05935873

LEGAL & GENERAL

PENSIONS LIMITED

REPORT AND ACCOUNTS

2010

LEGAL & GENERAL PENSIONS LIMITED
CONTENTS

Page

Registered Office
One Coleman Street
London EC2R 5AA

Registered in England and Wales No 05935873

The directors submit their annual report together with the audited financial statements of Legal & General Pensions Limited (the Company) for the year ended 31 December 2010

Principal activities

The Company is a wholly owned subsidiary of Legal & General Assurance Society Limited (Society) The principal activity of the Company is the transaction of long term reinsurance business in the UK and Ireland, with one main transaction with Society Whilst the principal activity of Society is life and pensions business. The Company is an Insurance Special Purpose Vehicle (ISPV) and therefore has no formal requirement to hold a regulatory solvency margin

Review of business and future outlook

The Company forms a material part of the activities of Legal & General Group Plc (the Group) and on this basis the review of business that is presented in the Group's financial statements is not duplicated here This information can be found within the Directors' Report included within the financial statements of the Group report and accounts The 2011 economic climate remains uncertain, but are confident that we are well positioned to exploit opportunities throughout the current economic cycle

Principal risks and uncertainties

The Company's business involves the acceptance and management of risks in respect of the non profit pensions and annuity business of Society A detailed review of the Company's exposure to risks, together with the framework for their management is set out on pages 37 to 49 of the financial statements The principal risks and uncertainties facing the Company are

1) Regulation and legislation

The markets in which the Company operates are highly regulated, with regulation defining the overall framework for the design, marketing and distribution of products, the acceptance and administration of business, and the prudential capital that regulated companies should hold Government fiscal policy may also influence the design of products, the retention of existing business and the required reserves for future liabilities

The Company bases its business strategy upon prevailing legislation and regulation, and known/anticipated change To mitigate the risk the Company engages with legislative authorities where appropriate to assist in the evaluation of change on the sector and its stakeholders However, sudden changes and/or retrospection in legislation and fiscal policy, or the differing interpretation and application of regulation over time, may have a detrimental effect on the delivery of the Company's strategy and profitability

2) UK financial services sector contagion risks

As a significant participant in the UK retail financial services sector, the earnings of the Company are influenced by the perception and confidence of the retail investor with the sector as a whole Participation in the Financial Services Compensation Scheme may also impact the Group should other financial services organisations fail

The Company seeks to differentiate itself from its competitors, however factors such as investment market performance, actions by regulators and shock events, such as significant market failures, can impact the confidence of retail investors and the timing of their purchase of financial service products

3) Financial market and economic conditions

The Company holds a broad range of investment assets to meet the obligations arising from writing insurance business The performance and liquidity of investment markets, interest rate movements and inflation can impact the value of these assets as well as the value of the underlying obligations A potential mismatch of assets and liabilities may impact the earnings, profitability and the capital requirements of the Company

The Company seeks to broadly match asset and liability cash flows to reduce the impact of changing economic conditions Additionally a range of risk management strategies are used to manage volatility in returns from investment assets and the broader effects of adverse market conditions The effect of market and economic conditions upon fee income and the timing of the purchase and retention of retail investment products are mitigated through utilisation of a low cost scalable business model and by maintaining a diversified portfolio of products

4) Counterparty and third party risks

The Company is exposed to default risk in respect of the issuers of corporate debt and financial instruments, through investment market and reassurance transactions and as part of its banking arrangements Counterparty risk may also arise in the investment settlement process and from custodian services Third party risk arises with regard to reliance upon external suppliers of certain administration and IT services

The Company seeks to limit the potential exposure to loss from counterparty and third party failure through pre-selection criteria for those counterparties with which it will do business, the setting of pre-defined risk based exposure limits, and the active management of positions Specific provisions are also made for defaults which help mitigate financial impacts should a counterparty fail However, in extreme circumstances, an event causing widespread default may impact the Company's profitability, whilst the loss of crucial suppliers may impact operational effectiveness

5) Mortality and other insurance assumption uncertainties

In addition to pricing for mortality and catastrophe risk, as part of the process to determine long term liabilities the Company makes assumptions in respect of other factors including persistency, valuation interest rates and credit defaults within its investment portfolio In 2010 the Company continued to hold reserves to protect against the risk of credit default For approved securities and swaps backing non profit business, the allowance remains at 3bps per annum (2009 3bps) For unapproved securities backing non profit annuity business the credit default allowances equate to £1 5bn, or 64bps per annum (2009 £1 5bn and 68bps respectively) when expressed over the duration of the assets held

The Company believes its total corporate default-related provision is prudent to cover all reasonably foreseeable circumstances

For equity investments, the yield is based on current dividend yield, adjusted for prudence For property holdings, yields are based on the rental income payable calculated by considering different categories of tenant separately, adjusted for the possibility of default Default rates used in the calculations vary by tenant category

Processes are in place to ensure that assumptions are subject to critical challenge, with potential variances from assumptions being stress tested as part of the Company's processes to assess adequacy of prudential capital However, extreme shifts in financial markets of the broader economic environment may require certain assumptions to be recalibrated impacting the Company's profitability

6) Industry Change

The Company may not maximise opportunities from structural and other changes within the financial services sector

The financial services sector continues to go through a period of change This presents a range of challenges as well as opportunities to providers of sufficient scale such as the Company Significant changes in the markets in which we operate may require the review and re-alignment of elements of our business strategy A failure to be sufficiently responsive to potential change and understand the implication to our businesses, or the incorrect execution of change may impact the achievement of our strategic objectives We seek to ensure we have market leading expertise in the core fields in which we operate, and actively focus on retaining the best personnel with the knowledge to design and support our products, and manage their evolution as market and consumer requirements change

Key performance indicators

The directors review a range of performance indicators in monitoring the performance of the Company with the following regarded as key performance indicators

Profit before tax £397m (2009 £537m) - This measures the profit or loss in a single period before deducting tax This gives an insight into the Company's ability to generate cash flows to support dividends during a period

Shareholder funds £981m (2009 £698m) - This represents the net assets that remain once all the Company's liabilities have been accounted for It also equates to the capital of the Company

Further details of the Group's key performance indicators can be found in the Group's published financial statements

Results for the year and dividend

The results for the year are set out on pages 8 to 12

The directors do not recommend the payment of a final dividend There was no interim dividend, bringing the total for the year to £nil (2009 £nil)

Directorate

The directors of the Company, who served during the period, together with their dates of appointment and resignation, where appropriate, are shown below

N D Wilson (Chairman)

J B Pollock

S B Gadd

Financial risk management objectives

The Company's exposure to financial risk through its financial assets and liabilities is provided in detail in Note 25 of the financial statements

Creditors

Legal & General Group Plc agrees terms and conditions for its business transactions with suppliers Payment is made in accordance with these terms provided the supplier meets its obligations As at 31 December 2010, the average number of days of payments outstanding for the Legal & General group of companies was 34 days (2009 33)

Directors' Indemnity and Insurance

As permitted by the Articles of Association, the Directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006 The indemnity was in force throughout the last financial year and is currently in force The ultimate parent company, Legal & General Group Plc, maintains an appropriate level of Directors' and Officers' liability insurance which is reviewed annually

Auditors

The Company has appointed PricewaterhouseCoopers LLP as auditor

There is no requirement under the Companies Act or the Company's articles of association to hold an Annual General Meeting or lay the Company's Report and Accounts before the shareholders

Statement of Directors' Responsibilities

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

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards 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 of 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 apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- 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

In accordance with Section 418, each director in office at the date the directors' report is approved, confirms that

(a) so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware, and

(b) he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

By Order of the Board

Andrew D Fairhurst

A D Fairhurst
On behalf of Legal & General Co Sec Limited
Company Secretary
15 March 2011

LEGAL & GENERAL PENSIONS LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LEGAL & GENERAL PENSIONS LIMITED

We have audited the financial statements of Legal & General Pensions Limited for the year ended 31 December 2010 which comprise the Profit and Loss Account, the Balance Sheet, the Reconciliation of Movements in Shareholders' Funds and the related notes The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2010 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LEGAL & GENERAL PENSIONS LIMITED

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches visited not by us, or

- the financial statements are not in agreement with the accounting records and returns, or

- certain disclosures of directors' remuneration specified by law are not made, or

- we have not received all the information and explanations we require for our audit

Richard Keers (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
15 March 2011

Company No 05935873

LEGAL & GENERAL PENSIONS LIMITED
PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2010

Technical account - Long-term business
Continuing operations

	Notes	2010 £m	2010 £m	2009 £m	2009 £m
Earned premiums, net of reinsurance					
Gross premiums written	2(i)		**3,529**		2,748
Investment income	3		**1,188**		1,505
Unrealised gains on investments	3		**1,193**		1,350
			5,910		5,603
Claims incurred, net of reinsurance					
Claims paid			**(2,535)**		(1,974)
Change in other technical provisions, net of reinsurance					
Long term business provision		**(2,188)**		(2,199)	
Other technical provisions, net of reinsurance					
Technical provisions for linked liabilities		**(644)**		(885)	
			(2,832)		(3,084)
Net operating expenses	4		**(165)**		(151)
Investment expenses and charges	3		**(39)**		(40)
Tax charge attributable to the long term business	5		**(101)**		(82)
			(5,672)		(5,331)
Balance on the technical account - long-term business			**238**		272

