,345
Analysed:		
Direct insurance premiums	936	1,338
Inwards reinsurance premiums	6	7
Gross written premiums per the long-term business technical account	942	1,345

The prior year balances have been restated to reclassify £43m from inwards reinsurance premiums to direct insurance premiums. These premiums were incorrectly classified at 31 December 2016.

(a) Direct insurance premiums written by type

	Regular premiums		Single premiums		Total	
	2017 £m	2016 £m	2017 £m	Restated 2016 £m	2017 £m	Restated 2016 £m
Individual						
Protection	417	555	53	69	470	624
Savings and investment	228	354	23	19	251	373
Pensions	11	27	35	71	46	98
Annuities	2	-	143	185	145	185
Total individual premiums	658	936	254	344	912	1,280
Group						
Protection	-	11	-	-	-	11
Pensions	12	26	12	21	24	47
Total group premiums	12	37	12	21	24	58
Total life and pensions	670	973	266	365	936	1,338

Within the above analysis of direct insurance premiums written by type the prior year figures have been restated to increase individual pensions single premiums by £43m reflecting the reclassification noted above between inwards reinsurance premiums and direct insurance premiums. In addition, the prior year balances have been restated to reclassify £170m of single premiums from individual pensions to annuities. These premiums were incorrectly classified as at 31 December 2016.

	2017 £m	Restated 2016 £m
Premiums from non-participating contracts	669	854
Premiums from participating contracts	117	293
Premiums from investment linked contracts	150	191
Total life and pensions	936	1,338

4. SEGMENTAL INFORMATION (continued)

(b) **Life and pensions gross premiums**

	2017 £m	2016 £m
Source		
United Kingdom	942	1,345
	942	1,345
Destination		
United Kingdom	879	1,270
Rest of the World	63	75
	942	1,345

5. REINSURANCE BALANCE

The aggregate of all reinsurance balances in the long-term business technical account for the year ended 31 December 2017 is positive £142m (2016: positive £953m).

6. NET INVESTMENT RETURN

	Technical account 2017	Technical account 2016	Non-technical account 2017	Non-technical account 2016
	£m	£m	£m	£m
Investment income				
Income from land and buildings	86	123	-	-
Income from Group undertakings	43	296	440	31
Income from other investments (i)	776	1,357	3	3
Gains on the realisation of investments	7,467	2,821	-	-
	8,372	4,597	443	34
Unrealised gains on investments	-	2,920	-	194
Investment expenses and charges				
Investment management expenses	(49)	(103)	(9)	(1)
Interest to Group undertakings	-	-	(52)	(69)
Other interest	(10)	(7)	-	-
Losses on the realisation of investments	-	(99)	(1,938)	(188)
	(59)	(209)	(1,999)	(258)
Unrealised losses on investments	(5,761)	-	(50)	-
Total net investment return	2,552	7,308	(1,606)	(30)

	Technical account 2017	Technical account 2016	Non-technical account 2017	Non-technical account 2016
Net gains/(losses) on financial assets at fair value through profit and loss:				
Assets designated at initial recognition	1,744	5,333	7	171
Assets held for trading	(38)	309	(31)	(165)
	1,706	**5,642**	**(24)**	**6**
Net gains on loans and receivable	-	-	-	-

(i) Includes £nil (2016: £6m) arising from investments not held at fair value through the profit and loss account.

Included in 'unrealised gains/(losses) on investments' is a net gain of £16m (2016: £318m gain) arising on investments classified as 'fair value through profit and loss' that is determined using valuation techniques.

7. OTHER TECHNICAL INCOME, NET OF REINSURANCE

Other technical income in the long-term business technical account comprises:

	2017 £m	2016 £m
FLP management charge	13	23
Fee and commission income from service activities	212	244
Other technical income, net of reinsurance	225	267

8. NET OPERATING EXPENSES

The Company receives services and administration from AAL and AMSUKL. During 2016 staff employed by AAL and AMSUKL entered into new employment contracts with AES, another Group service company. Accordingly, the Company has no direct employees.

(a) Net operating expenses in the long-term business technical account, including those on investment contracts, comprise:

	2017 £m	2016 £m
Acquisition costs	11	25
Change in deferred acquisition costs (see Note 20)	43	92
Administrative expenses	211	329
Net operating expenses	265	446

Total commissions for direct insurance accounted for by the Company during the year amounted to £10m (2016: £14m). Administrative expenses in 2017 include the impact of a £29m (2016: £50m) management fee charge in respect of pension deficit funding costs.

(b) **Auditors' remuneration**

	2017 £m	2016 £m
Fees payable to Company's auditors	1	2
Audit-related assurance services	-	1
Auditors' remuneration	1	3

The Company is exempt under SI 2008/489 from the obligation to disclose fees in respect of 'Other services' as the Company is a subsidiary of Aviva plc which prepares consolidated financial statements. Fees paid to the Company's auditors, PricewaterhouseCoopers LLP and its associates for services other than the statutory audit of the Company and other Group undertakings are disclosed in the consolidated financial statements of Aviva plc.

9. OTHER TECHNICAL CHARGES, NET OF REINSURANCE

Other technical charges in the long-term business technical account comprise:

	2017 £m	2016 £m
Amortisation of present value of acquired in-force business	2	1
Unit management charges	4	8
Other technical charges, net of reinsurance	6	9

10. TAXATION

Profit and loss account

United Kingdom and overseas taxation has been charged in profit and loss on assessable profits and income on the bases and rates appropriate to the various classes of business.

(a) **Tax charged to the long-term business technical account and non-technical account comprises:**

	Technical account		Non-technical account	
	2017	**2016**	**2017**	**2016**
	£m	**£m**	**£m**	**£m**
Current taxation				
United Kingdom corporation tax of 19.25% (2016: 20.00%)	115	388	(12)	(13)
Adjustment in respect of prior years	21	2	-	(3)
	136	390	(12)	(16)
Overseas taxation	12	14	-	-
Tax charge attributable to balance on the long-term business technical account	-	-	53	38
Total current taxation charge	148	404	41	22
Deferred taxation				
Origination and reversal of timing differences	1	(75)	(1)	-
Adjustment in respect of prior years	26	-	-	-
Total deferred taxation charge/(credit)	27	(75)	(1)	-
Total taxation charge/(credit)	175	329	40	22

(b) **Factors affecting tax charge/(credit) for the year**

The tax assessed for the year is higher (2016: lower) than the standard rate of corporation tax in the UK of 19.25% (2016: 20.00%).

The differences are explained below:

	2017	**2016**
	£m	**£m**
Profit/(loss) on ordinary activities before tax	(1,402)	338
Profit/(loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 19.25% (2016: 20.00%)	(270)	68
Effects of:		
Income not taxable	(85)	(6)
Adjustment in respect of prior period	-	(3)
Revaluation of subsidiaries not taxable	378	(34)
Difference between effective and standard rate on balance on long term fund	17	(3)
Total tax charge for the period	40	22

10. TAXATION (continued)

(c) Balance sheet

	2017 £m	2016 £m
Deferred taxation liability		
At 1 January	(352)	(427)
Charge in respect of prior years	(26)	-
(Charge) / credit in year	(1)	75
Scheme transfer	379	-
At 31 December	-	(352)

Details of the deferred tax liability are given below:

	2017 £m	2016 £m
Fair valuation of investments	-	(345)
Tax on intangible assets	-	(1)
Tax losses carried forward	-	26
Tax on timing differences	-	20
Deferred acquisition costs (including those on investment contracts)	-	(52)
Deferred taxation liability	-	(352)

(d) Changes in rates of corporation tax

Finance (No 2) Act 2015 introduced legislation reducing the rate of corporation tax from 20% at 1 April 2016 to 19% from 1 April 2017 and to 18% from 1 April 2020. Finance Act 2016, which received Royal Assent on 15 September 2016, will reduce the corporation tax rate further to 17% from 1 April 2020. The reductions in rate from 20% to 19% and then to 17% have been used in the calculation of the company's deferred tax assets and liabilities at 31 December 2017.

As at 31 December 2017 no deferred tax assets or liabilities have been recognised.

11. DIVIDEND

	2017 £m	2016 £m
Dividends paid during the year	854	-

During May 2017 a cash interim dividend of £414m and an in-specie interim dividend of £440m were paid (2016: £nil).

12. PRESENT VALUE OF ACQUIRED IN-FORCE BUSINESS

	£m
Cost	
At 1 January 2017	72
Scheme transfer	(72)
At 31 December 2017	-
Accumulated amortisation	
At 1 January 2017	57
Amortisation during year	2
Scheme transfer	(59)
At 31 December 2017	-
Net book value	
At 31 December 2016	15
At 31 December 2017	-

13. ANALYSIS OF ASSETS

The following table shows the split of assets between financial assets at fair value through profit and loss, loans and receivables, and other assets:

	Fair value 2017 £m	Cost 2017 £m	Fair value 2016 £m	Cost 2016 £m
Financial assets at fair value through profit and loss				
Designated at initial recognition				
Investments in group undertakings	5	5	4,111	3,485
Land and buildings	-	-	1,021	824
Financial investments	-	-	23,584	22,215
Assets held to cover linked liabilities	-	-	25,783	21,880
	5	5	54,499	48,404
Held for trading				
Financial investments – Derivatives	-	-	746	117
Assets held to cover linked liabilities				
- Derivative assets	-	-	33	-
- Derivative liabilities	-	-	(16)	-
Total financial assets held at fair value	**5**	**5**	**55,262**	**48,521**
Loans and receivables				
Debtors	5	5	231	231
Prepayments and accrued income (excluding deferred acquisition costs)	-	-	275	275
Assets held to cover linked liabilities (net current assets)	-	-	1,961	1,961
Cash	-	-	6,491	6,491
Total financial assets	**10**	**10**	**64,220**	**57,479**
Other assets				
Present value of acquired in-force business	-	-	15	15
Reinsurers' share of technical provisions	-	-	8,132	8,132
Deferred acquisition costs	-	-	491	491
Total assets	**10**	**10**	**72,858**	**66,117**

Assets held to cover linked liabilities are stated net of creditor balances in the linked funds.

Of the 'total assets' shown on the balance sheet on page 15, £nil (2016: £69,893m) is attributable to the long-term business fund.

14. FINANCIAL INVESTMENTS AND LAND AND BUILDINGS

	Fair value 2017 £m	Cost 2017 £m	Fair value 2016 £m	Cost 2016 £m
Land and buildings				
Freehold	-	-	849	666
Leasehold	-	-	172	158
Total land and buildings	-	-	1,021	824
Other financial investments				
Shares and other variable-yield securities and OEICs	-	-	2,955	2,737
Debt securities and other fixed-income securities	-	-	20,326	19,177
Loans secured by insurance policies	-	-	11	11
Loans secured by mortgages	-	-	292	289
Derivative financial instruments	-	-	746	117
Total other financial investments	-	-	24,330	22,331
Assets held to cover linked liabilities	-	-	27,761	23,841

In the carrying amounts of financial assets at fair value through profit and loss above, £nil (2016: £9,992m) is expected to be recovered less than 12 months after the balance sheet date and £nil (2016: £42,099m) is expected to be recovered more than 12 months after the balance sheet date.

Fair value of listed investments included in 'other financial investments' shown above comprise:

	2017 £m	2016 £m
Shares and other variable-yield securities	-	2,901
Debt securities and other fixed-income securities	-	19,672
	-	22,573

Fair value of listed investments included in 'assets held to cover linked liabilities' amounted to £nil (2016: £24,469m).

The extent and nature of derivative instruments included in investments are as follows:

	2017 £m	2016 £m
Interest rate swaps	-	529
Equity futures	-	11
Fixed interest futures	-	2
Equity options	-	90
Swaptions	-	92
Forward currency contracts	-	19
Credit default swaps	-	3
	-	746

14. FINANCIAL INVESTMENTS AND LAND AND BUILDINGS (continued)

Determination of fair value hierarchy

In accordance with the requirements of IFRS 7 *Financial Instruments* / IFRS 13 *Fair Value Measurements*, financial assets at fair value have been classified into three categories as set out below.

- Level 1 – quoted prices in active markets for identical assets. An active market is one in which transactions occur with sufficient frequency and volume to provide pricing information on an on-going basis. Examples include listed equities and bonds in active markets and quoted unit trusts/ Open Ended Investment Companies ("OEICs").

- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category generally includes assets that are priced based on models using market observable inputs for example derivatives.

- Level 3 – inputs for the asset that are not based on observable market data. Assets with single price feeds and/or limited trading activity are included in this category as well as assets valued using models that use inputs that are not directly derived from market data. Examples include unlisted equities and private equity.

The majority of the Company's assets held at fair value are valued based on quoted market information or market observable data. At 31 December 2016 3.08% (5.52% excluding unit-linked) were based on valuation techniques where significant observable market data was not available or the price was not observable from current market transactions. However, the fair value measurement objective of these assets remains the same, that is, an exit price from the perspective of the Company.

The requirements of IFRS 7 also require financial liabilities at fair value to be categorised into the above level 1, 2 or 3 hierarchies. Financial liabilities at fair value include unit-linked contracts, amounts due to reinsurers, and derivative financial instruments. The classifications take into account the types of inputs used to determine the fair value measurements. For unit-linked funds this has been undertaken on a fund by fund basis.

The following table shows a comparison of the carrying amounts and fair values of financial instruments carried at amortised cost:

	Fair value 2017 £m	Carrying amount 2017 £m	Fair value 2016 £m	Carrying amount 2016 £m
Subordinated liabilities	-	-	982	856

Fair value of the following financial assets and liabilities approximate to their carrying amounts:

- Other debtors
- Cash at bank and in hand
- Prepayments and accrued income
- Other creditors
- Accruals and deferred income

14. FINANCIAL INVESTMENTS AND LAND AND BUILDINGS (continued)

Recurring fair value measurements

An analysis of the recurring financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below for the financial investments held as at 31 December 2016. The table shows both the total recurring financial assets and liabilities and the total excluding unit-linked assets and liabilities as shareholders have no direct exposure to profits or losses on unit-linked assets (other than through investment management fees). No analysis has been shown for the asset and liabilities as at 31 Decemebr 2017 given that all the financial assets and liabilities, except for £10m, have been transferred to UKLAP under the Scheme transfer.

31 December 2016	Including unit-linked (restated)				Excluding unit-linked			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets held at fair value								
Shares and other variable-yield securities and OEICs	22,863	-	55	22,918	2,901	-	54	2,955
Debt securities and other fixed-income securities								
- Government securities	8,454	1,365	197	10,016	5,699	1,118	197	7,014
- Other debt securities	2	12,942	1,874	14,818	-	11,438	1,874	13,312
Loans secured by mortgages	-	-	292	292	-	-	292	292
Loans secured by insurance policies	-	-	11	11	-	-	11	11
Derivative financial instruments	105	670	3	778	94	649	3	746
Total financial assets held at fair value	31,424	14,977	2,432	48,833	8,694	13,205	2,431	24,330
Financial liabilities held at fair value								
Unit-linked, Non-participating investment contracts,net of reinsurance	-	17,560	-	17,560	-	-	-	-
Derivative financial instruments	47	565	76	688	32	564	76	672
Total financial liabilities held at fair value	47	18,125	76	18,248	32	564	76	672

There were no non-recurring fair value measurements as at 31 December 2016.

The total financial assets held at fair value of £48,833m which have been analysed within the table above exclude investments in group undertakings and participating interests £4,111m and land and buildings £2,138m.

Assets and liabilities for which fair value is disclosed

The table below shows the fair value and the level in which they are categorised in the fair value hierarchy of liabilities that are not carried at fair value but for which fair value is disclosed in the Notes as at 31 December 2016.

	Fair value hierarchy			
	Level 1	Level 2	Level 3	Total fair value
	£m	£m	£m	£m
Subordinated liabilities	-	982	-	982

14. FINANCIAL INVESTMENTS AND LAND AND BUILDINGS (continued)

Level 3 reconciliation

The following table shows a reconciliation of level 3 financial assets which are recorded at fair value:

	At 1 January 2017 £m	Total gains/ (losses) in the profit and loss account £m	Purchases £m	Sales £m	Transfers (to)/from level 1 and level 2 £m	Scheme transfer £m	At 31 December 2017 £m	Total Gains/(losses) for the period included in profit or loss for assets held at 31 December 2017 £m
Financial assets held at fair value								
Shares and other variable-yield securities and OEICs	55	(4)	5	(9)	-	(47)	-	-
Debt securities and other fixed-income securities	2,071	(1)	42	(166)	(237)	(1,709)	-	-
Loans secured by insurance policies	11	-	-	(1)	-	(10)	-	-
Loans secured by mortgages	292	-	258	-	-	(550)	-	-
Derivative financial instruments	3	1	-	-	23	(27)	-	-
	2,432	(4)	305	(176)	(214)	(2,343)	-	-

Prior Year

	At 1 January 2016 £m	Total gains/ (losses) in the profit and loss account £m	Purchases £m	Sales £m	Transfers (to)/from level 1 and level 2 £m	At 31 December 2016 £m	Total Gains/(losses) for the period included in profit or loss for assets held at 31 December 2016 £m
Financial assets held at fair value							
Shares and other variable-yield securities and OEICs	67	(14)	2	-	-	55	(2)
Debt securities and other fixed-income securities	1,767	123	14	(202)	369	2,071	124
Loans secured by insurance policies	11	-	-	-	-	11	-
Loans secured by mortgages	-	3	289	-	-	292	3
Derivative financial instruments	5	(2)	-	-	-	3	-
	1,850	110	305	(202)	369	2,432	125

Transfers between levels

During the period, securities amounting to £nil (2016: £131m) were transferred from level 1 to level 2. These transfers arose in respect of debt securities which are not considered to be valued using quoted prices in an active market. £25m (2016: £nil) was transferred from level 1 to level 3. These transfers arose in respect of derivatives due to sufficiently significant differences between the valuation provided by the counterparty and the validation models.

14. FINANCIAL INVESTMENTS AND LAND AND BUILDINGS (continued)

£80m (2016: £571m) was transferred from level 2 to level 3. These transfers arose in respect of debt securities of £78m (2016: £571m) and derivatives of £2m (2016: £nil) either due to the unavailability of significant observable market data or there being sufficiently significant differences between the valuation provided by the counterparty and broker quotes and the validation models.

£311m (2016: £202m) was transferred from level 3 to level 2. These transfers arose in respect of debt securities of £315m (2016: £202m) and derivatives liabilities of £(4m) (2016:£nil) where significant market observable data in now available and there are not significant differences between the valuation provided and valuation models.

The 2017 transfers between levels are deemed to have occurred just prior to the Scheme transfer date. The 2016 transfers between levels are deemed to have occurred at the end of the reporting period.

The valuation techniques used to value the significant Level 3 assets have been set out in Note 2(b).

IFRS 13 requires the disclosure, where available, of quantitative information relating to significant unobservable inputs used to derive the valuation of investments classified within the fair value hierarchy as level 3. The majority of the Company's investments are valued by third parties, resulting in limited availability of unobservable inputs used. Available unobservable inputs are as follows:

- Debt securities and other fixed income securities include £nil (2016: £1,339m) of private debt placements and loans include £nil (2016: £168m) of commercial mortgage loans which are valued using discounted cash flows using either a credit spread derived from an assumption of ratings and indices or by using a fixed spread over a reference debt security. In some cases an illiquidity premium, which is deemed to be an unobservable input, is added to the valuation. The illiquidity premium used in the discount rate will vary depending on the investment manager who is responsible for valuing the security.
- Investment properties at 31 December 2016 were typically valued based on equivalent rental multiples, ranging between 4 and 30.
- Loan includes £nil (2016: £124m) of commercial mortgage loans which have been valued using a Portfolio Credit Risk Model (PCRM). This model calculates a Credit Risk Adjusted Value (CRAV) for each mortgage. The risk adjusted cash flows are discounted using a yield curve taking into account the term dependent gilt yield curve, and global assumptions for the liquidity premium. The mortgage loans have been classified as Level 3 as the liquidity premium is not deemed to be market observable. The liquidity premium used in the discount rate at 31 December 2016 was 125bps.

Level 3 sensitivity analysis

	Carrying amount 2017 £m	Effect of reasonably possible alternative assumptions 2017 £m	Carrying Amount 2016 £m	Effect of reasonably possible alternative assumptions 2016 £m
Unit linked investments	-	-	1	-
Shares and other variable-yield securities	-	-	54	11
Government Securities	-	-	197	20
Corporate bonds (including ABS)	-	-	1,874	187
Loans secured by mortgages	-	-	292	29
Loans secured by insurance policies	-	-	11	1
	-	-	2,429	248

14. FINANCIAL INVESTMENTS AND LAND AND BUILDINGS (continued)

For unit-linked assets the policyholder bears the investment risk and any change in asset values is matched by a broadly equivalent change in liability. Consequently there is no significant net impact on shareholder profit from changes to underlying assumptions used to value these assets.

For shares and other variable-yield securities, although the values are based on the latest information available, these instruments are subject to fluctuations in the market and the current prices could reasonably be expected to be higher or lower by approximately 20%.

For corporate bonds and other loans it could reasonably be expected that the current prices could be higher or lower by approximately 10% to reflect changes in the credit ratings of the underlying bonds, or movements in interest rates.

15. INVESTMENT PROPERTY

(a) Carrying amounts

	Freehold £m	Leasehold £m	Total £m
Carrying amount at 1 January 2017	1,687	451	2,138
Additions	22	8	30
Capitalised expenditure on existing properties	18	7	25
Fair value gains	51	15	66
Disposals	(174)	(5)	(179)
Scheme transfer	(1,604)	(476)	(2,080)
At 31 December 2017	-	-	-

The total carrying amount of £nil (2016: £2,138m) analysed above includes £nil (2016: £1,021m) relating to non-linked investment property.

Investment property in the UK is valued at least annually by external chartered surveyors at open market values in accordance with the guidance issued by The Royal Institution of Chartered Surveyors or using internal valuations and estimates during the intervening period. In the event of a material change in market conditions between the valuation date and balance sheet date, adjustments are made to reflect any material changes in fair value.

Values are calculated using a discounted cash flow approach and are based on current rental income plus anticipated uplifts at the next rent review, lease expiry, or break option taking into consideration lease incentives and assuming no future growth in the estimated rental value of the property. This uplift and the discount rate are derived from rates implied by recent market transactions on similar properties.

(b) Operating leases

The fair value of investment properties leased on commercial terms to third parties under operating leases is as follows:

	2017 £m	2016 £m
Freeholds	-	1,687
Long leaseholds – over 50 years	-	451
	-	2,138

15. INVESTMENT PROPERTY (continued)

Future contractual aggregate minimum lease rentals receivable under non-cancellable operating leases are as follows:

	2017 £m	2016 £m
Within one year	-	124
Later than one year and not later than five years	-	385
Later than five years	-	310
	-	819

16. INTERESTS IN UNCONSOLIDATED STRUCTURED ENTITIES

A structured entity is defined as an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only, or when the relevant activities are directed by means of contractual arrangements.

The Company invests in the following structured entities:

- Debt securities which comprise securitisation vehicles that the Company does not originate e.g. asset backed securities.
- Investment funds and specialised investment vehicles which comprise unit trusts, OEICs and Private Equity Limited Partnerships ("PLPs").

As at 31 December 2017, the total fair value recognised on the balance sheet in respect of interests in unconsolidated structured entities was £nil (2016: £11,730m). At 31 December 2016 these interests were classified as financial investments held at fair value through profit or loss. The Company does not sponsor any of the unconsolidated structured entities.

A summary of the Company's interest in unconsolidated structured entities is as follows:

	2017 £m	2016 £m
Shares and other variable yield participations	-	10,338
Debt securities and other fixed income securities	-	1,392
Total	-	11,730

Outstanding commitments to private equity vehicles are £nil (2016: £51m).

There are no other contractual arrangements that could require the Company to provide financial support to these structured entities, the Company has not provided any support in the period and there is no current intention to provide support. The carrying amounts represent the Company's maximum exposure to loss from its interests in unconsolidated structured entities other than commitments to private equity vehicles.

17. INVESTMENTS IN GROUP UNDERTAKINGS AND PARTICIPATING INTERESTS

31 December 2017	**Shares in Group undertakings £m**	**Shares in participating interests and joint ventures £m**	**Total £m**
Fair value			
At 1 January 2017	4,103	8	4,111
Additions	82	-	82
Disposals	(163)	(8)	(171)
Scheme transfer	(2,094)	-	(2,094)
Gains recognised in the technical account	41	-	41
(Losses) recognised in the non-technical account	(1,964)	-	(1,964)
At 31 December 2017	**5**	**-**	**5**
Cost			
At 1 January 2017	3,478	7	3,485
Additions	82	-	82
Disposals	(163)	(7)	(170)
Scheme transfer	(1,488)	-	(1,488)
Impairment	(1,904)	-	(1,904)
At 31 December 2017	**5**	**-**	**5**

The £5m of shares in group undertakings at 31 December 2017 reflects the fair value of the Company's holding in FLP.

31 December 2016	**Shares in Group undertakings £m**	**Shares in participating interests and joint ventures £m**	**Total £m**
Fair value			
At 1 January 2016, restated	4,133	8	4,141
Additions	214	-	214
Disposals	(430)	-	(430)
Gains recognised in the technical account	18	-	18
Gains recognised in the non-technical account	168	-	168
At 31 December 2016	**4,103**	**8**	**4,111**
Cost			
At 1 January 2016, restated	3,835	7	3,842
Additions	214	-	214
Disposals	(430)	-	(430)
Impairment	(141)	-	(141)
At 31 December 2016	**3,478**	**7**	**3,485**

The participating interest relates to shares owned in Tenet Group Limited, an adviser support business.