Company No 05935873

LEGAL & GENERAL PENSIONS LIMITED
PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2010

Non-technical account
Continuing operations

	Notes	2010 £m	2010 £m	2009 £m	2009 £m
Balance on the long-term business technical account		**238**		272	
Tax charge attributable to balance on the long term business technical account	5	**92**		106	
			330		378
Investment income		**54**		122	
Unrealised gains on investments		**14**		38	
Investment expenses and charges		**(1)**		(1)	
	3		**67**		159
Profit on ordinary activities before tax			**397**		537
Tax on (profit) on ordinary activities	5		**(114)**		(52)
Profit for the financial year			**283**		485
Retained profit			**283**		485

The notes on pages 13 to 50 form part of the financial statements

The Company has no recognised gains and losses other than those included in the results above, and therefore no separate statement of total recognised gains and losses has been presented

All results derive from continuing operations

Company No 05935873

LEGAL & GENERAL PENSIONS LIMITED
BALANCE SHEET

As at 31 December 2010

Assets	Notes	**2010 £m**	**2010 £m**	2009 £m	2009 £m
Investments					
Land and buildings	8		**130**		-
Financial investments	6		**18,269**		16,467
Assets held to cover linked liabilities	6		**7,365**		6,650
Other debtors	14	**286**		366	
			286		366
Other assets					
Cash at bank and in hand		**156**		81	
			156		81
Prepayments and accrued income					
Deferred acquisition costs	11	**90**		87	
Other prepayments and accrued income		**5**		3	
			95		90
Total assets			**26,301**		23,654

LEGAL & GENERAL PENSIONS LIMITED
BALANCE SHEET

As at 31 December 2010

Liabilities	Notes	2010 £m	2010 £m	2009 £m	2009 £m
Capital and reserves					
Called up share capital	9	**300**		300	
Profit and loss account	10	**681**		398	
Total shareholders' funds			**981**		698
Technical provisions					
Long-term business provision	12	**16,670**		14,482	
Technical provisions for linked liabilities	12	**6,752**		6,108	
			23,422		20,590
Creditors amounts falling due within one year					
Amounts owed to credit institutions	15	-		9	
Other creditors including taxation and social security	16	**1,307**		1,376	
			1,307		1,385
Creditors amounts falling due after more than one year					
Contingent loan	17		**591**		981
Total liabilities			**26,301**		23,654

The notes on pages 13 to 50 form part of the financial statements

The financial statements on pages 8 to 50 were approved by the directors on 15 March 2011 and were signed on their behalf by

N. D. Wilson, Chairman

J. B. Pollock, Director

Registered No 05935873
One Coleman Street
London
EC2R 5AA

Company No 05935873

LEGAL & GENERAL PENSIONS LIMITED
RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

For the year ended 31 December 2010

	Notes	**2010 £m**	2009 £m
As at 1 January		**698**	(387)
Profit / (loss) for the penod		**283**	485
Capıtal contnbutıon receıved	10	-	600
As at 31 December		**981**	698

In March 2009 the Company receıved a capıtal contnbutıon of £600m from ıts parent company, Socıety to ımprove ıts capıtal posıtıon

1. Accounting policies

(a) Basis of preparation

These financial statements have been prepared under the provisions of the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 relating to insurance companies except with regard to the non depreciation of investment properties

These financial statements conform to the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business (SORP) issued in December 2005 and revised in December 2006

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of land and buildings and financial assets and liabilities (including derivative instruments) at fair value through profit and loss

Compliance with Statement of Standard Accounting Practice ('SSAP') 19 'Accounting for investment properties' requires departure from the requirement of the Companies Act 2006 relating to depreciation and an explanation of the departure is given in Accounting policy 1(c) "Investments" below

In accordance with accounting standard FRS 1, 'Cash Flow Statements (Revised 1996)', the Company has not prepared a cash flow statement as the ultimate holding company, Legal & General Group Plc, has included a group cash flow statement in its financial statements

Use of estimates

The preparation of the financial statements includes the use of estimates and assumptions which affect items reported in the balance sheet and profit and loss account and the disclosure of contingent assets and liabilities at the date of the financial statements Although these estimates are based on management's best knowledge of current circumstances and future events and actions, actual results may differ from those estimates, possibly significantly They are particularly relevant to the estimation of insurance and investment contract liabilities and associated balances, deferred acquisition costs, tax liabilities and the determination of fair values of unquoted financial investments and investment properties The significant estimates and assumptions used are disclosed in the relevant notes to these financial statements, including Note 13 on Long-term Insurance valuation assumptions

(b) Long term business

Product classification

The products and reinsurance arrangements are classified for accounting purposes as either insurance contracts (participating and non-participating) or investment contracts (participating and non-participating) Insurance contracts are contracts which transfer significant insurance risk to the insurer at the inception of the contract Contracts which do not transfer significant insurance risk to the insurer are investment contracts Both insurance and investment contracts may contain a discretionary participating feature which is defined as a contractual right to receive additional benefits as a supplement to guaranteed benefits These are referred to as participating contracts The Company only has one contract with Society which is considered to transfer significant risk

Hybrid contract types, containing both insurance and investment features, have been treated as investment contracts when accounting for premiums, claims and other revenue This accounting treatment does not comply with the Association of British Insurers' SORP, but it ensures that participating investment contracts are treated consistently with other investment contracts and with the Group's accounting policy in this area

1. Accounting policies (continued)

(b) Long term business (continued)

Premium income

Gross premiums written comprise all amounts receivable during the period in respect of inwards reinsurance contracts entered into, which are accounted for when due for payment

Acquisition costs

Acquisition costs comprise direct costs, such as initial commission, and the indirect costs of obtaining and processing new business

Acquisition costs, which are incurred during a financial period, are deferred to the extent that they are recoverable out of future revenue margins Deferral is effected by the use of an explicit asset which is amortised over the period during which the costs are expected to be recoverable, and in accordance with the incidence of future related margins All other costs are recognised as expenses when incurred

Claims

Gross claims incurred comprise all claims and claims handling costs paid in the period and the movement in the provision for claims outstanding Claims include maturities and annuities due for payment and claims and surrenders notified at the balance sheet date and payable during the period Future payments under annuity contracts are held within Long Term Business Provision Provision is made at the balance sheet date for the cost of all claims incurred and reported at that date together with related claims handling expenses less amounts already paid

Long term business provision

The provision is determined following an annual investigation of the long term business The provision is calculated on the basis of current information and using the gross premium valuation method This includes an assessment of the cost of any future options and guarantees included in this business on a market consistent basis

Long term insurance provisions are established on the basis of current information Such provisions are subject to subsequent reassessment as changes to underlying factors such as mortality and morbidity occur These factors are discussed in more detail in Note 13

Tax

The balance of the Technical Account - Long Term Business is subject to a notional gross up at the corporate tax rate applicable for the period

(c) Investments

Land and buildings

Land and buildings, which are held for long term rental yields and capital growth are carried at fair value with changes in fair value recognised in the profit and loss account within investment income Land and buildings in the UK are valued bi-annually by external chartered surveyors at open market values in accordance with the 'Appraisal and Valuation Manual' of The Royal Institution of Chartered Surveyors Outside the UK, valuations are produced in conjunction with external qualified professional valuers in the countries concerned In the event of a material change in market conditions between the valuation date and balance sheet date, an internal valuation is performed and adjustments made to reflect any material changes in fair value.

1. Accounting policies (continued)

(c) Investments

Land and buildings (continued)

In accordance with SSAP 19, no depreciation or amortisation is provided in respect of freehold investment properties and leasehold investment properties with over 20 years to run The requirement of the Companies Act 2006 is to depreciate all properties This requirement conflicts with the generally accepted accounting principle set out in SSAP 19 The directors consider that, as these properties are held for investment, to depreciate them would not give a true and fair view, and that it it is necessary to adopt SSAP 19 in order to give a true and fair view Depreciation is only one of the factors reflected in the annual valuations, and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified

Financial investments

The Company classifies its financial investments on initial recognition as either Held For Trading (HFT), designated at Fair Value Through Profit or Loss (FVTPL), or Loans and Receivables Initial recognition of financial investments is on the trade date

Certain financial investments held by the Company are designated as FVTPL as their performance is evaluated on a total return basis, consistent with asset performance reporting to the Board of Directors and the Company's investment strategy Assets designated as FVTPL include debt securities and equity instruments which would otherwise have been classified as available for sale

The Company determines the fair values of certain financial assets and liabilities based on quoted market prices, where available The Company also determines fair value based on estimated cash flows discounted at the appropriate current market rate As appropriate, fair values reflect adjustments for counterparty credit quality, the Company's credit standing, liquidity and risk margins on observable inputs

Fair value measurements are based on observable and unobservable inputs Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's view of market assumptions in the absence of observable market information The Company utilises valuation techniques that maximise the use of observable inputs The levels of fair value measurement bases and principal asset classifications are defined as follows

Tier	***Principal asset classifications***	***Fair value measurement basis***
Level 1	listed equity instruments, government and certain supranational institution bonds and exchange traded futures and options	quoted prices (unadjusted) in active markets for identical assets and liabilities
Level 2	listed corporate bonds, commercial paper, derivative instruments which are not exchange traded and asset backed securities including collateralised debt obligations	valuation techniques for all inputs significant to the measurement other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i e as prices) or indirectly (i e derived from prices)
Level 3	unquoted equities, including investments in infrequently traded property unit trusts	valuation techniques for any input for the asset or liability significant to the measurement that is not based on observable market data (unobservable inputs)

1. Accounting policies (continued)

(c) Investments (Continued)

Financial investments classified as HFT and FVTPL are measured at fair value with gains and losses reflected in the profit and loss account

Loans and receivables are initially measured at fair value less acquisition costs, and subsequently measured at amortised cost using the effective interest rate method

(d) Impairment policy

The Company reviews the carrying value of its assets (other than those held at FVTPL) at each balance sheet date If the carrying value of a financial asset is impaired, the carrying value is reduced through a charge to the profit and loss account There must be objective evidence of impairment as a result of one or more events which occurred after the initial recognition of the asset Impairment is only recognised if the loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated -

Assets which are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable The recoverable amount is the higher of an asset's fair value less costs to sell and value in use

(e) Derivative financial instruments

Derivatives are initially recognised at purchase price on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value Changes in the fair value are recognised immediately in the profit and loss account Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models, as appropriate All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i e the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i e without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

Cash inflows and outflows are presented on a net basis where the Company has a legally enforceable right of offset and the intention to settle on a net basis

(f) Embedded derivatives

Where the risks and characteristics of derivatives embedded in other contracts are not closely related to those of the host contract and the whole contract is not carried at fair value, the derivative is separated from that host contract and measured at fair value, with fair value movements reflected within investment income, in the profit and loss account

1. Accounting policies (continued)

(g) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs Borrowings classified as liabilities are subsequently stated at amortised cost Borrowings include the contingent loan owed to Society The difference between the proceeds and the redemption value is recognised in the profit and loss account over the borrowing period using the effective interest rate method

(h) Investment return

The reporting of investment return comprises investment income, realised gains and losses from all financial assets and unrealised gains and losses from financial investments held at FVTPL Investment income includes dividends, interest and rent Dividends are accrued on an ex-dividend basis Interest is included on an accruals basis Interest income for financial assets that are not classified as FVTPL is recognised using the effective interest method

(i) Deferred tax

Deferred tax is recognised in respect of timing differences which have not reversed at the balance sheet date and which result in an obligation to pay more tax, or a right to pay less tax, at a future date Deferred tax is measured at rates expected to apply when the timing differences reverse, based on current tax rates and law Deferred tax assets are recognised to the extent that it is more likely than not that they will be recovered Deferred tax assets and liabilities are not discounted

(j) Related party transactions

The Company has taken advantage of the exemption in FRS 8, 'Related Party Disclosures' from disclosing related party transactions with other entities included in the consolidated financial statements of Legal & General Group Plc as Society owns more than 90% of the Company

(k) Dividend recognition

Dividend distribution to the Company's shareholder is recognised as a liability in the period in which the dividend is authorised and is no longer at the discretion of the Company

(l) Foreign currencies

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions Foreign exchange gains and losses resulting from the settlement of such transactions and from the transactions at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account for the period

Translation differences on non-monetary items, such as equities held at fair value through profit and loss are reported as part of the fair value gain or loss

2. Analysis of revenue

(i) Long term business (all written in the UK)

All premiums written in the period relate to reinsurance premiums inward of long term business written in the UK, and are classified as non-participating premiums £3,529m (2009. £2,748m)

(ii) New business

New business is presented for all business written by the Company	**2010**	2009
Gross premiums written	**3,529**	2,748
	3,529	2,748

3. Investment return

	Technical account - long term business 2010 £m	Non-technical account 2010 £m	Technical account - long term business 2009 £m	Non-technical account 2009 £m
Investment income and gains				
Investment income				
Income in respect of land and buildings	2	-	-	-
Income in respect of other financial investments [1]				
Income from loans and receivables	-	8	1	1
Income from financial assets at fair value through profit or loss	977	15	983	14
	979	23	984	15
Net realised gains on assets at fair value through profit or loss	152	31	498	107
Net realised gains on assets held for trading	58	-	23	-
Net unrealised gains on assets at fair value through profit or loss	981	14	1,450	38
Net unrealised gains on assets held for trading	212	-	-	-
Net gains on investments [2]	1,403	45	1,971	145
	2,382	68	2,955	160
Investment expenses, charges and losses				
Interest payable on financial liabilities, at amortised cost	(11)	-	(18)	-
Investment management expenses	(28)	(1)	(22)	(1)
Total investment management expenses, including interest	(39)	(1)	(40)	(1)
Net unrealised loss on assets held for trading	-	-	(100)	-
Net unrealised losses on investments	-	-	(100)	-
Net losses on investments [2]	(39)	(1)	(140)	(1)
Total investment return	2,343	67	2,815	159

1 The income from other financial investments includes dividends and interest from equity and debt securities held during the year

2 Unrealised gains / (losses) represent the fair value movements for the year on land and building on financial assets designated at fair value through profit and loss or held for trading

4. Net operating expenses

Technical account - long term business

	2010 £m	2009 £m
Acquisition costs	36	37
Change in deferred acquisition costs	(3)	(25)
Administrative expenses	132	139
	165	151

5. Tax charge / (credit)

	Technical account - long term business 2010 £m	Non-technical account 2010 £m	Technical account - long term business 2009 £m	Non-technical account 2009 £m
UK corporation tax at 28% (2009: 28%)				
Current tax for the year	-	-	-	-
Adjustments in respect of prior periods	(6)	-	(39)	-
Deferred tax				
Origination and reversal of timing differences	101	20	121	(54)
Effect of tax rate change	6	2		
	101	22	82	(54)
Tax attributable to the balance on the technical account long term business		92		106
Tax charge for the period		114		52

Factors affecting current tax credit:

The tax assessed for the year is lower than the standard rate of corporation tax in the UK for a company 28% (2009 28%) The differences are explained below

	2010 £m	2009 £m
Profit / (loss) on ordinary activities before tax	397	537
Corporation tax at 28% (2009 28%)	111	150
Effects of:		
Non taxable UK dividends	-	(1)
Differences between taxable and accounting investment gains / losses	-	(97)
Unrelieved tax losses	-	54
Utilisation of brought forward tax losses	(19)	
Current tax charge / (credit) for the period	92	106

6. Financial investments

	Shareholder assets 2010 £m	Non profit non-RPI linked 2010 £m	Total 2010 £m	RPI Linked 2010 £m
Fair value through profit or loss	693	16,846	17,539	6,961
Held for trading	6	724	730	404
Financial investments at fair value (i)	699	17,570	18,269	7,365
Land and buildings	-	130	130	-
Total Investments	699	17,700	18,399	7,365

	Shareholder assets 2009 £m	Non profit non-RPI linked 2009 £m	Total 2009 £m	RPI Linked 2009 £m
Fair value through profit or loss	629	15,300	15,929	6,178
Held for trading	8	508	516	291
Financial investments at fair value (i)	637	15,808	16,445	6,469
Loans and receivables	22	-	22	181
Total financial investments	659	15,808	16,467	6,650

Bespoke collateralised debt obligations (CDO) holdings of £911m (2009 £1,104m) are included within non-profit, non-RPI linked assets above

(i) Financial investments at fair value	Total 2010 £m	Tier 1 2010 £m	Tier 2 2010 £m	Tier 3 2010 £m
Shareholder assets				
Equity securities	440	254	-	186
Debt securities	251	9	242	-
Accrued interest	2	-	2	-
Derivative assets (Note 7)	6	-	6	-
Non profit non-RPI linked				
Equity securities	313	313	-	-
Debt securities	15,351	1,663	13,688	-
Collateralised debt obligations	911	-	911	-
Accrued interest	271	16	255	-
Derivative assets (Note 7)	724	58	666	-
Total financial investments at fair value	18,269	2,313	15,770	186
RPI Linked				
Equity securities	150	150	-	-
Debt securities	6,725	791	5,934	-
Accrued interest	85	5	80	-
Derivative assets (Note 7)	405	20	385	-
Total assets held to cover linked liabilities at fair value	7,365	966	6,399	-

6. Financial investments (continued)

(i) Financial investments at fair value (continued)

	Total 2009 £m	Tier 1 2009 £m	Tier 2 2009 £m	Tier 3 2009 £m
Shareholder assets				
Equity securities	254	97	-	157
Debt securities	371	3	368	-
Accrued interest	4	0	4	-
Derivative assets (Note 7)	8	2	6	-
Non profit non-RPI linked				
Equity securities	133	133	-	-
Debt securities	13,787	452	13,335	-
Collateralised debt obligations	1,104	-	1,104	-
Accrued interest	276	6	270	-
Derivative assets (Note 7)	508	37	471	-
Total financial investments at fair value	16,445	730	15,558	157
RPI Linked				
Debt securities	6,091	341	5,750	-
Accrued interest	87	3	84	-
Derivative assets (Note 7)	291	9	282	-
Total assets held to cover linked liabilities at fair value	6,469	353	6,116	-