In the opening balance for 2016 £9m of assets previously classified as debt securities have been reclassified as shares.

17. INVESTMENTS IN GROUP UNDERTAKINGS AND PARTICIPATING INTERESTS (continued)

All of the subsidiary, related undertakings and participating interests of the Company, except for the holding in FLP, were transferred to UKLAP under the Scheme on 1 October 2017.

FLP is incorporated in England and Wales and has only one class of issued ordinary shares of which 100% is owned by the Company. The registered addess of FLP is Pixham End, Dorking, Surrey, RH4 1QA.

18. REINSURERS' SHARE OF TECHNICAL PROVISIONS

The reinsurers' share of technical provisions of £nil (2016 : £8,132m) reflects the amount of gross technical provisions expected to be recovered from reinsurers. The methodologies and assumptions used to determine the amount of the reinsurers' share of technical provisions are consistent with those used to calculate the gross technical provisions as disclosed in Note 25. Note 25 includes a movement analysis of the reinsurers' share of technical provisions from opening to closing balances.

19. OTHER DEBTORS

	2017 £m	2016 £m
Amounts falling due within one year		
Investment income receivable	-	70
Amounts due from Group undertakings	5	91
Other debtors	-	10
	5	171

20. DEFERRED ACQUISITION COSTS

	Insurance contracts		Investment contracts		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
At 1 January	249	282	242	301	491	583
Deferred in the year	-	2	-	2	-	4
Amortisation and impairment charges for the year	(17)	(35)	(26)	(61)	(43)	(96)
Scheme transfer	(232)	-	(216)	-	(448)	-
At 31 December	**-**	**249**	**-**	**242**	**-**	**491**

Acquisition expenses that do not meet the criteria for deferral are expensed directly as incurred.

21. CALLED UP SHARE CAPITAL

	2017 £m	2016 £m
Issued and fully paid		
702,000,000 (2016: 702,000,000) Ordinary shares of £1 each	702	702

Ordinary shares in issue in the Company rank pari passu. All the ordinary shares in issue carry the same right to receive all dividends and other distributions declared, made or paid by the Company.

22. DISTRIBUTABLE RESERVES

Included in capital and reserves at 31 December 2017 is an amount of £10m which is non-distributable (2016: £1,358m). The 31 December 2017 non-distributable amount reflects the £702m share capital of the Company less the negative profit and loss account reserves of £692m. Included in the profit and loss account reserves is the loss on the transfer of the scheme assets of £980m, for more information see note 37.

23. OTHER EQUITY – STEP-UP TIER ONE INSURANCE CAPITAL SECURITIES

	2017 £m	2016 £m
At 1 January	495	495
Scheme transfer	(495)	-
At 31 December	-	495

On 27 June 2005 the Company issued £500m of Step-up Tier one Capital Securities ("STICS"), bearing interest from 30 June 2005 to 30 June 2015 at a rate of 6.302%. As at 1 July 2015 the interest rate was reset to 4.39% and this rate will be applicable to 30 June 2020. The STICS have no maturity date but were redeemable in the whole or part at the option of the Company on 1 July 2015, or thereafter on every fifth anniversary of this date. £5m of issue costs are capitalised in the carrying value of the instruments.

The STICS are perpetual securities and are not redeemable at the option of the holders at any time. For each coupon period after 1 July 2015 the STICS will bear interest that is reset every five years. Under IAS 32 *Financial Instruments* it is necessary to treat STICS as equity as there is no requirement to settle the obligation in cash or another financial asset. As disclosed in note 37 the securities were transferred to UKLAP under the Scheme transfer.

24. SUBORDINATED LIABILITIES

	2017 £m	2016 £m
Debt instruments		
At 1 January	856	856
Reclassification of accrued interest	30	-
Scheme transfer	(886)	-
At 31 December	-	856

The debt instruments were transferred to UKLAP under the Scheme transfer. As at 31 December 2016 the debt instruments consist of:

(a) £500m lower tier two subordinated debt with Friends Life Holdings plc ("FLH") with an interest rate of 8.25% and a maturity date of 2022.

(b) £356m upper tier two subordinated debt with FLH with an interest rate of 7.92% which is redeemable at option of the issuer in 2018.

25. TECHNICAL PROVISIONS

As reported in the Strategic Report and note 37 to the financial statements, the Scheme transfer was completed on 1 October 2017. All technical provisions of the Company have transferred to UKLAP. Correspondingly. the quantitative and qualitative disclosure given in this note in respect of the assumptions used to value technical provisions all refers to the technical provisions as at 31 December 2016. As at 31 December 2016 the Company had six separate with-profits funds which are referred to in these disclosures as the FP WPF, the FPLAL WPF, the FLC New WPF, the FLC Old WPF, the FLAS WPF and the WL WPF. Where assumptions for particular products are identified as FLAS transferred, FLC transferred, or FLWL transferred this reflects the historic Friends Life entity the products were underwritten in before they were transferred to the Company by Part VII schemes.

(a) Change in long term business provision

The table below provides an analysis of the movements in the long term business provision.

	2017 Gross £m	2017 Reinsurance £m	2017 Net £m	2016 Gross £m	2016 Reinsurance £m	2016 Net £m
At 1 January	31,128	1,227	29,901	30,162	1,102	29,060
Provisions in respect of new business	192	2	190	228	6	222
Expected change in existing business provisions	(1,839)	11	(1,850)	(2,931)	(24)	(2,907)
Variance between actual and expected experience	541	(60)	601	2,678	158	2,520
Impact of operating assumption changes	-	-	-	(158)	(106)	(52)
Impact of economic assumptions changes	54	20	34	1,220	15	1,205
Other movements	(229)	58	(287)	(71)	76	(147)
Scheme transfer	(29,847)	(1,258)	(28,589)	-	-	-
At 31 December	-	-	-	31,128	1,227	29,901

The total movement in the long term business provision during the year can be split between insurance contracts, investment contracts, and investment contracts with DPF as follows:

(i) Insurance contracts

	2017 Gross £m	2017 Reinsurance £m	2017 Net £m	2016 Gross £m	2016 Reinsurance £m	2016 Net £m
At 1 January	22,292	1,097	21,195	21,345	979	20,366
Provisions in respect of new business	192	2	190	228	6	222
Expected change in existing business provisions	(1,723)	4	(1,727)	(1,752)	(24)	(1,728)
Variance between actual and expected experience	286	(49)	335	1,652	159	1,493
Impact of operating assumption changes	-	-	-	(201)	(106)	(95)
Impact of economic assumptions changes	59	20	39	1,218	15	1,203
Other movements	(122)	57	(179)	(198)	68	(266)
Scheme transfer	(20,984)	(1,131)	(19,853)	-	-	-
At 31 December	-	-	-	22,292	1,097	21,195

25. TECHNICAL PROVISIONS (continued)

(a) Change in long term business provision (continued)

(ii) Non-participating investment contracts

	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
At 1 January	561	8	553	407	8	399
Expected change in existing business provisions	(2)	(1)	(1)	(8)	-	(8)
Variance between actual and expected experience	(34)	(15)	(19)	(50)	(1)	(49)
Impact of operating assumption changes	-	-	-	17	-	17
Impact of economic assumptions changes	3	-	3	1	-	1
Other movements	(377)	1	(378)	194	1	193
Scheme transfer	(151)	7	(158)	-	-	-
At 31 December	-	-	-	561	8	553

(iii) Participating investment contracts

	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
At 1 January	8,275	122	8,153	8,410	115	8,295
Expected change in existing business provisions	(114)	8	(122)	(1,171)	-	(1,171)
Variance between actual and expected experience	289	4	285	1,076	-	1,076
Impact of operating assumption changes	-	-	-	26	-	26
Impact of economic assumptions changes	(8)	-	(8)	1	-	1
Other movements	270	-	270	(67)	7	(74)
Scheme transfer	(8,712)	(134)	(8,578)	-	-	-
At 31 December	-	-	-	8,275	122	8,153

25. TECHNICAL PROVISIONS (continued)

(b) Change in technical provisions for linked liabilities

The following movements have occurred in the technical provisions backing linked liabilities during the year.

	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
At 1 January	34,610	6,849	27,761	33,872	6,598	27,274
Provisions in respect of new business	20	5	15	100	1	99
Expected change in existing business provisions	(2,761)	(381)	(2,380)	(2,362)	(1)	(2,361)
Variance between actual and expected experience	1,535	530	1,005	2,709	204	2,505
Impact of operating assumption changes	-	-	-	(21)	(15)	(6)
Impact of economic assumptions changes	423	(237)	660	301	51	250
Other movements	151	(76)	227	11	11	-
Scheme transfer	(33,978)	(6,690)	(27,288)	-	-	-
At 31 December	-	-	-	34,610	6,849	27,761

The total movement in the technical provision backing linked liabilities during the year can be split between insurance contracts, investment contracts and investment contracts with DPF as follows:

(i) Insurance contracts

	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
At 1 January	9,120	920	8,200	8,981	974	8,007
Provisions in respect of new business	-	-	-	24	1	23
Expected change in existing business provisions	(764)	(8)	(756)	(683)	(1)	(682)
Variance between actual and expected experience	450	182	268	511	(99)	610
Impact of operating assumption changes	-	-	-	(21)	(15)	(6)
Impact of economic assumptions changes	43	(5)	48	301	51	250
Other movements	102	(49)	151	7	9	(2)
Scheme transfer	(8,951)	(1,040)	(7,911)	-	-	-
At 31 December	-	-	-	9,120	920	8,200

25. TECHNICAL PROVISIONS (continued)

(b) Change in technical provisions for linked liabilities (continued)

(ii) Non-participating investment contracts

	2017 Gross £m	2017 Reinsurance £m	2017 Net £m	2016 Gross £m	2016 Reinsurance £m	2016 Net £m
At 1 January	23,487	5,927	17,560	22,975	5,624	17,351
Provisions in respect of new business	20	5	15	76	-	76
Expected change in existing business provisions	(1,746)	(373)	(1,373)	(1,423)	-	(1,423)
Variance between actual and expected experience	923	347	576	1,850	303	1,547
Impact of economic assumptions changes	338	(232)	570	-	-	-
Other movements	16	(27)	43	9	-	9
Scheme transfer	(23,038)	(5,647)	(17,391)	-	-	-
At 31 December	-	-	-	23,487	5,927	17,560

(iii) Participating investment contracts

	2017 Gross £m	2017 Reinsurance £m	2017 Net £m	2016 Gross £m	2016 Reinsurance £m	2016 Net £m
At 1 January	2,003	2	2,001	1,916	-	1,916
Provisions in respect of new business						
Expected change in existing business provisions	(251)	-	(251)	(256)	-	(256)
Variance between actual and expected experience	162	1	161	348	-	348
Impact of operating assumption changes	-	-	-			
Impact of economic assumptions changes	42	-	42	-	-	-
Other movements	33	-	33	(5)	2	(7)
Scheme transfer	(1,989)	(3)	(1,986)	-	-	-
At 31 December	-	-	-	2,003	2	2,001

25. TECHNICAL PROVISIONS (continued)

(b) Change in technical provisions for linked liabilities (continued)

As unit-linked investment contracts are deposit accounted for, the change in technical provisions for linked liabilities net of reinsurance recorded in the technical account for long-term business does not equal the movement in the technical provisions for linked liabilities. The difference is explained below:

	2017 £m	2016 £m
Change in net technical provisions for linked liabilities per technical account	1,098	2,537
Net investment premiums	96	234
Net investment claims paid	(1,502)	(2,060)
Other technical income	(165)	(224)
Scheme transfer	-	-
Change in linked liabilities, net of reinsurance, on balance sheet	(473)	487

Included in the carrying amount of technical provisions in respect of insurance contracts is £nil (2016: £27,530m) that is expected to be settled more than 12 months after the balance sheet date.

Included in the carrying amount of technical provisions in respect of liabilities for investment contracts and investment with DPF contracts is £nil (2016: £29,122m) that is expected to be settled more than 12 months after the balance sheet date.

(c) Method used for reserving for insurance contracts and participating investment contract

The liability for insurance contracts and participating investment contracts is calculated on the basis of recognised actuarial methods, having due regard to actuarial principles and best practice. The principle method of actuarial valuation of liabilities arising under long-term insurance contracts is the gross premium method which involves the discounting of projected income (e.g. premiums and annual management charges) and charges (e.g. claims and expenses). It includes explicit assumptions for valuation interest rates, mortality and morbidity, persistency and future expenses. The assumptions used can vary by contract type and reflect current and expected future experience.

For unit-linked insurance and participating investment contracts and some unitised with-profits business the liabilities are valued by adding a non-unit reserve to the bid value of units. The non-unit reserve is based on non-unit cash flows. In circumstances where the resultant future income is greater than charges (i.e. negative liabilities), credit can only be taken in circumstances where penalties exist to recover this income on surrender of the policy.