In current market conditions, the liquidity of certain financial instruments is less than it has been in the past All of the Company's tier 2 assets have been valued using standard market pricing sources, such as iBoxx, IDC and Bloomberg except for bespoke CDO and swaps holdings (see below) In normal market conditions, we would consider these market prices to be observable market prices However, following consultation with our pricing providers and a number of their contributing brokers, we have concluded that these prices are not from an active market and have classified them as tier 2

Our holdings in bespoke CDOs and swaps are priced using industry standard models which utilise market assumptions Accordingly these assets have also been classified in tier 2 The CDO valuations have also been verified using externally provided prices

Tier 3 assets are where internal models with observable inputs are used, represent a small proportion of assets to which shareholders are exposed for example infrequently traded property unit trusts

In many situations, inputs used to measure the fair value of an asset or liability may fall into different levels of the fair value hierarchy In these situations, the Company will determine the level in which the fair value falls based upon the lowest level input that is significant to the determination of the fair value As a result, both observable and unobservable inputs may be used in the determination of fair values that the Company has classified as tier 3

6. Financial investments (continued)

(ii) Assets measured at fair value based on level 3

	Equity securities £m
As at 1 January 2010	157
Total gains or losses for the period recognised	
Purchases	9
Sales	(8)
Other	28
As at 31 December 2010	**186**

(iii) Effect on changes in significant unobservable inputs (level 3) to reasonably alternative assumptions

As discussed above, the fair value of financial instruments are, in certain circumstances measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on unobservable market data The following table shows the tier 3 financial instruments carried at fair value as at the balance sheet date, the valuation basis, main assumptions used in the valuation of these instruments and reasonably possible increases or decreases in fair value based on reasonably possible alternative assumptions

				Reasonably possible alternative assumptions	
Financial investments	**Valuation basis / technique**	**Main assumptions**	**Current fair value £m**	**Increase in fair value £m**	**Decrease in fair value £m**
Assets					
Shareholder					
Property unit trusts	**Note 1**	Property yield, occupancy	186	10	(10)
Total			**186**	**10**	**(10)**

Note 1: Unquoted investments in property vehicles are valued by independent valuers on the basis of open market value as defined in the appraisal and valuation manual of the Royal Institute of Chartered Surveyors

6. Financial investments (continued)

(iv) Financial investments by category

As at 31 December 2010	**Loans and receivables**	**Assets at fair value through profit and loss**	**Derivatives held for trading**	**Total**
Assets as per balance sheet	**£m**	**£m**	**£m**	**£m**
Equity securities	-	903	-	903
Debt securities	-	22,327	-	22,327
Collateralised debt obligations	-	911	-	911
Accrued interest	-	358	-	358
Derivative assets	-	-	1,135	1,135
Debtors	286	-	-	286
Cash at bank and in hand	156	-	-	156
Total	442	24,499	1,135	26,076

	Liabilities held for trading	**Other financial liabilities**	**Total**
Liabilities as per balance sheet	**£m**	**£m**	**£m**
Contingent loan (Note 17)	-	591	591
Financial liabilities	6	-	6
Derivative financial instruments	1,300	-	1,300
Other Creditors	-	1	1
Total	1,306	592	1,898

As at 31 December 2009	Loans and receivables	Assets at fair value through profit and loss	Derivatives held for trading	Total
Assets as per balance sheet	£m	£m	£m	£m
Equity securities	-	387	-	387
Debt securities	-	20,249	-	20,249
Collateralised debt obligations	-	1,104	-	1,104
Accrued interest	-	367	-	367
Derivative assets	-	-	807	807
Loans and receivables	203	-	-	203
Debtors	366	-	-	366
Cash at bank and in hand	81	-	-	81
Total	650	22,107	807	23,564

Liabilities as per balance sheet	Liabilities held for trading	Other financial	Total
Contingent loan (Note 17)	-	981	981
Amounts owed to credit institutions	-	9	9
Amounts owed to group undertakings	-	13	13
Corporation tax payable	-	35	35
Financial liabilities	10	-	10
Derivative financial instruments	1,318	-	1,318
Total	1,328	1,038	2,366

(v) Original cost of investments	Shareholder assets 2010 £m	Non profit non-RPI linked 2010 £m	Total 2010 £m	RPI Linked 2010 £m
Equity securities	378	-	378	-
Debt securities	245	16,150	16,395	6,135
Collateralised debt obligations	-	1,180	1,180	-
Accrued Interest	2	271	273	85
Derivative assets	-	13	13	-
	625	17,614	18,239	6,220

	Shareholder 2009 £m	Non profit 2009 £m	Total 2009 £m	RPI Linked 2009 £m
Equity securities	222	-	222	-
Debt securities	348	15,389	15,737	5,738
Collateralised debt obligations	-	1,180	1,180	-
Accrued Interest	4	276	280	86
Derivative assets	-	12	12	-
	574	16,857	17,431	5,824

Included in the carrying values of financial investments above are amounts in respect of listed investments as follows

	2010 £m	2009 £m
Equity securities	903	387
Debt securities	22,327	20,249
	23,230	20,636

(vi) Ageing of financial assets that are past due but not impaired

All financial assets held are neither past due nor impaired (2009 no assets past due or impaired)

6. Financial investments (continued)

(vii) Collateralised debt obligations

The Company holds bespoke collateralised debt obligations (CDO) with a market value of £911m (2009 £1,104m) classified within debt securities

These holdings include £37m (2009 £41m) exposure to an equity tranche of a bespoke CDO The current market value of the equity tranche is approximately equal to the present value of future interest payable on the notes

The balance of £874m (2009 £1,063m) relates predominantly to a further four CDOs that were constructed in 2007 and 2008 in accordance with terms specified by Legal & General These CDOs mature in 2017 and 2018 The Company selects the reference portfolios underlying the CDOs to give exposure to globally diversified portfolios of investment grade corporate bonds

These CDOs are termed as super senior since default losses on the reference portfolio have to exceed 28%, on average across the four CDOs, before the CDOs incur any default losses Assuming an average recovery rate of 30%, then over 39% of the reference names would have to default before the CDOs incur any default losses

Beyond 28% of default losses on the reference portfolio, losses to the CDO would occur at a rate that is a multiple of the loss rate on the reference portfolio For illustration a £200m loss could be incurred if default losses to the reference portfolio exceeded 31% or if 44% of the names in the diversified global investment grade portfolio defaulted, with an average 30% recovery rate (All figures are averages across the four CDOs)

Despite the difficult financial conditions in early 2009, the underlying reference portfolio has had no reference entity defaults in 2009 or 2010

Losses are limited under the terms of the CDOs to assets and collateral invested

These CDOs also incorporate features under which, in certain circumstances, the Company can choose either to post additional cash or collateral, or to allow wind up of the structures These features are dependant on the portfolios' weighted average spreads, default experience to date and time to maturity No additional collateral was posted to any of the CDOs in 2010 During the year the Company received £155m of previously posted collateral, which was the primary reason for the reduction in the CDOs market value

These CDOs are valued using an external valuation which is based on observable market inputs This is then validated against the internal valuation

For the purposes of valuing the non profit annuity regulatory liabilities the yield on the CDOs is included within the calculation of the yield used to calculate the valuation discount rate for the annuity liabilities An allowance for the risks, including default, is also made For EEV purposes, the yield on the CDOs, reduced by the realistic default assumption, is similarly included in assumed future investment returns

7. Derivative assets and liabilities

Financial investments include £435m (2009 £667m) of debt securities pledged as collateral against derivative liabilities The assets used as collateral are Treasury Gilts, Foreign Government Bonds, AAA Supranational Bonds and AAA Corporate Bonds (2009 Treasury Gilts, AAA Supranational Bonds, and AAA and AA rated bonds) having a residual maturity of over 34 years (2009 over 18 years) The Company is entitled to receive all of the cash flows from assets during the period when they are pledged as collateral Further, there is no obligation to pay or transfer these cash flows to another entity The Company can decide to substitute an asset which is designated as collateral at anytime, provided the relevant terms and conditions of the International Swap Dealers Association agreement are met

7. Derivative assets and liabilities (continued)

	Contract /notional amount 2010 £m	Fair values Assets[1] 2010 £m	Fair values Liabilities[2] 2010 £m	Contract /notional amount 2009 £m	Fair values Assets[1] 2009 £m	Fair values Liabilities[2] 2009 £m
Shareholder assets derivatives						
Equity/index contracts - HFT	(36)	-	-	(46)	1	-
Interest rate contracts - HFT	74	2	(4)	153	2	(7)
Foreign exchange contracts - HFT	-	-	(1)	-	2	(1)
Credit derivatives - HFT	89	4	(4)	179	3	(6)
Total shareholder assets derivatives	127	6	(9)	286	8	(14)