For non-linked business, where the discounted value of future income is greater than the discounted value of future charges at a policy level (i.e. negative liabilities), credit can be taken to the extent that it offsets policies with positive liabilities within the same broad product group. For overseas business, negative liabilities are limited to zero at a policy level.

The valuation of with-profits business uses the methodology previously used for the Realistic Balance Sheet, adjusted to remove the shareholders' share of future bonuses where applicable. The valuation includes an assessment of the cost of any future options and guarantees and anticipated future and regular bonuses. In calculating the realistic liability account is taken of the future management actions consistent with those set out in the Principles and Practices of Financial Management ("PPFM").

25. TECHNICAL PROVISIONS (continued)

(d) Options and guarantees

Options and guarantees are features of life assurance and pensions contracts that confer potentially valuable benefits to policyholders. They are not unique to with-profits funds and can arise in non-participating funds. They can expose an insurance company to two types of risk: insurance (such as mortality/morbidity) and financial (such as market prices/interest rates). The value of an option or guarantee comprises two elements: the intrinsic value and the time value. The intrinsic value is the amount that would be payable if the option or guarantee was exercised immediately. The time value is the additional value that reflects the possibility of the intrinsic value increasing in future, before the expiry of the option or guarantee. All options and guarantees are valued and included in policyholder liabilities. Options and guarantees are valued on a market consistent stochastic basis that takes into account both the time value and the intrinsic value of the options and guarantees.

All material options and guarantees are valued stochastically and included in the liabilities. There are two main types of guarantees and options within the with-profits funds: maturity guarantees and guaranteed annuity options. Maturity guarantees are in respect of conventional with-profits business and unitised with-profits business and represent the sum assured and reversionary bonuses declared to date. For certain with-profits pension policies there are options guaranteeing the rates at which annuities can be purchased. The cost of the maturity guarantees and guaranteed annuity options have been calculated as:

	31 December 2017 – FP WPF/ FPLAL WPF £m	31 December 2017 – FLC New WPF £m	31 December 2017 – FLC Old WPF £m	31 December 2017 – FLAS WPF £m	31 December 2017 – WL WPF £m
Maturity guarantees	-	-	-	-	-
Guaranteed annuity options	-	-	-	-	-

	31 December 2016 – FP WPF/ FPLAL WPF £m	31 December 2016 – FLC New WPF £m	31 December 2016 – FLC Old WPF £m	31 December 2016 – FLAS WPF £m	31 December 2016 – WL WPF £m
Maturity guarantees	202	147	38	224	93
Guaranteed annuity options	792	252	109	123	6

25. TECHNICAL PROVISIONS (continued)

(e) Process used for assumptions

(i) Economic assumptions

Details regarding the economic assumptions used in the stochastic model for the valuation of with-profits policyholder liabilities are set out below.

The cost of with-profits guarantees is most sensitive to the assumed volatility of future returns on asset shares, the level of future interest rates and the rates of discontinuance on these policies. The guarantee cost in respect of guaranteed annuity options is most sensitive to the level of future interest rates, future mortality rates, assumed rates of discontinuance and early retirements, and the assumptions relating to the exercise of the tax free cash option on these policies. Further details on these assumptions are provided below.

The cost of the with-profits guarantees is assessed using a market consistent stochastic model as the economic scenario generator (produced by Moody's Analytics) and is calculated using 2,000 simulations.

The model is calibrated using the swaps curve assuming interest rates of between 0.54% and 1.52% per annum and implied volatilities in the market as shown in the table below.

Volatility assumptions are set with reference to implied volatility data on traded market instruments, where available, or on a best estimate basis if not

Class	Volatility	
	2017	2016
UK Equities	n/a	24%
Property	n/a	16%
Government Bond Yields	n/a	49%

The equity volatility used depends on term, money-ness and region. The figure shown is for a sample UK equity, at the money, with a 10 year term. Fixed interest volatility is also dependent on term and money-ness. The figure shown is for a 10 year swap option with 10 year term, currently at the money.

For the WPFs the stochastic model used to determine the liabilities for with-profits business incorporates an algorithm which determines future regular bonus rates and policy pay outs in a range of possible economic scenarios. The assumptions used within the algorithm are consistent with the provisions of the PPFM and aim to maintain a large enough margin over the expected guaranteed benefits from which to pay a final bonus under most scenarios. In addition, allowance is made for planned enhancements to pay out in accordance with the PPFM.

The guarantee cost in respect of guaranteed annuity options is assessed using a market consistent stochastic model and values both the current level of the guaranteed annuity rate benefit (allowing for future improvements in annuitant mortality) and the time value due to uncertainty in future interest rates. The guarantee cost in each scenario is the value of the excess annuity benefit provided by the options, relative to an annuity purchased in the open market. In estimating the future open market annuity rate, the model allows for stochastic variation in interest rates and for future mortality improvements. The stochastic interest rate assumption reflects that implied by current market interest rate derivative prices. Future annuitant mortality within the with-profits balance sheet allows for future mortality improvements.

The guaranteed annuity options cost also depends upon other factors such as policy discontinuance and the take up rate for the options.

25. TECHNICAL PROVISIONS (continued)

(e) Process used for assumptions (continued)

(ii) Non-economic assumptions

The provision for insurance contracts and investment contracts with DPF liabilities is sensitive to the principal assumptions in respect of mortality, morbidity and maintenance expenses (except for net premium valuations), persistency and guaranteed annuity option take-up rates, although the relative sensitivity will vary depending on the insurance or investment contract.

Long-term estimates of future mortality and morbidity assumptions are based on standard tables wherever possible but adjusted to reflect the Company's own experience. Expense assumptions are based on recent experience.

Experience investigations for mortality, morbidity, persistency, guaranteed annuity option take-up rates and maintenance expenses are performed at least annually for major product classes. Where industry analysis indicates that changes in expected future mortality/morbidity or other assumptions factor patterns mean that claim costs are likely to rise in the future, then this is taken into account in the liability calculation.

No benefit is taken in regulatory reserves where industry analysis indicates that future trends are likely to reduce claim costs in the future. For FLC New WPF, FLC Old WPF and the FLAS WPF, the benefit from a prudent view of expected future mortality improvements is taken on non-profit protection business in the realistic balance sheet. Improving mortality has been assumed when valuing annuities and deteriorating morbidity has been assumed when valuing some critical illness business. Assumptions, for policies other than with-profits, are generally intended to be a prudent estimate of future experience.

Policy discontinuances: lapse, early retirement and paid-up rates vary by policy type and period and have been based on recent experience together with a prudent margin. The rates also include allowance for expected future changes where appropriate (for example arising as a result of regulatory change).

Early retirement rates vary by age band and policy type and are set based on recent experience.

Tax free cash option: For the 2016 valuation where a guaranteed annuity option is more valuable than the cash equivalent it is assumed that 5% to 27% of the benefit of the option is taken tax-free depending on the type of business. This is based on recent experience.

25. TECHNICAL PROVISIONS (continued)

(f) **Valuation interest rates**

The impact of these liability changes on surplus is generally to offset some or all of the corresponding impact on the value of fixed interest assets backing the liabilities.

(i) **Conventional with-profits business**
With-profits business is valued in accordance with FRS 27 requiring a realistic valuation.

(ii) **Annuities in payment**
Fixed interest assets, predominantly corporate bonds, are held to match the expected benefit outgo of the annuity portfolio. The excess yields on corporate bonds over that on gilts are called bond spreads and these reflect compensation for the higher risk of default (credit risk premium) and lower liquidity (illiquidity premium) compared to gilts. One of the key judgements is the assessment of how much of the spread is attributable to the illiquidity premium.

The illiquidity premium assumed on backing assets in the derivation of valuation interest rates for annuities in payment is derived by taking the overall spread on a bond and deducting an allowance for defaults (called the credit defaults deduction) with the remainder of the spread being treated as illiquidity premium. The credit default deduction is based on:

- historical defaults and recovery experience;
- a margin for prudence.

(iii) **Other than conventional with-profits business**
Valuation interest rates for other than conventional with-profits business are shown in table below. Interest rates are shown gross of tax and investment fees.

25. TECHNICAL PROVISIONS (continued)

(f) Valuation interest rates (continued)

(iii) Other than conventional with-profits business (continued)

Class of Business	Funds	2017 %	2016 %
Life			
Endowment and Whole Life in NP funds	FLL-pre	n/a	1.30
Protection	existing	n/a	1.30
Over 50 Plan in NP Funds	FLC –	n/a	1.21
Additional Life Reserves	transferred	n/a	1.21
Other conventional life in NP funds		n/a	1.21
Life annuities from FLAS		n/a	1.52
Unit-linked Life		n/a	1.21
Conventional Life	FLAS -	n/a	1.17
Unit-linked Life	transferred	n/a	1.17
With-profits fund immediate annuities	FLWL -	n/a	1.60
Life (other)	transferred	n/a	1.60
Non-profit fund life		n/a	1.60
Income Protection			
Income Protection	FLL-pre existing	n/a	1.10
PHI	FLC - transferred	n/a	1.52
Pensions			
Annuities in payment	FLL-pre	n/a	2.05-2.16
Protection	existing	n/a	1.60
Individual and Group Pensions in NP Funds		n/a	1.60
Unit-linked Pensions	FLC -	n/a	1.52
Conventional Pensions in NP funds	transferred	n/a	1.52
WPAD Stage 1 Immediate Annuities		n/a	2.02
WPAD Stage 2 Immediate Annuities		n/a	2.02
WPAD Stage 3 Immediate Annuities		n/a	2.02
Additional Pensions Reserves		n/a	1.52
Conventional Pensions	FLAS -	n/a	1.46
Unit-linked Pensions	transferred	n/a	1.46
With-profits fund pensions (immediate annuities)	FLWL –	n/a	1.60
Non-profit fund pensions (immediate annuities)	transferred	n/a	2.16
Non-profit fund pensions (other)		n/a	1.60

Certain products can have positive or negative reserves. The interest rates used for these products for the 2016 valuation in pre-existing FLL are 0.90% to 2.60% ; for transferred FLC the rates are 0.81% to 1.61% for life business and 1.02% to 2.02% for pension business. The more onerous rate is used for each product.

Other valuation interest rates have been calculated in the same way as in previous years by reference to changes in consistent economic indices.

The FLC transferred and FLAS transferred valuation interest rates are quoted net of allowances for policyholder tax and investment expenses. The FLWL transferred valuation interest rates are quoted gross of allowances for policyholder tax and investment expenses. The FLL pre-existing valuation interest rates are quoted net of allowances for policyholder tax but gross of allowances for investment expenses. This difference in presentation reflects differences in the way in which the business is managed.

25. TECHNICAL PROVISIONS (continued)

(g) Mortality and morbidity assumptions

The liabilities in respect of insurance contracts reflected in the long term business provision and the technical provision allow for mortality and morbidity risk by making assumptions about the proportion of policyholders who die or become sick. Allowance for future mortality has been made using the following percentages of the standard published tables:

	2017 – FLL pre-existing	2016 – FLL pre-existing
Term assurances – smoker	n/a	78.1% TMS00(5) /82.5% TFS00(5)
Term assurances – non-smoker	n/a	77% TMN00(5) / 82.5% TFN00(5)
Critical illness	n/a	CIBT02 (i, iii)
Other life assurances	n/a	120% AM/FC00ult
Unitised policies (life regular premium)	n/a	130% AM/FC00ult
Unitised policies (other)	n/a	110% AM/FC00ult
Pension policies	n/a	65% AMC00ult / 55% AFC00ult
Individual income protection	n/a	60% AM/F80ult (iv)
Individual pension annuities in payment	n/a	PCMA/PCFA00 (v, vi)
Group pension annuities in payment	n/a	PCMA/PCFA00 (v, vi)
Lifestyle / Enhanced annuity	n/a	Bespoke tables

	2017 – FLC transferred	2016 – FLC transferred
Term assurances – smoker	n/a	78.1% TMS00(5) / 82.5% TFS00(5)
Term assurances – non-smoker	n/a	77% TMN00(5) / 82.5% TFN00(5)
Critical illness	n/a	CIBT02 (ii, iii)
Other life assurances	n/a	140% AMC00 / 125% AFC00
Unitised policies (life/other)	n/a	105% AMC00ult / 110% AFC00ult
Pension policies	n/a	90.91% A67/70ult-1 / AF80ult-1
Individual income protection	n/a	100% AM/AF92 (iv)
Individual pension annuities in payment	n/a	101% PCMA00 / 105.9% PCFA00 (vi)

	2017 – FLAS transferred	2016 – FLAS transferred
Term assurances – smoker	n/a	78.1% TMS00(5) / 82.5% TFS00(5)
Term assurances – non-smoker	n/a	77% TMN00(5) / 82.5% TFN00(5)
Critical illness	n/a	CIBT02 (ii, iii)
Other life assurances	n/a	140% AMC00 / 125% AFC00
Unitised policies (life/other)	n/a	105% AMC00ult / 110% AFC00ult
Pension policies	n/a	90.91% A67/70ult-1 / AF80ult-1
Individual income protection	n/a	100% A67/70 (iv)
Individual pension annuities in payment	n/a	98.5% PCMA00 /98.5% PCFA00 (vi)

	2017 – FLWL transferred	2016 – FLWL transferred
Term assurances – smoker	n/a	78.1%TMS00(5) / 82.5% TFS00(5)
Term assurances – non-smoker	n/a	77%TMN00(5) /82.5%TFN00(5)
Immediate annuities	n/a	108.4% PCMA00 / 108.4% PCFA00 (vi)

25. TECHNICAL PROVISIONS (continued)

(g) Mortality and morbidity assumptions (continued)

(i) The percentages of the table used differ by sex and smoker status. CIBT02 has been adjusted to allow for a select period as follows: Year 1: 80% of CIBT02; Year 2: 95% of CIBT02; Year 3+: 100% of CIBT02

(ii) The percentages of the table used differ by sex, smoker status and sales group.