	Contract /notional amount 2010 £m	Fair values Assets[1] 2010 £m	Fair values Liabilities[2] 2010 £m	Contract /notional amount 2009 £m	Fair values Assets[1] 2009 £m	Fair values Liabilities[2] 2009 £m
Non profit plus RPI linked derivatives						
Equity/index contracts - HFT	-	-	-	(44)	8	(3)
Interest rate contracts - HFT	23,805	941	(1,041)	21,783	654	(961)
Foreign exchange contracts - HFT	-	77	(60)	-	38	(160)
Inflation swap contracts - HFT	6,218	81	(163)	5,913	70	(152)
Credit derivatives - HFT	267	30	(27)	29	29	(28)
Total non profit plus RPI linked derivatives	30,290	1,129	(1,291)	27,681	799	(1,304)

1 Derivative assets are reported in the balance sheet within financial investments (Note 6)

2 Derivative liabilities are reported in the balance sheet within other creditors

The Company uses derivatives to reduce market risk The most widely used derivatives are over the counter interest rate swaps The Company may use futures to facilitate efficient asset allocation In addition, derivatives are used to improve asset-liability matching and to manage interest rate and foreign exchange risk It is the Company's policy that all derivative transactions are on a covered basis against underlying holdings of assets Derivative counterparty risk is managed by the posting of collateral on a daily basis

The notional amounts of some derivative instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Company's exposure to credit or price risks

7. Derivative assets and liabilities (continued)

		Maturity profile of undiscounted cash flows					
As at 31 December 2010	**Fair values £m**	**Within 1 year £m**	**1-5 years £m**	**5-15 years £m**	**15-25 years £m**	**Over 25 years £m**	**Total £m**
Cash inflows							
Shareholder assets derivatives							
Derivative assets	6	151	5	3	2	-	161
Derivative liabilities	(9)	126	8	1	-	-	135
Non profit (NPR) plus RPI linked derivatives							
Derivative assets	1,129	5,519	1,680	4,293	3,169	5,094	19,755
Derivative liabilities	(1,291)	5,972	1,188	3,812	3,583	4,372	18,927
Total cash inflows	(165)	11,768	2,881	8,109	6,754	9,466	38,978
Net shareholder assets derivatives cash inflows		277	13	4	2	-	296
Net NPR plus RPI linked derivative cash inflows		11,491	2,868	8,105	6,752	9,466	38,682
Cash outflows							
Shareholder assets derivatives							
Derivative assets	6	(151)	(6)	(2)	(2)	(1)	(162)
Derivative liabilities	(9)	(135)	(13)	(2)	-	-	(150)
Non profit plus RPI linked derivatives							
Derivative assets	1,129	(5,247)	(1,260)	(4,017)	(2,858)	(4,536)	(17,918)
Derivative liabilities	(1,291)	(6,327)	(1,947)	(3,927)	(3,665)	(3,943)	(19,809)
Total cash outflows	(165)	(11,860)	(3,226)	(7,948)	(6,525)	(8,480)	(38,039)
Net shareholder assets derivative cash outflows		(286)	(19)	(4)	(2)	(1)	(312)
Net NPR plus RPI linked derivative cash outflows		(11,574)	(3,207)	(7,944)	(6,523)	(8,479)	(37,727)
Total net cash flows		(92)	(345)	161	229	986	939

7. Derivative assets and liabilities (continued)

Maturity profile of undiscounted cash flows

As at 31 December 2009	Fair values £m	Within 1 year £m	1-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m	Total £m
Cash inflows							
Shareholder assets derivatives							
Derivative assets	8	86	9	1	1	-	97
Derivative liabilities	(14)	237	9	6	2	-	254
Non profit (NPR) plus RPI linked derivatives							
Derivative assets	798	2,886	1,483	3,933	3,201	3,784	15,287
Derivative liabilities	(1,304)	7,081	1,382	3,058	2,633	5,529	19,683
Total cash inflows	(512)	10,290	2,883	6,998	5,837	9,313	35,321
Net shareholder assets derivatives cash inflows		323	18	7	3	-	351
Net NPR plus RPI linked derivative cash inflows		9,967	2,865	6,991	5,834	9,313	34,970
Cash outflows							
Shareholder assets derivatives							
Derivative assets	8	(82)	(5)	(1)	-	-	(88)
Derivative liabilities	(14)	(244)	(22)	(7)	(1)	-	(274)
Non profit plus RPI linked derivatives							
Derivative assets	798	(2,762)	(1,314)	(3,535)	(2,833)	(3,306)	(13,750)
Derivative liabilities	(1,304)	(7,464)	(1,905)	(4,113)	(2,844)	(4,520)	(20,846)
Total cash outflows	(512)	(10,552)	(3,246)	(7,656)	(5,678)	(7,826)	(34,958)
Net shareholder assets derivative cash outflows		(326)	(27)	(8)	(1)	-	(362)
Net NPR plus RPI linked derivative cash outflows		(10,226)	(3,219)	(7,648)	(5,677)	(7,826)	(34,596)
Total net cash flows		(262)	(363)	(658)	159	1,487	363

8. Land and buildings

	Non profit non linked	Non profit non linked
	2010	2009
	£m	£m
Long leaseholds	130	-
Original cost	134	-

9. Share capital

	Number of shares	2010	2009
	000's	**£m**	£m
Issued share capital			
Fully paid ordinary shares of £1 each			
At 31 December fully paid ordinary shares of £1 each	**300,000**	**300**	300

10. Movement in reserves

	Profit and loss account	Profit and loss account
	2010	2009
	£m	£m
Balance at 1 January	**398**	(687)
Retained Profit	**283**	485
Capital contribution	-	600
At 31 December	**681**	398

11. Deferred Acquisition Costs

	2010	2009
	£m	£m
Insurance contract deferred acquisition costs	**90**	87
As at 1 January	**87**	62
Acquisition costs deferred	**10**	31
Amortisation charged to income	**(7)**	(6)
As at 31 December	**90**	87

12. Technical provisions

(i) Balances

	2010 £m	2010 £m	2009 £m	2009 £m
Long term business provision - gross	16,670		14,482	
Life and pensions RPI linked non-participating insurance contracts	6,752		6,108	
Non-participating insurance contracts		23,422		20,590
Deferred acquisition costs		(90)		(87)
Total long term insurance funds		23,332		20,503

Valuation assumptions have been determined in accordance with rules relating to the valuation of liabilities as published by the FSA (see Note 13)

(ii) Expected cash flows

	Date of undiscounted cash flow					
As at 31 December 2010	**0-5 years £m**	**5-15 years £m**	**15-25 years £m**	**Over 25 years £m**	**Total £m**	**Carrying value £m**
Non-participating insurance contracts	7,091	14,011	11,858	14,836	47,796	23,422
	7,091	14,011	11,858	14,836	47,796	23,422

	Date of undiscounted cash flow					
As at 31 December 2009	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m	Total £m	Carrying value £m
Non-participating insurance contracts	6,775	12,428	10,966	14,565	44,734	20,590
	6,775	12,428	10,966	14,565	44,734	20,590

13. Long term insurance valuation assumptions

Non-participating business

The Company writes only non-participating business and it seeks to make prudent assumptions about its future experience based on current market conditions and recent experience As an ISPV, the Company is not required to calculate liabilities on an FSA statutory Peak 1 basis However, the basis used to set technical provisions is generally similar to a statutory Peak 1 basis The assumptions incorporate prudent margins in excess of our best estimate assumptions to reduce the possibility of actual experience being less favourable than assumed

Valuation rates of interest and discount rates

The valuation interest rate for the underlying annuity business is based on the internal rate of return on the portfolio of assets backing the liabilities

For the valuation interest rate assumption, asset yields are adjusted to reflect the risk of default associated with the investments held

In 2010 the Company continued to hold reserves to protect against the risk of credit default For approved securities and swaps backing non profit business, the allowance remains at 3bps per annum (2009 3bps) For unapproved securities backing non profit annuity business the credit default allowances equate to £1 5bn, or 64bps per annum (2009 £1 5bn and 68bps respectively) when expressed over the duration of the assets held

The Company believes the total default allowance is prudent to cover all reasonably foreseeable circumstances

Mortality and morbidity

Mortality and morbidity assumptions are set with reference to standard tables drawn up by the Continuous Mortality Investigation Bureau (CMIB) of the Institute and Faculty of Actuaries These tables are based on industry-wide experience

The majority of internal statistical investigations are carried out at least annually to determine the extent to which the Company's experience differs from that of the industry and suggest appropriate adjustments which need to be made to derive the valuation assumptions

Persistency

The Company monitors its persistency experience and carries out detailed investigations annually Persistency can be volatile and past experience may not be an appropriate future indicator

The Company tries to balance past experience and future conditions by making prudent assumptions about the future expected long term average persistency levels

Where explicit persistency assumptions are not made, prudence is also incorporated into the liabilities by ensuring that they are sufficient to cover the more onerous of the two scenarios where the policies either remain in-force until maturity or where they discontinue at the valuation date

13. Long term insurance valuation assumptions (continued)

Expenses

The Company monitors its expense experience and carries out detailed investigations regularly to determine the expenses incurred in writing and administering the different products and classes of business An allowance for expense inflation in the future is also made, taking account of both salary and price information

The principal assumptions are

	2010	2009
(i) Rate of interest/discount rate		
Pension assurances	**2.50% - 3.50% pa and 7.60%pa [1]**	2 75% - 3 75% pa and 7 60%pa [1]
Annuities in deferment	**4.975%pa**	5 49%pa
Annuities in deferment (RPI linked, net rate after allowance for inflation)	**1.040%pa**	1 31%pa
Vested annuities	**4.975% pa**	5 49% pa
Vested annuities (RPI linked, net rate after allowance for inflation)	**1.040% pa**	1 31% pa
(ii) Mortality Tables		
Non-linked individual term assurances		
- Smokers	**96% TMS00 / TFS00 Sel 5[2]**	105% TMS00 / TFS00 Sel 5[2]
- Non-smokers	**93% TMN00 / TFN00 Sel 5[2]**	95% TMN00 / TFN00 Sel 5[2]
Annuities in deferment	**88 - 92% PNMA00/PNFA00[3]**	67 - 70% AM92 / AF92
Vested annuities[4]		
- Bulk purchase annuities	**89 - 93% PCMA00 / PCFA00**	90 - 94% PCMA00 / PCFA00
- Other annuities	**55 - 86% PCMA00 / PCFA00**	60 - 88% PCMA00 / PCFA00

1 For product groups where liabilities are positive, the lower interest rate of 2 50 - 3 50% is used (2009 2 75% – 3 75%) However, for product groups where liabilities are negative, the higher rate of 7 60% (2009 7 60%) is used

2 For pension term assurance, mortality rates are assumed to increase at a rate of 0% pa (2009 0% pa)

3 Table created by blending PCXA00 with PNXA tables The base table to be used for BPA policies in deferment is PNMA00 up to and including age 55 and PCMA00 for age 65 and above for males The identical method is applied to females using PNFA00 and PCFA00

4 For vested annuities, mortality rates are assumed to reduce according to CMIB's mortality improvement model, CMI 2009 with the following parameters Males Long term rate of 2% p a up to age 85 tapering to 0% at 120 Females Long term rate of 1 5% p a up to age 85 tapering to 0% at 120 (2009 CMIB Working Paper 30 projection MC with a minimum of 2 0% p a up to age 90 tapering to a minimum of 0% p a at age 120 for males For females, mortality rates are assumed to reduce according to 75% CMIB projection MC with a minimum of 1 5% p a up to age 90 tapering to a minimum of 0% p a at age 120) For certain annuities a further allowance is made for the effect of initial selection

13. Long term insurance valuation assumptions (continued)

Premiums

For those contracts where the policyholder does not have the right to vary the amount of the premium paid, full credit is taken for the premiums contractually due at the valuation date For contracts where the policyholder has the option to vary the rate of premium, the provision is taken as being the higher of the amount calculated as if the policyholder continues to make premium payments or, alternatively, ceases to pay premiums altogether

Persistency

It is permissible to value all long term business assuming a prudent lapse basis For these contracts, the valuation persistency basis is set by applying a prudential margin over the best estimate assumptions

This margin acts to increase the best estimate lapse rate in the early part of a policy's lifetime (when it is being treated as an asset) but to reduce the best estimate lapse rate later in the policy's lifetime (when it is treated as a liability) The crossover point at which the margin changes direction is assessed for broad product groups but applied at a policy by policy level Any liability to reinsurers on discontinuance within the first four years from inception is allowed for explicitly in the cash flows using the valuation lapse basis, together with a prudent allowance for clawback of commission from agents upon lapse

For unit linked business the margin acts to either increase or decrease the best estimate lapse rates, depending upon which approach results in the higher liability

A summary of the lapse basis for major classes of business is shown below

	2010 Average lapse rate for the policy years			
Product	**1 - 5**	**6 - 10**	**11 - 15**	**16 - 20**
Pensions term	**12.7%**	**8.5%**	**6.0%**	**5.6%**
Individual pension regular premium (unit linked)	**2.2%**	**1.6%**	**1.4%**	**1.4%**
Group pension regular premium (unit linked)	**2.1%**	**1.9%**	**1.3%**	**1.3%**
Trustee Investment Plan regular premium (unit linked)	**1.3%**	**1.3%**	**1.3%**	**1.3%**
Individual pension single premium (unit linked)	**4.0%**	**3.5%**	**2.7%**	**2.7%**
Group pension single premium (unit linked)	**7.6%**	**7.6%**	**7.6%**	**7.6%**
Trustee Investment Plan single premium (unit linked)	**6.8%**	**5.8%**	**4.3%**	**4.3%**

	2009 Average lapse rate for the policy years			
Product	1 - 5	6 - 10	11 - 15	16 - 20
Pensions term	12 5%	8 6%	5 7%	5 1%
Individual pension regular premium (unit linked)	2 1%	1 5%	1 6%	1 6%
Group pension regular premium (unit linked)	1 4%	1 4%	1 2%	1 2%
Trustee Investment Plan regular premium (unit linked)	1 3%	1 3%	1 3%	1 3%
Individual pension single premium (unit linked)	3 6%	3 2%	2 5%	2 5%
Group pension single premium (unit linked)	7 3%	7 3%	7 3%	7 3%
Trustee Investment Plan single premium (unit linked)	6 4%	5 5%	4 1%	4 1%

14. Other Debtors

(i) Balances	2010 £m	2009 £m
Other debtors	2	-
Amounts due from group undertakings	47	-
Deferred tax	237	366
	286	366

(ii) Deferred Tax (see Note 5)

	2010 £m	2009 £m
Balance b/f	366	433
(Charge) / credit for the period	(121)	(67)
Effect of tax rate change	(8)	
The balance for deferred tax consists of the following amounts		
Tax loss for the period carried forward	237	366

Deferred tax has been determined using the rate of corporation tax due to be implemented in April 2011 of 27% (2009 28%)

The deferred tax asset has been recognised based on projections of taxable profits produced using the Company's internal actuarial models

15. Amounts owed to credit institutions

	2010 £m	2009 £m
Unsecured bank loans and overdrafts repayable, otherwise than by instalments, within one year	-	9

16. Creditors: amounts falling due within one year

Table 1 - Analysis of other creditors (Note 6(iv))

	2010 £m	2009 £m
Amounts owed to group undertakings	-	13
Corporation tax payable	-	35
Derivative financial instruments (Note 7)	1,300	1,318
Financial liabilities	6	10
Accruals	1	-
	1,307	1,376

Table 2 - Financial liabilities at fair value

	Total 2010 £m	Tier 1 2010 £m	Tier 2 2010 £m	Tier 3 2010 £m
Shareholder liabilities				
Derivative financial instruments (Note 7)	9	1	8	-
Non profit non-RPI linked				
Derivative financial instruments (Note 7)	878	45	833	-
Financial liabilities	6	6	-	-
RPI Linked				
Derivative financial instruments (Note 7)	413	15	398	-
Total financial liabilities at fair value	1,306	67	1,239	-

16. Creditors: amounts falling due within one year (continued)

Table 2 - Financial liabilities at fair value

	Total 2009 £m	Tier 1 2009 £m	Tier 2 2009 £m	Tier 3 2009 £m
Shareholder liabilities				
Derivative financial instruments (Note 7)	14	1	13	-
Non profit non-RPI linked				
Derivative financial instruments (Note 7)	899	111	788	-
Financial liabilities	10	10	-	-
RPI Linked				
Derivative financial instruments (Note 7)	405	52	353	-
Total financial liabilities at fair value	1,328	174	1,154	-

Table 3 - Contractual cash flows

	Date of undiscounted cash flow		
	0-5 years	**Total**	**Carrying value**
As at 31 December 2010	**£m**	**£m**	**£m**
Amounts owed to group undertakings	-	-	-
Financial liabilities	(6)	(6)	(6)
	(6)	(6)	(6)

	0-5 years	Total	Carrying value
As at 31 December 2009	£m	£m	£m
Amounts owed to group undertakings	(13)	(13)	(13)
Financial liabilities	(10)	(10)	(10)
	(23)	(23)	(23)

17. Creditors: amounts falling due after more than one year

Contingent loan

The contingent loan is owed to Society's Shareholder fund (SHF) and is interest bearing at variable rate of Libor + 1% The interest is accrued monthly but settled annually

The repayment of the contingent loan and related interest to the Society SHF is subject to a surplus arising from the long term business of the Company Where the surplus of the Company is insufficient to cover the interest repayment in any year, the unpaid portion of the interest payment shall accrue to future years

The outstanding loan balance currently stands at £591m (2009· £981m) including interest charges of £11m during the year (2009 £18m)

On 11 March 2011 the directors of the Company approved a payment to its parent, Society, under the contingent loan agreement of £375m in respect of the 2010 calendar year