(iii) Future deterioration is assumed to apply at the rate of 0.4% per annum for males and 0.9% per annum for females.

(iv) Individual income protection sickness and recovery rates are based on percentages of CMIR 12 (male and female) published tables. Rates differentiate by smoker status, deferred period and occupational class.

(v) Percentages of the mortality tables used vary by age and the period the business was written in.

(vi) Base tables apply in 2000; improvements are based on CMI 2015 (CMI 2013 for 2015) mortality projections, with a long term rate of 1.75% for males (1.5% for females).

(h) Investment contracts and unit linked insurance / participating investment contracts

The provision for linked contracts is based on the current unit fund value, plus additional non-unit reserves if required based on a discounted cash flow analysis. There is no significant difference between carrying values and maturity values of liabilities in respect of investment contracts.

Additional technical provisions arising from unit-linked business classified under IFRS 4 as insurance/participating investment contracts are held within the long-term business provision, and include an allowance for any excess of future costs over policy charges. A discounted cash-flow valuation method has been adopted to determine these additional provisions for all major classes of business. The main assumptions relate to the discount rate, future expenses, unit growth and mortality experience. Further provisions such as those in respect of mis-selling costs are also held.

(i) Support Arrangements

Following the Scheme transfer of the Company's with-profit funds to UKLAP there are no longer any support arrangements in operation in the Company.

As at 31 December 2016, the Company's shareholder fund and non-profit fund were required by the terms of a business transfer scheme of 28 December 2013 under Part VII of the Financial Services Act and Markets Act 2000 ("the FLL 2013 scheme") to retain £543m of capital support assets. Of this, £499m needed to be held in the form of tangible assets which could be transferred to the various with-profits funds of the Company on a temporary basis if necessary.

26. CAPITAL MANAGEMENT

Until the Company has been de-authorised it is required to comply with Solvency II regulatory rules and capital requirements.

In managing its capital under the Solvency II regieme, the Company seeks to:

- Match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- Maintain sufficient, but not excessive, financial strength to support new business growth and satisfy the requirements of its policyholders and its regulator, the Prudential Regulation Authority (PRA);
- Retain financial flexibility by maintaining strong liquidity; and
- Allocate capital efficiently to support growth and repatriate excess capital where appropriate.

The Company considers not only the traditional sources of capital funding, but alternative sources of capital as appropriate when assessing its available capital. This includes reinsurance, securitisation and certain financing arrangements that can be recognised as capital on a regulatory basis.

In accordance with Solvency II regulatory rules, the Company is required to hold sufficient capital (own funds) to meet its solvency capital requirements. The Company also complies with Group mandated Capital Management Risk Standards, which include the setting of risk appetites what are designed to give some buffer against adverse events when compared with minimum solvency. These appetites define what action should be taken by management where the actual capital level is above or below the desired target level.

The Company complied with its regulatory capital requirements throughout the financial year.

The reconciliation below is between total equity under FRS 101 attributable to equity holders of the Company and total own funds under Solvency II.

	2017 £m	2016 £m
Total equity per the balance sheet (FRS 101 basis)	10	3,304
Adjusted for:		
Elimination of intangibles assets and liabilities	-	(401)
Differences in technical provisions	-	4,290
Risk Margin	-	(1,253)
Deferred Tax	-	(30)
Revaluation of assets and liabilities to an SII basis	-	(212)
Elimination of Fund for Future Appropriations	-	692
Solvency II net assets	10	6,390
Restricted own funds due to ring fencing	-	(757)
Elimination of subordinated debt	-	927
Total own funds	10	6,560

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS

The following disclosure relates to the risks and uncertainties that the Company experienced during 2016 and 2017 prior to the Scheme transfer on 1 October 2017. There were no significant changes in the exposure to risk during the period until the Scheme date. No analysis has been included for the assets and liabilities as at 31 December 2017 within the following disclosure given that all of the assets and liabilities of the Company, except for £10m required to cover capital requirements until de-authorisation, have been transferred to UKLAP under the Scheme transfer and the Company is therefore no longer exposed to any of the following risks and uncertainties.

(a) Risk Management Framework

The ultimate parent company, Aviva plc, and its subsidiaries, joint ventures and associates, (collectively known as "the Group"), operate a risk management framework ("RMF"), which forms an integral part of the management and board processes and decision-making framework across the Group. The key elements of our risk management framework comprise risk strategy and risk appetite, risk policy categorisation, enterprise-wide approach to managing risk, including how to identify, measure, manage, monitor and report risks, and risk governance and oversight (including boards and board committees, risk policies and business standards, delegated authorities and management committees, and roles and responsibilities). The Group's approach to risk management ensures that significant existing or emerging risks are actively identified, measured, managed, monitored and reported on a continuous basis. The RMF has been adopted by the boards of the legal entities within the business collectively referred to as "UK Life" (including this Company).

For the purposes of risk identification and measurement risks are usually grouped by risk type: market, credit, life insurance, liquidity and operational risk. Risks falling within these types may affect a number of key metrics including those relating to balance sheet strength, liquidity and profit. They may also affect the performance of the products that the Company delivers to customers and the service to customers and distributors, which can be categorised as risks to our brand and reputation or as conduct risk.

Risk models were an important tool in the Company's measurement of risk and were used to support the monitoring and reporting of the risk profile and in the consideration of the risk management actions available. The Company carried out a range of stress tests (where one risk factor, such as equity returns, is assumed to vary) and scenario tests (where combinations of risk factors are assumed to vary) to evaluate their impact on the business and the management actions available to respond to the conditions envisaged. Board oversight of risk and risk management across the Group is maintained on a regular basis through its Risk Committee. The Board has overall responsibility for determining risk appetite, which is an expression of the risk it is willing to take. The Group's position against risk appetite is monitored and reported to the Board on a regular basis. A similar arrangement prevails at the UK Life business level.

UK Life sets limits to manage material risks to ensure the risks stay within risk tolerance (the desired or upper bound on the level or risk that UK Life will take in pursuit of its purpose and strategy). UK Life assesses the size and scale of a risk by considering how likely it is that the risk will materialise and the potential impact the risk could have on its business and its stakeholders. Where risks are outside of tolerance, actions are agreed to bring the risks within tolerance. Impact assessments are considered against financial, operational and reputational criteria and take into account underlying factors such as economic conditions, for example, UK economic growth and inflation. Whilst as at 31 December 2017 the Company remains within the UK Life risk governance framework, following the Scheme transfer of business the Company is not considered to be exposed to risks or uncertainties. As such the level of risk management required in respect of the Company's activities has diminished.

The UK Life business has an established governance framework, which has the following key elements:

- defined terms of reference for the legal entity boards and the associated board committees within the UK Life business including the Risk Committee, Conduct Committee, Audit Committee, Investment Committee, With Profits Committee and Independent Governance Committee;

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(a) Risk Management Framework (continued)

- a clear organisational structure with documented delegated authorities and responsibilities from the legal entity Boards to CEOs and senior management. Often the senior management were assisted on discharging their delegated authority through the discussions at management committees (for example, the Executive Committee, Operational Risk and Conduct Committ ee and Asset Liability Committee); and

- adoption of the Group policy framework that defines risk appetite measures and sets out risk management and control standards for the Group's worldwide operations. The risk policies and associated business standards also set out the roles and responsibilities of Group, Businesses, Policy and Standard Owners, and Board and Management Committees.

UK Life operates within a three lines of defence risk management model that encourages close working relationships between line management and the risk function whilst facilitating independent assurance by internal audit, and the roles of the three lines of defence each contribute to embedded risk management:

- First line of defence (Management): Primary responsibility for risk identification, measurement, management, monitoring and reporting lies with management. The first-line management is responsible for the implementation and practice of risk management.
- Second line of defence (Risk function): Responsibility for reviewing and challenging the completeness and accuracy of risk identification, measurement, management, monitoring and reporting, and the adequacy of, and progress against, mitigation plans lies with the Risk function. This necessitates the early involvement by management of the risk function in key business decisions or projects, both in relation to customer and shareholder risks. The Risk function is responsible for overseeing effective operation of the Risk Management Framework, particularly in relation to setting Risk Appetite, and compliance with Solvency II requirements.
- Third line of defence (Internal Audit function): Responsibility for assessing and reporting (to group and business unit audit, risk and governance committees, as appropriate) on the effectiveness of the design and operation of the framework of controls which enable risk to be assessed and managed lies with Internal Audit.

The Regulators also require UK Life to assess its economic capital requirements to ensure that it adequately reflects the risks facing the business. UK Life has accordingly developed economic capital models that support the measurement, comparison and further understanding of its risks. The results of the modelling are incorporated into key strategic planning and decision-making processes. These models show the relative impact to economic capital from the risks faced. In turn this supports the assessment of appropriate and effective mitigating strategies where risks are outside of appetite.

Regulatory impact on risk and risk assessments

Where the Company has written products where the majority of investment risks are borne by its policyholders, these risks were actively and prudently managed in order to satisfy the policyholders' risk and reward objectives. In addition, the insurance operations were subject to numerous regulatory requirements that prescribe the type, quality, and concentration of investments, and the level of assets to be maintained in order to meet insurance liabilities. Meeting these requirements helped to ensure the Company's market risk is maintained at an acceptable level.

(b) Market risk

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices, foreign exchange rates, inflation rates and property prices. Market risk arose within the Company due to fluctuations in the relationship

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(b) **Market risk (continued)**
between the values of the liabilities and the value of investments held as a result of movements in market prices.

For each of the major components of market risk, described in more detail below, the Company had put in place additional policies and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite.

The Company managed market risks within the asset/liability management ("ALM") framework and within regulatory constraints. The Company was also constrained by the requirement to meet policyholders' reasonable expectations and to minimise or avoid market risk in a number of areas.

The financial impact of market risk was examined through stress tests on the capital position under Solvency II (SII), which considered the impact on Economic Capital from variations in financial circumstances on either a remote scenario or to changes from the central operating scenario. Management actions that may be taken in mitigation of the change in circumstances were also considered.

The Company's market risk policy set out the minimum principles and framework for setting an ALM and investment strategy, the approaches to be taken when liabilities could not be matched, and the monitoring and reporting processes that were required. The Company applied appropriate matching techniques to assets and liabilities for all classes of business in order to manage the financial risk from the mismatching of assets and liabilities when investment markets changed. The Company monitored adherence to this policy through the Asset & Liability Committee ("ALCO").

Mandates were set for each fund within the Company. Unit-linked funds were managed in line with their underlying objectives as set out in policyholder contracts. The mandates sought to limit exposure to market risk by using some or all of the following mechanisms:
- restrictions on the asset classes held;
- restrictions on the maximum exposure to any one issuer; and
- defined sector, country or regional limits.

Funds were able to use derivatives for the purpose of efficient portfolio management and risk reduction.

Certain policyholder participation features contributed to the Company's market risk. The major features included guaranteed surrender values, guaranteed annuity options, and minimum surrender and maturity values.

In order to manage the exposure arising from guarantees and options, the Company purchased a number of derivatives, including interest rate swaps, equity put options, currency forwards, inflation swaps, interest rate swaptions and equity futures to manage exposures to movements in equity prices or interest rates. Hedge accounting was not applied to these derivatives, as movements in the fair value of these instruments was offset by the movement in the valuation of the liability. As noted, the majority of these guarantees arose within the Company's with-profits funds and so any fair value movement would have been reflected in the fund for future appropriations rather than within shareholders' funds. In addition, derivatives were used to manage guarantees in respect of non-profit business.

During 2016 equity futures were purchased by the Company's shareholder fund to hedge against the market risk in respect of the Value In Force ("VIF") arising within the unit linked funds.

(i) **Equity risk**

The Company was subject to equity risk from equity market dynamics due to both price and index movements and changes in volatility and correlation. The Company's shareholders were exposed to direct equity holdings in shareholder assets, to indirect impact of changes in the value of equities held in

27. **RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

(b) **Market risk (continued)**

(i) **Equity risk (continued)**
policyholder funds from which management charges or a share of performance are taken, and to its interest in the free assets of long-term funds.