18. Parent and ultimate parent company

The ımmedıate parent company ıs Legal & General Assurance Socıety Lımıted, a company ıncorporated ın England and Wales The ımmedıate parent company for Legal & General Assurance Socıety Lımıted ıs Legal & General Insurance Holdıngs Lımıted and the ımmedıate parent company for Legal & General Insurance Holdıngs Lımıted ıs Legal & General Insurance Holdıngs (No 2) Lımıted Legal & General Assurance Socıety Lımıted ıs exempt from the oblıgatıon to prepare and delıver group accounts as ıts parent Legal & General Insurance Holdıngs (No 2) Lımıted ıs a wholly-owned subsıdıary of Legal & General Group Plc, whıch heads the smallest and largest group of undertakıngs for whıch consolıdated financıal statements are prepared, a company ıncorporated ın England and Wales Copıes of the accounts of the ultımate holdıng company, Legal & General Group Plc, are avaılable on the group websıte, www legalandgeneralgroup com or from the Company Secretary at the Regıstered Office, One Coleman Street, London, EC2R 5AA

19. Auditors' remuneration

Fees payable to the Company's audıtors for the audıt of ıts financıal statements were £115,117 (2009 £104,926)

The dısclosure of fees payable to the audıtors and ıts assocıates for other (non-audıt) servıces has not been made because thıs has been dısclosed ın the consolıdated financıal statements of the Company's ultımate holdıng company

20. Pension costs

The Company has no dırect employees and hence makes no dırect contrıbutıons towards retırement benefits

21. Directors' emoluments

	2010	2009
	£'000	£'000
Aggregate emoluments	502	556

Emoluments relate to salarıes and performance bonuses Dırectors are not employees of the Company but theır servıces are reflected ın a management charge levıed by the parent, Socıety

Retırement benefits are accruıng to 2 dırectors under a defined benefit pensıon scheme One dırector ıs a member of a defined contrıbutıon scheme and the value of the apportıoned company contrıbutıon ın the year ıs £16,632

Hıghest paıd dırector

	2010	2009
	£'000	£'000
Emoluments	244	221
Defined benefit pensıon scheme accrued at end of year*	65	61

* Accrued pensıon represents the amount of the annual pensıon that would be payable to the dırector when he reaches normal pensıon age

Dırectors' emoluments for the Group durıng the year have been attrıbuted to the Company on the basıs of the tıme spent on Company busıness by each Dırector

Dırectors' loans

At 31 December 2010 there were no loans to dırectors (2009 none)

Dırectors' transactıons and arrangements

No dırector had any materıal ınterest ın any contract or arrangement of sıgnıficance ın relatıon to the busıness of LGPL durıng 2010 (2009 none)

22. Employee information

The Company does not have dırect employees sınce they are employed by a fellow subsıdıary of Legal & General Group Plc The Company ıs recharged a proportıon of the staff costs

23. Related party transactions

Transactions involving directors and key management

No contract of sıgnıficance exısted at any tıme durıng the year ın whıch a dırector or key manager was materıally ınterested or whıch requıres dısclosure as a related party transactıon as defined under FRS 8

24. Exchange rates

Prıncıpal rates of exchange used for translatıon ınto sterlıng at the end of the perıod

	2010	2009
U S Dollar	**1.57**	1 62
Euro	**1.17**	1 13

25. Risk management

25.1 Risk management objective

The Company's prımary objectıve ın undertakıng rısk management actıvıty ıs to manage rısk exposures ın lıne wıth rısk appetıte, mınımısıng ıts exposure to unexpected financıal loss and lımıtıng the potentıal for devıatıon from antıcıpated outcomes In thıs respect, a framework of lımıts and qualıtatıve statements, alıgned wıth the Group's rısk appetıte, ıs ın place for materıal exposures

25.2 Risk management approach

A sıgnıficant part of the Company's busıness ınvolves the acceptance and management of rısk The Company ıs exposed to financıal rısk through ıts financıal assets, financıal lıabılıtıes, reınsurance assets and polıcyholder lıabılıtıes The most ımportant components of thıs financıal rısk are market rısk, credıt rısk and lıquıdıty rısk and these are defined below

Market rısk the rısk arısıng from fluctuatıons ın ınterest rates, exchange rates, share prıces and other relevant market prıces

Credıt rısk the rısk of loss ıf another party faıls to perform ıts financıal oblıgatıons to the Company

Lıquıdıty rısk the rısk that the Company, though solvent, does not have suffıcıent financıal resources avaılable to enable ıt to meet ıts oblıgatıons as they fall due, or can secure them only at excessıve cost

Overall responsıbılıty for the management of the Company's exposure to rısk ıs vested ın the Board To support ıt ın thıs role, a rısk framework ıs ın place comprısıng a structure of formal commıttees, rısk assessment and reportıng processes and rısk revıew functıons The framework provıdes assurance that rısks are beıng approprıately ıdentıfied and managed and that an ındependent assessment of rısks ıs beıng performed

25.3 Management of risks

The Company seeks to manage ıts exposures to rısk through control technıques whıch ensure that the resıdual rısk exposures are wıthın acceptable tolerances agreed by the Board The key control technıques for the major categorıes of rısk exposure are summarısed below

25. Financial risk management (continued)

25.3 Management of risks (continued)

Asset Analysis

The Company has categorised its assets and liabilities in the following disclosure in accordance with the level of shareholder exposure for market and credit risks The two categorisations presented are

Shareholder assets

Shareholders of the Company are directly exposed to market and credit risk on these assets

Non profit plus RPI linked

These are assets backing the business held within the Long-Term Fund (LTF) Shareholders are exposed to the risk and rewards attributable to these assets

Market risk

The Company's exposure to market risk is influenced by one or more external factors, including changes in specified interest rates, financial instrument prices, foreign exchange rates, and indices of prices or rates

Significant areas where the Company is exposed to these risks are

- Assets backing insurance contracts other than unit linked contracts
- Assets and liabilities denominated in foreign currencies
- Other financial assets and liabilities

The Company manages market risk using the following methods

Asset-liability matching

The Company manages its assets and liabilities in accordance with relevant regulatory requirements, reflecting the differing types of liabilities it has in its business

For business such as immediate annuities, which is sensitive to interest rate risk, analysis of the liabilities is undertaken to create a portfolio of securities, the value of which changes in line with the value of liabilities when interest rates change This type of analysis helps protect profits from changing interest rates Interest rate risk cannot be completely eliminated, due to the nature of the liabilities and early redemption options contained in the assets

The Company holds a range of asset types to meet liabilities and it uses stochastic models to assess the impact of a range of future return scenarios on investment values and associated liabilities This allows the Company to devise an investment strategy which optimises returns to its policyholders over time whilst limiting the capital requirements associated with this business

Derivatives

The Company uses derivatives to reduce market risk The most widely used derivatives are Over The Counter (OTC) interest rate swaps and exchange-traded foreign exchange futures and swaps The Company may use futures to facilitate efficient asset allocation In addition, derivatives are used to improve asset liability matching and to manage interest rate, foreign exchange and inflation risks It is the Company's policy that amounts at risk through derivative transactions are covered by cash or corresponding assets and that swaps are collateralised to reduce counterparty exposure

25. Financial risk management (continued)

25.4 Interest rate risk

Interest rate risk is the risk that the Company is exposed to loss as a direct or indirect result of fluctuations in the value of, or income from, specific assets and liabilities arising from changes in underlying interest rates

The Company is exposed to interest rate risk on the investment portfolio it maintains to meet the obligations and commitments under its non-linked insurance contracts, in that the proceeds from the assets may not be sufficient to meet the Company's obligations to policyholders

To mitigate the risk that guarantees and commitments are not met, the Company purchases financial instruments, which broadly match the expected non-participating policy benefits payable, by their nature and term The composition of the investment portfolio is governed by the nature of the insurance or savings liabilities, the expected rate of return applicable on each class of asset and the capital available to meet the price fluctuations for each asset class, relative to the liabilities they support

25.5 Currency risk

The Company is potentially exposed to loss as a result of fluctuations in the value of, or income from, assets denominated in foreign currencies The Company manages its currency risk by hedging it's exposure to overseas investment

The adjacent table summarises the Company's exposure to foreign currency exchange risk expressed in sterling However, there is no risk in respect of sterling as it is the functional currency Non-linked assets and liabilities are reported in their underlying currency

25. Financial risk management (continued)

Table 1 - Exposure to currency risk

Shareholder assets	Sterling 2010 £m	Euro 2010 £m	US 2010 £m	Other 2010 £m	Carrying value 2010 £m
Assets					
Financial investments and cash	620	73	59	-	752
Other operational assets	1	0	0	-	1
Total assets	621	73	59	-	753
Liabilities					
Other creditors	124	(74)	(59)	-	(9)
Total liabilities	124	(74)	(59)	-	(9)

Non profit plus RPI linked	Sterling 2010 £m	Euro 2010 £m	US 2010 £m	Other 2010 £m	Carrying value 2010 £m
Assets					
Financial investments and cash	19,191	1,802	4,176	-	25,169
Other operational assets	378	1	-	-	379
Total assets	19,569	1,803	4,176	-	25,548
Liabilities					
Technical provisions	(23,422)	-	-	-	(23,422)
Contingent loan	(591)	-	-	-	(591)
Other creditors	4,703	(1,828)	(4,173)	-	(1,298)
Total liabilities	(19,310)	(1,828)	(4,173)	-	(25,311)