Equity price risk was actively managed in order to mitigate anticipated unfavourable market movements where this lay outside the risk appetite of the fund concerned. The Company held diversified portfolios of assets thereby reducing exposure to individual equities.

The Company actively modeled the performance of equities through the use of stochastic models, in particular to understand the impact of equity performance on guarantees, options and bonus rates.

In the principal with-profits funds a dynamic hedging strategy was in place which aimed to protect the surplus within the funds from adverse changes in assets values, in particular equities and properties.

Asset allocation in the Company's with-profits funds was actively managed with the proportion of property and equity backing asset shares monitored against target equity backing ratios ("EBR"). At 31 December 2016, the target EBRs were 45% for the FP WPF pre-demutualisation business, 55% for the post-demutualisation business, 60% for the FLC WPFs and 50% for the FLAS and WL WPFs. These ratios reflected the perceived risk preferences of the with-profits funds and are in line with the Company's commitment to fair treatment of all its customers and the published Principles and Practices of Financial Management.

For the FLAS, FP and FPLAL WPF the proportion of equity and property backing asset shares was managed on a basis which targets a stable proportion over time. This was also true for policies with equity participation in the WL WPF, although as policies got close to maturity their allocation was moved towards short-term fixed interest investments, and thus the overall equity and property proportion was likely to fall over time. For the FLC WPFs, asset allocation varied for different policies depending on how close they were to maturity, and thus the overall equity and property proportion within the fund was expected to gradually reduce over time.

The Company actively monitored its directly owned equity assets, including subsidiary investments and shareholdings in strategic business partners, with regular management information being prepared. The Company valued subsidiaries on a fair value basis and these fair values fluctuated as the underlying assets and liabilities held by the subsidiaries, including the in-force business where applicable, changed in value.

A sensitivity of profit and total equity to changes in equity prices is given in section (g) below.

(ii) **Property risk**

The Company was subject to property risk due to holdings of investment properties. The investment in property was managed and was subject to liquidity requirements and the expectations of policyholders. The financial impact from changes in property values was examined through stress tests adopted for SII reporting.

A sensitivity of profit and total equity to changes in property prices is given in section (g) below.

(iii) **Currency risk**

The Company was subject to currency risk from financial instruments held in currencies other than Sterling, although this risk was limited as nearly all such holdings are backing either unit-linked or with-profit contract liabilities or were mitigated by hedging.

27. **RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

(b) **Market risk (continued)**

(iii) **Currency risk (continued)**

During 2016 FX forward contracts were entered into by the Company's shareholder fund to hedge against the currency risk in respect of the VIF arising within the unit linked funds.

(iv) **Interest rate risk**

Interest rate risk arose primarily from the Company's nominal and real yield curve exposure within both assets and liabilities. Interest rate risk also existed in policies that carried investment guarantees on early surrender or at maturity, where claim values could become higher than the value of backing assets when interest rates rise or fall.

The Company managed this risk by adopting asset liability matching techniques, to minimise the impact of mismatches between the value of assets and liabilities from interest rate movements. However, where any mismatch was within the Company's risk appetite, the impact was monitored through economic capital measures such as SII.

Interest rate risk was also managed using a variety of derivative instruments, including futures, options and swaps, in order to provide a degree of hedging against unfavourable market movements in interest rates inherent in the assets backing technical liabilities. Swaps were put in place to improve the overall matching of asset and liability cash flows.

A sensitivity of profit and total equity to changes in interest rates is given in section (g) below.

(v) **Derivative risk**

Derivatives were used to a limited extent, within policy guidelines agreed by the Board of Directors and overseen by Group Risk which monitors implementation of the policy, exposure levels and supports large or complex transactions.

Derivatives were used for efficient investment management, risk hedging purposes or to structure specific retail-savings products. Derivative transactions were materially covered by either cash or corresponding assets and liabilities. Speculative activity is prohibited. Over the counter derivative contracts were entered into only with approved counterparties, in accordance with the Company's policies, thereby reducing the risk of credit loss.

(vi) **Correlation risk**

Interdependencies between risks were taken into consideration in SII through the aggregation of stress tests. Stress and Scenario testing also considered scenarios involving a number of correlated events.

(c) **Legislative risk**

The Company operated in a complex legislative environment and could have been impacted by changes in legislation. The Company performed regular risk assessments of the relevant risks (including the risks linked to the change in legislation) and of the resulting impacts, to inform business strategy and to ensure on-going compliance with all applicable laws. The Company also actively monitored legislative changes and had processes in place to take account of them in its businesses, both to be compliant, but also to enable the business to respond commercially to anticipate legislative changes.

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) Credit risk

Credit risk is the risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements. The Company's management of credit risk under the oversight of ALCO included the articulation of risk appetite, exposure limit frameworks and investment and lending criteria within credit risk policies and management agreements. Our approach to managing credit risk recognised that there is a risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements. Credit risk categories include spread risk, default risk and rating migration risk:

- Spread risk arises from changes in level of volatility of third party credit spreads over risk-free interest rates, that can be caused by credit concerns (improving or worsening) on the issuer, or from market factors, such as risk appetite and liquidity within the market;

- Default risk is the risk that a counterparty is unable or unwilling to meet its financial obligations when they fall due, and includes delays in repayments, restructuring or repayments/interest schedule and bankruptcy;

- Rating migration risk is the risk that a change in external credit rating of counterparty adversely impacts Aviva.

Financial assets were graded according to current credit ratings issued. AAA is the highest possible rating. Investment grade financial assets were classified within the range of AAA to BBB ratings. For the purposes of the table below financial assets which fell outside this range are classified as non-investment grade. Credit limits for individual counterparties were set based on default probabilities that were in turn based on the rating of the counterparty concerned. Ratings published by companies such as Standard & Poor's were used where available. Whilst not externally rated, the risk characteristics of commercial mortgages were assessed before acquisition and were monitored thereafter. Internal reinsurance assets were not externally rated.

The following table provides information regarding the aggregated credit risk exposure, for financial assets with external credit ratings, of the Company. The following assets have been excluded: (i) Assets held within unit-linked funds as the credit risk on these assets is borne by the policyholders rather than the shareholders, (ii) Reinsurance assets (reinsurance credit exposures are covered separately within this section), (iii) Government bonds and (iv) Other unlisted debt and fixed interest securities because they do not have a rating. The carrying amount of assets included in the balance sheet represents the maximum credit exposure.

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) **Credit risk (continued)**

As at 31 December 2016

	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Debt securities and other fixed-interest securities	1,057	2,394	5,255	5,091	273	62	32	14,164
Derivatives	-	2	570	148	-	-	26	746
Cash at bank and in hand	5,293	-	922	276	-	-	-	6,491
Total	6,350	2,396	6,747	5,515	273	62	58	21,401
%	30%	11%	32%	26%	1%	0%	0%	100%

The carrying amount of assets included on the balance sheet represents the maximum credit exposure.

Concentration of credit risk was mitigated by internal credit limits. In cases where the Company was particularly exposed to credit risk, this risk was translated into a more conservative discount rate used to value the liabilities, creating a greater capital requirement, and this credit risk was actively managed. The impact of aggregation of credit risk was monitored as described above.

With the exception of AAA and AA rated Governments, the largest aggregated counterparty exposure excluding reinsurance did not exceed 0.62% of the Company's total financial assets during 2016.

The Company had looked to diversify its assets backing the annuity portfolio. The Company had made an infrastructure investment in the Drax power station, illustrating where the Company has sourced investments with an explicit Treasury underpin and reduced the credit risk accompanying such infrastructure projects. The Company had also made subsequent infrastructure investments and investments in other illiquid asset classes, such as commercial real estate loans and commercial mortgage assets.

The impact of collateral held on the net credit exposure is shown below. The following table provides further information on financial instruments that are subject to master netting agreements and illustrates the potential effect of netting offset arrangements after taking into account these agreements.

As at 31 December 2016	Gross amounts recognised	Related amounts not set off in the balance sheet (i)			
		Financial instruments	Collateral received	Collateral pledged	Net exposure
	£m	£m	£m	£m	£m
Financial assets (ii)	480	(149)	(320)	n/a	11
Financial liabilities (ii)	(492)	193	n/a	321	22

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) **Credit risk (continued)**

(i) Financial assets and financial liabilities do not meet the offsetting criteria and are reported gross in the balance sheet.
(ii) Amounts that could be offset in the case of default, governed by master netting financial instrument and collateral agreements.
(iii) Total gross financial assets recognised in Note 14 of £nil (2016: £778m) consist of the recognised financial derivative assets of £nil (2016: £480m) plus the total financial assets offsetting financial liabilities of £nil (2016: £193m) in the tables above and other derivative assets that are not subject to master netting agreements of £nil (2016: £105m). Total gross financial liabilities recognised in Note 14 of £nil (2016: £688m) consist of financial liabilities of £nil (2016: £492m) plus the total financial liabilities offsetting financial assets of £nil (2016: £149m) in the tables above and other derivative liabilities that are not subject to master netting agreements of £nil (2016: £47m).

There are no other financial assets and liabilities which are offset and reported net within the financial statements.

In 2016 collateral of £50m in UK government bonds was posted in the Company's favour in respect of future margins due to the Company under longevity insurance contracts. The Company was not permitted to sell or re-pledge the collateral in absence of default by the owner of the collateral. The Company was not exposed to the risks and rewards of ownership of the assets posted as collateral and therefore the collateral was not reflected on the Company's balance sheet.

The Company can receive or pledge collateral in respect of over the counter derivatives. Such collateral consists of gilts, non-sterling government bonds and cash. Collateral is valued at bid price. For the majority of over the counter derivative transactions undertaken by the Company, collateral is received from the counterparty if the sum of all contracts held with the counterparty is in-the-money (i.e. it is being valued as an asset). Cash received as collateral from the counterparty is recognised within the Company's balance sheet along with the obligation to return this collateral which is reflected within 'other creditors'. Securities received as collateral from the counterparty are not recognised on the Company's balance sheet. The Company has a legal right to this collateral if the counterparty does not meet its obligations but has no economic benefit from holding the assets and the counterparty may substitute at any time the collateral delivered for another asset of the same value and quality. It is repayable if the contract terminates or the contract's fair value falls. Contractual agreements between the Company and each counterparty exist to protect the interests of each party, taking into consideration minimum threshold, asset class of collateral pledged and the frequency of valuation.

The total amount of collateral received which the Company is permitted to sell or re-pledge in the absence of default was £209m in 2016.

Where cash has been pledged as collateral to the counterparty, this cash has been derecognised from the Company's balance sheet and a debtor to reflect the counterparty's obligation to return this collateral is reflected within 'other debtors'. Securities which are pledged to the counterparty remain on the Company's balance sheet on the basis that no market risk or economic benefit has been transferred to the counterparty.

Prior to the scheme transfer the Company could be required to post collateral in respect of certain longevity hedge reinsurance arrangements. As at 31 December 2017 the value of collateral posted was £nil (2016: £nil).

The Company has acquired credit default swap instruments in the year to mitigate credit risk arising in the non-profit fund.

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) Credit risk (continued)

Reinsurance credit exposures

The Company was exposed to concentrations of risk with individual reinsurers, due to the nature of the reinsurance market. The Company placed reinsurance with those reinsurers that have acceptable credit ratings. The Company operated a policy to manage its reinsurance counterparty exposures and the impact from reinsurer default is measured regularly, in particular through SII tests, and is managed accordingly.

Derivative credit exposures

The Company was exposed to counterparty credit risk through derivative trades. This risk was mitigated through collateralising almost all trades (the exception being certain FX trades where it has historically been the market norm not to collateralise). The Company operated strict standards around collateral management and controls including the requirement that all "over the counter" derivatives were supported by credit support annexes and ISDAs.

Unit-linked business

For unit-linked business the policyholder bore the market risk, including credit risk, on investment assets in the unit funds. The exception to this was credit risk on certain reinsured unit-linked business which was borne by the Company. Therefore the shareholders' exposure to credit risk was limited to the reinsured funds and to the extent that their income arose from asset management charges based on the value of assets in the fund.

Impairment of financial assets

The following table shows the amounts of 'debtors' and 'prepayments and accrued income', excluding deferred acquisition costs ("DAC") and 'deferred fees and charges' ("DFF") that are neither past due nor impaired, past due but not impaired, and those where provision for impairment has been made. No other financial assets were either past due or impaired at the end of the year (2016: £nil). However, some issuers of subordinated bonds in which the Company has holdings have suspended or announced that they intend to suspend the payment of coupons. Assets held in unit-linked funds have been excluded from the table because any losses will be borne by the policyholders.

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) **Credit risk (continued)**

As at 31 December 2017	**Debtors and prepayments and accrued income (excluding DAC and DFF)**
Financial assets neither past due nor impaired	100.0%
Financial assets that are past due:	
0-3 months past due	-
3-6 months past due	-
6-12 months past due	-
More than 12 months past due	-
Impaired financial assets for which provision is made	-
Total before provision for impairment (£m)	-

As at 31 December 2016	**Debtors and prepayments and accrued income (excluding DAC and DFF)**
Financial assets neither past due nor impaired	91.8%
Financial assets that are past due:	
0-3 months past due	2.1%
3-6 months past due	1.7%
6-12 months past due	4.1%
More than 12 months past due	0.0%
Impaired financial assets for which provision is made	0.3%
Total before provision for impairment (£m)	499

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(e) Liquidity risk

ALCO seeks to determine that the Company has sufficient financial resources to meet its obligations as they fall due.

Analysis of expected maturity of financial and insurance liabilities

The following table details the contractual net cash flows in respect of financial and insurance liabilities. Net cash flows are shown on an undiscounted basis. It is expected that surrenders, transfers and maturities in respect of technical provisions will occur over many years and the tables reflect these expected cash flows even though a significant proportion of the contracts (i.e. linked business) are payable on demand.

As at 31 December 2016		Undiscounted cash flows		
	Carrying value £m	Within 1 year or payable on demand £m	1-5 years £m	More than 5 years £m
Non-derivative financial liabilities				
Technical provisions	31,527	3,211	9,033	21,345
Technical provisions for linked liabilities	34,610	5,076	14,952	17,576
Creditors arising out of direct insurance operations	30	30	-	-
Creditors arising out of reinsurance operations	32	32	-	-
Other creditors (excluding derivative financial liabilities)	570	570	-	-
Accruals and deferred income	116	116	-	-
Derivative financial liabilities				
Interest and inflation rate swaps	507	4	38	458
Equity futures	39	39	-	-
Bond Futures	8	8	-	-
Forwards	8	8	-	-
Credit default swaps	63	-	62	-
Cross currency swaps	63	3	41	19

Amounts expected to be settled from the fund for future appropriations ("FFA") are excluded from the analysis above as there is no contractual obligation to settle the liability. Of the carrying amount on the balance sheet in respect of the FFA £nil (2016: £601m) is expected to be settled more than 12 months after the balance sheet date.

Amounts due to Group undertakings have been excluded from the analysis as they do not have any fixed repayment terms.

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(f) Life Insurance risk

(i) Type of risk

Life insurance risk includes mortality risk, morbidity risk, longevity risk, persistency risk, expense risk (including commissions) and policyholder behaviour risk around take-up of insurance guarantees and options.

Risk management

The Company had developed a policy for the management of life insurance risk and guidelines for the practical application of key areas of life insurance practice. The impact of life insurance risk was monitored by the Company as part of the control cycle of business management. Exposure was monitored through the assessment of liabilities, the asset liability management framework, operation of a deals governance framework that included economic capital assessments of insurance risk-related deals, profit reporting under IFRS, Stress & Scenario analysis, and the Internal Model process (the Standard Formula process is used for the With Profit funds).

Mortality and morbidity risks were mitigated by use of reinsurance. The Company assessed the risk exposures and monitored the aggregation of risk ceded to individual reinsurers.

Longevity risk was carefully monitored against the latest internal and external industry data and emerging trends.

Persistency risk was managed through frequent monitoring of Company experience, benchmarked against expectations. Where possible the financial impact of lapses was reduced through appropriate product design and risk management actions.

Expense risk was primarily managed through the assessment of profitability and frequent monitoring of expense levels.

In addition to economic capital modeling and Stress & Scenario analysis, SII reporting used sensitivity testing to measure the impact on the SII closing balance sheet due to exposure to life insurance risks. This enabled the Company to determine whether action was required to reduce risk, or whether that risk was within the overall risk appetite.

(ii) Concentration risk

The Company wrote a diverse mix of business that was subject to similar risks (mortality, persistency etc.). The Company assessed the relative costs and concentrations of each type of risk through the Internal Model (the Standard Formula process for the With Profit funds). This analysis enabled the Company to assess whether accumulations of risk exceeded risk appetite.

The main concentrations of insurance risk for the Company were persistency, mortality, morbidity and longevity. The Company continually monitored these risks and the opportunities for mitigating actions through reinsurance, improved asset liability matching, or innovative solutions that emerged in the market.

Internal Model analysis (the Standard Formula process for the With Profit funds) helped identify both concentrations of risk types and the benefits of diversification of risk.

27. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(f) Life Insurance risk (continued)

(iii) Embedded derivatives within insurance contracts

The Company had exposure to a variety of embedded derivatives within its long-term savings business due to product features offering varying degrees of guaranteed benefits at maturity or on early surrender, along with options to convert their benefits into different products on pre-agreed terms.

Examples of each type of embedded derivative affecting the Company were:

Options: call, put, surrender and maturity options, guaranteed annuity options, option to cease premium payment, options for withdrawals free of market value adjustment, annuity option, guaranteed insurability options;

Guarantees: embedded floor (guaranteed return), maturity guarantee, guaranteed death benefit, and guaranteed minimum rate of annuity payment;

Other: indexed interest or principal payments, maturity value, loyalty bonus.

The impact of these was reflected in the economic capital model reporting and managed as a part of the asset liability framework.

(g) Quantitative risk exposure

The Company used a number of sensitivity test based risk management tools to understand the volatility of earnings, the volatility of its capital requirements, and to manage its capital more efficiently. Primarily Stress & Scenario analysis and the Internal Model (the Standard Formula process for the With Profit funds) were used. Sensitivities to economic and operating experience were regularly produced on all of the Company's financial performance measurements to inform the Company's decision making and planning processes, and as part of the framework for identifying and quantifying the risks to which the Company was exposed.

Some results of sensitivity analysis for long-term business are set out below. For each sensitivity test the impact of a change in a single factor is shown, with other assumptions left unchanged. This reflects the sensitivity of profit and total equity in the non-profit and shareholder funds only. Profit in the with profit funds arises on the shareholders' share of bonuses paid on claims during the year or added to policies at the end of the year. Changes in the sensitivity factors will have no impact upon this figure.

Sensitivity Factor	Description of sensitivity factor applied
Interest rate and investment returns	The impact of a change in market interest rates by +/- 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6%). This test allows consistently for similar changes to investment returns and movements in the market value of fixed interest securities.
Expenses	The impact of an increase in maintenance expenses by 10%
Equity/ Property market values	The impact of a change in equity/ property market values by +/- 10%
Assurance mortality/ morbidity	The impact of an increase in mortality/ morbidity rates for assurance contracts by 5%
Annuitant mortality	The impact of a reduction in mortality rates for annuity contracts by 5%
Credit spreads	The impact of an increase in credit spreads by 0.5%

27. **RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

(g) **Quantitative risk exposure (continued)**

The above sensitivity factors are applied using actuarial and statistical models, with the following pre-tax impacts on UKGAAP profit and total equity at 31 December.

Impact on profit before tax and total equity before tax

2016	Interest rates +1% £m	Interest rates –1% £m	Equity/ property +10% £m	Equity/ property – 10% £m	Expenses +10% £m	Assurance mortality +5% £m	Annuitant mortality –5% £m	Credit spreads +0.5% £m
Insurance and investment liabilities	111	(136)	6	(22)	(86)	(25)	(136)	(135)
Assets backing shareholder funds	(40)	43	(101)	101	-	-	-	31
Total	**71**	**(93)**	**(95)**	**79**	**(86)**	**(25)**	**(136)**	**(104)**

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, such an occurrence is remote, due to correlations between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses did not take into consideration that the Company's assets and liabilities were actively managed and may be different at the time that any actual market movement occurs. Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Company's view of possible near-term market changes that cannot be predicted with any certainty, and the assumption that all interest rates move in an identical fashion.

28. PROVISIONS FOR OTHER RISKS

	2017 £m	2016 £m
Vacant properties		
At 1 January	-	2
Charge in year	-	-
Release in year	-	-
Utilised in year	-	(2)
At 31 December	-	-
Customer redress		
At 1 January	71	127
Charge in year	2	30
Release in year	(4)	(74)
Utilised in year	(11)	(12)
Transfer in year	20	-
Scheme transfer	(78)	-
At 31 December	-	71
Integration		
At 1 January	24	44
Charge in year	1	26
Release in year	-	-
Utilised in year	(25)	(46)
Scheme transfer	-	-
At 31 December	-	24
Other		
At 1 January	-	2
Charge in year	-	-
Release in year	-	(2)
Utilised in year	-	-
At 31 December	-	-
Total Provisions for Other Risks		
At 1 January	95	175
Charge in year	3	56
Release in year	(4)	(76)
Utilised in year	(36)	(60)
Transfer in year	20	-
Scheme transfer	(78)	-
At 31 December	-	95

Of the above total £nil (2016: £9m) is expected to be paid more than one year after the balance sheet date.

Vacant properties
The Company held leases for a number of vacant and sub-let properties previously occupied by the Group. Provision had been made for the residual lease commitments and for other outgoings where significant, after taking into account the existing and expected sub-tenant arrangements. The remaining terms of the leases were up to 10 years. Assumptions as to whether each leasehold property may be sub-let or assigned in the future were made.

Customer redress
These provisions related to the estimated likely cost of redress, including compensation and professional fees expected to arise as a result of reviewing administrative procedures. Provisions related to certain aspects of the administration by the Company of defined benefit schemes have been fully released during 2016.

28. PROVISIONS FOR OTHER RISKS (continued)

Integration

The provision was established during 2015 to cover specific costs associated with the integration activities of the business from Friends Life Group into the Aviva Group. At 31 December 2016 the provision predominantly relates to break fees payable in respect of historic investment management contracts. The provision was substantively utilised during 2017 prior to the Scheme transfer.

29. OTHER CREDITORS INCLUDING TAXATION AND SOCIAL SECURITY

	2017 £m	2016 £m
Amounts falling due within one year		
Taxation	-	188
Amounts due to Group undertakings	-	92
Derivative financial instruments	-	70
Other creditors	-	276
	-	626

	2017 £m	2016 £m
Amounts falling due after one year		
Taxation	-	16
Derivative financial instruments	-	602
	-	618

30. GUARANTEES

(a) **6.875% Step-up Tier one Insurance Capital Securities ("STICS") issued by FLH ("2003 STICS")**

On 21 November 2003 FPL issued £300m of STICS which bear interest from 21 November 2003 to 20 November 2019 at a rate of 6.875%. The 2003 STICS have no maturity date but are redeemable at the option of the issuer on 21 November 2019 and thereafter on the coupon payment date falling on or nearest successive fifth anniversaries of this date. The 2003 STICS are perpetual securities and are not redeemable at the option of the holder at any time.

On 6 July 2009, as part of a reorganisation of the Group, Friends Life FPG Limited ("FPG") was substituted for FPL as the issuer of the 2003 STICS. On 14 December 2010, as part of a restructuring of the Group, FLH was substituted for FPG as the issuer of the 2003 STICS. On 2 October 2015, as part of a restructuring of the Group, the 2003 STICS were transferred from FLH to Aviva plc.

The 2003 STICS were irrevocably guaranteed on a subordinated basis by the Company, but as a result of the Scheme transfer as at 31 December 2017 the STICS are guaranteed by UKLAP.

The guarantee was intended to provide the holder with rights against the Company in respect of the guaranteed payments which were as nearly as possible equivalent to those which they would have had if the 2003 STICS had been directly issued preference shares of the Company.

This guarantee did not meet the definition of a financial guarantee under IAS 39 *Financial instruments – recognition and measurement*, as the Company was able to defer its obligation to make payments under the guarantee to holders of STICS for an unlimited period, and the holders have no right to enforce the obligation on the Company.

30. GUARANTEES (continued)

(b) Other guarantees in respect of FLH debt

The Company had irrevocably guaranteed (on a subordinated basis) the interest and principal payments in respect of the £162m subordinated debt issued by Friends Life FPG Limited in May 2009 but now transferred to FLH. The principal is due to be repaid in 2021.

On 21 April 2011, FLH issued a £500m external Lower Tier 2 ("LT2") debt instrument with a coupon of 8.25% and a maturity of 2022. Interest and principal payments in respect of this LT2 debt were irrevocably guaranteed on a subordinated basis by the Company.

On 8 November 2012, FLH issued a US$575m Upper Tier 2 ("UT2") reset perpetual subordinated debt instrument with a coupon of 7.875%. The interest payments on this debt were irrevocably guaranteed on a subordinated basis by the Company.

As at 31 December 2017, following the Scheme transfer, these guarantees have transferred from the Company to UKLAP.

The possibility of the Company having to make payments under the guarantees was considered to be very remote and as such no amounts for the guarantees were provided under IAS 39.

31. PENSION OBLIGATIONS

Prior to the Scheme transfer on 1 October 2017 the Company was charged management fees by AMSUKL in relation to monthly deficit recovery contributions made into the Friends Provident Pension Scheme ('FPPS'), a defined benefit pension scheme. In total management fees of £29m (2016: £50m) in respect of the deficit recovery contributions made into the FPPS were charged to the Company and have been recorded as administrative expenses.

In the absence of any contractual arrangements or stated policy to allocate the net defined benefit cost for the FPPS, measured in accordance with IAS 19 *Employee Benefits*, to individual businesses it is Aviva Group's policy to allocate this cost fully to AES (the statutory employer of the FPPS). The pension surplus/deficit, calculated in accordance with IAS 19 as required under FRS 101, is reflected within the balance sheet of AES. The cost recognised by the Company is equal to its contribution payable for the period.

The disclosures required by IAS 19 in respect of group pension plans where there are no contractual arrangements or stated policy to allocate the net defined benefit cost are set out in this note. Given that post the Scheme transfer the Company is no longer bearing the costs of deficit reduction contributions these disclosures are provided for 2016 only.

The assets of the FPPS are held in separate trustee-administered funds to meet long-term pension liabilities to past and present employees. The appointment of trustees is determined by trust documentation. Trustees are required to act in the best interests of the scheme's beneficiaries. The long-term investment objectives of the trustees and the employer are to limit the risk of the assets failing to meet the liabilities of the scheme over the long term, and to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the scheme. The scheme operates within the UK pensions' regulatory framework. A full actuarial valuation of the defined benefit scheme is carried out at least every three years for the benefit of scheme trustees and members. The FPPS has been closed to new members since 1 July 2007 and was closed to active membership on 31 December 2012.

On 4 January 2016 the FPPS Trustees signed a new deficit recovery plan and supporting schedule of contributions which requires contributions of £43m from January 2016 to September 2016 and from October 2016 to December 2019 at a fixed rate of £43m per annum until the scheme is at least 100% funded on a technical provisions basis.

31. PENSION OBLIGATIONS (continued)

In addition to the management fees incurred in respect of deficit recovery contributions made into the FPPS, the Company also incurs management fees in respect of contributions made by Group service companies into defined contribution arrangements.

(a) Net pension deficit/surplus

The net pension asset reflected within the balance sheet of AES was £161m . The movements in the scheme liabilities and assets are as follows:

(i) Changes in the present value of obligations

	2016 £m
Present value of obligations at 1 January	1,376
Interest cost	50
Actuarial losses	449
Benefits paid	(71)
Present value of obligations at 31 December	1,804
Analysed	
Wholly or partly funded plans	1,804

(ii) Changes in the present value of defined benefit plan assets

	2016 £m
Fair value of plan assets at 1 January	1,541
Actual return on plan assets	440
Administrative expenses paid	(2)
Employer contributions	57
Benefits paid	(71)
Fair value of plan assets at 31 December	1,965

(b) Scheme Assets

Total scheme assets are analysed as follows.

	Total quoted £m	Total other £m	2016 Total £m
Bonds	1,022	-	1,022
Equities	71	-	71
Pooled investment vehicles	-	441	441
Derivatives	64	-	64
Insurance policy	-	633	633
Cash and other	(266)	-	(266)
Total market value	891	1,074	1,965

31. PENSION OBLIGATIONS (continued)

(c) Actuarial Assumptions

The valuation used for accounting under IAS 19 at 31 December 2016 was based on the most recent full actuarial valuations updated to take account of the standard's requirements in order to assess the liabilities at 31 December 2016.

Projected unit credit methodology

The inherent uncertainties affecting the measurement of scheme liabilities require these to be measured on an actuarial basis. This involved discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit credit methodology. This is an accrued benefits valuation method which calculates the past service liability to members and makes allowance for their projected future earnings. It is based on a number of actuarial assumptions, which vary according to the economic conditions. Changes in these assumptions can materially affect the measurement of the pension obligations.

Financial assumptions

The main financial assumptions used to calculate scheme liabilities under IAS 19 were:

	2016 %
Rate of increase in pensions in payment	Relevant inflation assumption with Black-Scholes Model and Caps and Floors
Rate of increase for deferred benefits	RPI assumption less deduction of 1.1% at all terms
RPI Inflation	3.33
Discount rate for active and deferred members	2.60
Discount rate for pensioners	2.50
Single equivalent discount rate	2.55

31. PENSION OBLIGATIONS (continued)

(c) Actuarial Assumptions (continued)

Mortality Assumptions

Mortality assumptions are significant in measuring the obligations under the FPPS defined benefit scheme. The assumptions are summarised in the table below and have been selected to reflect the characteristics and experience of the membership of the scheme.

The mortality tables, average life expectancy and pension duration used at 31 December 2016 for scheme members are as follows:

		Life expectancy / (pension duration) at NRA of a male		Life expectancy / (pension duration) at NRA of a female	
	Normal retirement age (NRA)	Currently aged NRA	20 years younger than NRA	Currently aged NRA	20 years younger than NRA
SAPS including allowances for future improvement	60	89.1 (29.1)	91.2 (31.2)	89.7 (29.7)	92.0 (32.0)

For deferred pensioners the mortality table adopted is "SAPS Pensioners" with a 90% multiplier for males and a 100% multiplier for females both with CMI 2015 central improvements with a long term trend of 1.75% for males and 1.50% for females.

For pensioners the mortality table adopted is "SAPS Pensioners" with an 83% multiplier for males and a 98% multiplier for females both with CMI 2015 central improvements with a long term trend of 1.75% for males and 1.50% for females.

The tables make allowance for observed variations in such factors as age, gender, pension amount, salary and postcode-based lifestyle group, and have been adjusted to reflect recent research into mortality experience. However, the extent of future improvements in longevity is subject to considerable uncertainty.

Sensitivity analysis

Significant actuarial assumptions for the determination of the defined benefit obligation are discount rate, inflation rate and longevity. The sensitivity analyses below have been determined based on reasonable possible changes of the respective assumptions, holding all other assumptions constant.

Assumption	Increase in assumption	Impact on scheme liabilities
Inflation	Increase by 1.0%	£289m
Inflation	Decrease by 1.0%	£(247m)
Discount rate	Increase by 1.0%	£(129m)
Discount rate	Decrease by 1.0%	£184m
Longevity assumption	Increase by 1 year	£36m

The sensitivity analyses presented above may not be representative as in practice it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated. In addition, the sensitivities shown are for liabilities only and ignore the impact on assets, which would significantly mitigate the net interest rate and inflation sensitivity impact on the net surplus.

31. PENSION OBLIGATIONS (continued)

(c) Actuarial Assumptions (continued)

Maturity profile of the defined benefit obligation

The maturity profile of the defined benefit obligation as at 31 December 2016 was as follows:

	£m
Expected benefit payments during fiscal year ending 31 December 2017	37
Expected benefit payments during fiscal year ending 31 December 2018	40
Expected benefit payments during fiscal year ending 31 December 2019	43
Expected benefit payments during fiscal year ending 31 December 2020	46
Expected benefit payments during fiscal year ending 31 December 2021	47
Expected benefit payments during fiscal years ending 31 December 2022 to 31 December 2026	288

(d) Risk Management

The risk management approach in relation to the FPPS during 2016 was set out in the 2016 Report and Financial Statements of the Company.

32. DIRECTORS' EMOLUMENTS

Emoluments of directors in office during 2017 were:

	2017 £'000	2016 £'000
Aggregate emoluments in respect of qualifying services	**3,384**	3,006
Pension	**320**	331
Termination benefits	**-**	-
Emoluments of the highest paid director:		
Aggregate emoluments in respect of qualifying services	**1,801**	1,698
Pension	**203**	198
Accrued pension at end of year from defined benefit pension scheme	**-**	-

Where directors have multiple directorships, it is not possible to accurately apportion their emoluments to individual companies. The emoluments of directors reported in the above table are in respect of qualifying services performed for the Aviva Group, which may also be disclosed within the financial statements of other Aviva Group companies.

The highest paid director during the year received shares under the executive long-term incentive scheme.

Certain of the directors are covered by private medical insurance provided by Aviva Insurance UK Limited. Payments may be made to, or on behalf of, directors, subject to the normal policy rules.

Pension contributions consist of employer contributions into the money purchase section of the Aviva Staff Pension Scheme, excluding salary exchange contributions made by the employees, plus payments in lieu of pension above the lifetime or annual allowance caps.

During the year, 1 of the directors exercised share options (2016: 3) and 2 of the directors received shares under long term incentive schemes (2016: 2).

33. RELATED PARTY TRANSACTIONS

The Company is a wholly owned subsidiary undertaking of Aviva plc. The results of both the Company and its subsidiaries are consolidated in the results of Aviva plc, the Company's ultimate parent and controlling company, whose financial statements are publicly available. Under FRS 101 the Company is exempt from the requirements of IAS 24 Related Party Disclosures, concerning the disclosure of transactions entered into between two or more members of a group provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

A number of key management personnel, and their close families, have long-term insurance policies with the Company. Such policies are on normal commercial terms which are also available to other members of staff. Under FRS 101 the company is exempt from disclosing the key management compensation.

34. CONTINGENT LIABILITIES

The exposure to contingent liabilities arising from the Company's historic business has been transferred to UKLAP at 1 October 2017 under the terms of the Scheme as disclosed in the Strategic Report. As such the Company is not considered to have any contingent liabilities requiring disclosure as at 31 December 2017.

The Company made the following disclosure in respect of contingent liabilities as at 31 December 2016:

In the normal course of its business, the Company is subject to matters of litigation or dispute. While there can be no assurances, at this time the directors believe, based on the information currently available to them, that it is not probable that the ultimate outcome of these will have a material adverse effect on the financial condition of the Company.

FLL is the indemnifying party of AAL which currently acts as a distributor and third party administrator for FLL's products and services. This indemnity is provided in the event of AAL becoming insolvent, to meet and deal with any civil liability which AAL has incurred to investors in the course of its relevant business, for as long as AAL remains in its role. Furthermore, FLL indemnifies AAL from any liability which it may incur to investors in connection with the marketing of investments to which AAL is party or with which AAL is connected, whether as an insurer, adviser, operator or otherwise. There is not limit of liability under this indemnity.

35. COMMITMENTS

Commitments have been transferred to UKLAP at 1 October 2017 under the terms of the Scheme transfer as disclosed in the Report of the Directors. The Company disclosed the following commitments as at 31 December 2016:

The Company had investment property commitments of £29m relating to on-going construction, renovation costs and costs of acquiring existing properties.

The Company had potential commitments of £206m to venture capital vehicles (partnerships and similar vehicles) that allow exposure to private equity investments in UK, US and European markets. All investments are held under agreements between the private equity managers and the Company which have committed the Company to providing an agreed maximum level of funding to the managers to invest. As at 31 December 2016 there were still funds that had yet to be utilised that, under the agreements, are still available to the private equity managers and hence are classified as potential commitments.

36. ULTIMATE PARENT UNDERTAKING

The Company's ultimate parent undertaking is Aviva plc. Copies of the Group Report and Financial Statements of Aviva plc can be viewed via its website at www.aviva.com.

37. SCHEME TRANSFER OF BUSINESS

On 1 October 2017, as disclosed in the Strategic Report, all the assets and liabilities of the Company except for £10m to cover the Company's capital requirement until de-authorisation, were transferred under the Scheme into UKLAP. No consideration was paid by UKLAP to the Company in respect of this transfer.
The Part VII Transfer during the year is considered to meet the definition of business combinations under common control which are scoped out of the requirements of IFRS 3 Business Combinations. The approach applied in respect of these transfers has been to recognise a loss directly in the statement of changes in equity for the net value of assets and liabilities transferred. The value of assets and liabilities transferred has been determined using the carrying value of the assets and liabilities.

The following table summarises the value of assets and liabilities transferred.

	£m
Long term insurance business	
Present value of acquired in-force business	13
Land and buildings	1,004
Investments in Group undertakings and participating interests	2,094
Other financial investments	23,200
Assets held to cover linked liabilities	27,288
Reinsurers' share of long-term business provision	1,258
Reinsurers' share of claims outstanding	61
Reinsurers' share of technical provisions for linked liabilities	6,690
Debtors	435
Other assets	4,937
Prepayments and accrued income	689
Fund for future appropriations	(665)
Long-term business provision	(29,847)
Claims outstanding	(424)
Technical provision for linked liabilities	(33,978)
Provisions for other risks and charges	(315)
Creditors	(1,103)
Accruals and deferred income	(108)
Loss on the Scheme transfer	1,229
Shareholders' fund	
Financial Investments	211
Other Assets	428
Subordinated Liabilities	(886)
Other Liabilities	(2)
Gain on the Scheme transfer	(249)
Total loss on the Scheme transfer (recognised in Statement of changes in equity)	(980)

In addition to the above the Scheme resulted in the transfer of £495m of STICS which were previously disclosed as Other equity reserves of the Company. No consideration was paid in respect of the transfer of these STICS resulting in the recognition of a £495m gain which has been reported directly in the Statement of changes in equity. This gain offsets the impact of the de-recognition of the STICS balance from Other equity reserves which has also been reported directly in the Statement of changes in equity.

Following the transfer of business the Company ceased trading. Consequently all amounts included in the profit and loss account are in respect of discontinued operations.