25. Financial risk management (continued)

Shareholder assets	Sterling 2009 £m	Euro 2009 £m	US 2009 £m	Other 2009 £m	Carrying value 2009 £m
Assets					
Financial investments and cash	419	10	240	-	669
Total assets	419	10	240	-	669
Liabilities					
Other creditors	234	(9)	(239)	-	(14)
Total liabilities	234	(9)	(239)	-	(14)

Non profit plus RPI linked	Sterling 2009 £m	Euro 2009 £m	US 2009 £m	Other 2009 £m	Carrying value 2009 £m
Assets					
Financial investments and cash	14,977	76	7,456	19	22,528
Other operational assets	456	-	-	-	456
Total assets	15,433	76	7,456	19	22,984
Liabilities					
Technical provisions	(20,590)	-	-	-	(20,590)
Contingent loan	(981)	-	-	-	(981)
Other creditors	5,970	(92)	(7,248)	-	(1,370)
Total liabilities	(15,601)	(92)	(7,248)	-	(22,941)

25. Financial risk management (continued)

Currency sensitivity

The Company's management of currency risk reduces shareholders' exposure to exchange rate fluctuations The Company's exposure to a 10% exchange movement in the Euro and US Dollar is detailed below

Currency sensitivity test

	Euro 2010 £m	US 2010 £m	Euro 2009 £m	US 2009 £m
10% appreciation impact on profit post tax / equity	(2)	0	(1)	15

25.6 Other price risk

Other price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices other than those arising from interest rate risk or currency risk These changes may be as a result of features of the individual instrument, its issuer or factors affecting all similar financial instruments traded in the market

The Company controls its exposure to geographic price risks by using internal country ratings These ratings are based on macroeconomic data and key qualitative indicators The latter take into account the economic, social and political environments Table 2 indicates the Company's exposure to different equity markets around the world

Table 2 - Exposure to worldwide equity markets

	Shareholder assets 2010 £m	Non profit non-linked 2010 £m	Shareholder assets 2009 £m	Non profit non-linked 2009 £m
UK	64	-	60	-
North America	1	-	1	-
Europe	-	-	1	-
Listed equities	65	-	62	-

25.7 Credit Risk

Credit risk is the risk that the Company is exposed to loss if another party fails to perform its financial obligations to the Company The Company is exposed to credit risk through its holdings in corporate bonds to back part of its insurance liabilities Significant exposures are managed by the application of concentration limits, with allowance being made in the actuarial valuation of insurance liabilities for possible defaults

Aggregate counterparty exposures are regularly monitored

Table 3 shows the credit profile of the Company's assets exposed to credit risk The credit rating bands are provided by independent rating agencies For unrated assets the group maintains internal ratings which are used to manage exposure to these counterparties The carrying amount of non-linked assets included in the balance sheet represents the maximum credit exposure

25. Financial risk management (continued)

Credit Risk (continued)

Table 3 - Exposure to credit risk

As at 31 December 2010 Shareholder assets	AAA £m	AA £m	A £m	BBB £m	BB & below £m	Unrated £m	Total £m
Government securities	10	-	-	-	-	-	10
Other fixed rate securities	30	13	27	47	7	2	126
Variable rate securities	20	13	33	47	2	-	115
Total debt securities	60	26	60	94	9	2	251
Accrued interest	-	-	1	1	-	-	2
Derivative assets	-	2	4	-	-	-	6
Total financial investments	60	28	65	95	9	2	259
Other assets	-	-	-	-	-	2	2
Cash at bank	-	51	3	-	-	-	54
Total assets exposed to credit risk	60	79	68	95	9	4	315

Non profit plus RPI-linked	AAA £m	AA £m	A £m	BBB £m	BB & below £m	Unrated £m	Total £m
Government securities	1,967	73	9	37	-	-	2,086
Other fixed rate securities	1,068	1,944	7,515	5,286	373	575	16,761
Variable rate securities[1]	1,132	368	1,217	282	1	1,140	4,140
Total debt securities	4,167	2,385	8,741	5,605	374	1,715	22,987
Accrued interest	31	38	160	113	5	9	356
Derivative assets	-	184	945	-	-	-	1,129
Total financial investments	4,198	2,607	9,846	5,718	379	1,724	24,472
Other assets	-	-	-	-	-	6	6
Cash at bank	-	63	39	-	-	-	102
Total assets exposed to credit risk	4,198	2,670	9,885	5,718	379	1,730	24,580

1 Unrated variable rate securities includes £911m of bespoke CDOs (2009 £1,104m) (Note 6)

At the year end the Company held collateral in respect of derivative assets of £166m (2009 £287m)

25. Financial risk management (continued)

Credit Risk (continued)

Table 3 - Exposure to credit risk

As at 31 December 2009 Shareholder assets	AAA £m	AA £m	A £m	BBB £m	BB & below £m	Unrated £m	Total £m
Government securities	3	-	-	-	-	-	3
Other fixed rate securities	7	17	69	113	10	-	216
Variable rate securities	48	5	53	41	5	-	152
Total debt securities	58	22	122	154	15	-	371
Accrued interest	-	-	2	2	-	-	4
Derivative assets	-	-	8	-	-	-	8
Total financial investments	58	22	132	156	15	-	383
Other assets	-	-	-	-	-	1	1
Cash at bank	-	7	25	-	-	-	32
Total assets exposed to credit risk	58	29	157	156	15	1	416

Non profit plus RPI-linked	AAA £m	AA £m	A £m	BBB £m	BB & below £m	Unrated £m	Total £m
Government securities	408	25	6	-	-	-	439
Other fixed rate securities	894	1,444	7,078	6,025	546	590	16,577
Variable rate securities[1]	1,002	367	1,065	238	32	1,263	3,967
Total debt securities	2,304	1,836	8,149	6,263	578	1,853	20,983
Accrued interest	20	30	156	134	14	9	363
Derivative assets	-	37	763	-	-	-	800
Total financial investments	2,324	1,903	9,068	6,397	592	1,862	22,146
Other assets	-	-	-	-	-	3	3
Cash at bank	-	60	192	-	-	-	252
Total assets exposed to credit risk	2,324	1,963	9,260	6,397	592	1,865	22,401

25. Financial risk management (continued)

25.8 Liquidity risk

Liquidity risk is the risk that the Company, though solvent, either does not have sufficient financial resources available to enable it to meet its obligations as they fall due or can secure them only at excessive cost The Group's liquidity risk policy defines the overall framework for the management of liquidity risk The Company does not seek exposure to liquidity risk in its own right, but recognises that exposure to liquidity risk can arise as a consequence of the markets in which it operates, the products that it writes and through the execution of investment management strategies

The liquidity risks to which the Company's insurance business may be exposed primarily stem from low probability events that if not adequately planned for may result in unanticipated liquidity requirements Collateral requirements for derivative/futures transactions and other types of financial instrument can also give rise to liquidity risk if sufficient cash or suitable alternative assets are not available to meet collateral calls when due

A limited level of contingent liquidity risk is an accepted element of writing contracts of insurance However, the Company's insurance business seek to maintain sufficient liquid assets and standby facilities to meet a prudent estimate of the cash outflows that may arise from contingent events The level of required liquidity to be maintained by insurance funds is identified using techniques including cash flow analysis for ranges of extreme scenarios and stress tests for shock events

To ensure an appropriate pool of liquid assets is maintained in line with a prudent estimate of cash outflows, the profile of investment assets held to meet future liabilities from writing insurance business are structured to include an appropriate proportion of cash and other readily realisable assets The required profile is formally defined as part of asset benchmarks provided to the investment managers, with regular management information provided by the investment manager on the actual holding relative to the fund benchmark

In addition to each insurance fund maintaining a pool of liquid assets, the Group's Treasury function provides formal facilities to the Group's operating subsidiaries to cover contingent liquidity requirements arising from more extreme events and where investment assets may not be readily realisable The facility available to each subsidiary is determined through analysis of potential shock events and the potential timing differences that may arise in cash flows

Specific liquidity risks associated with the Company's core product lines and the risk mitigation techniques are as follows

Annuities Potential for liquidity risk arises within two specific aspects of the Company's annuity business (i) changes in future pension commitments and (ii) collateral requirements risk hedging strategies

(i) changes in future pension commitments - Once business has been written, cash outflows for pensions in payment are generally predictable, enabling the Company to structure the liquidity, income and maturity profile of investment assets backing long term liabilities to meet projected cash outflows Although variations in longevity can alter the duration of outflows over the long term, trends are gradual, providing opportunity to respond with appropriate risk mitigation strategies

25. Financial risk management (continued)

25.8 Liquidity risk (continued)

(ii) Collateral requirements for risk hedging strategies - As part of the investment asset management strategy for the Company's annuity business, financial instruments are utilised to manage exposure to fluctuations in interest rates, inflation and foreign currency, which may otherwise result in long term liabilities being unmatched Financial instruments are also used to mitigate the impact of rating downgrades and defaults within corporate bond portfolios The use of such financial instruments can require the posting of liquid collateral with counterparties, and as such an appropriate pool of the asset types specified by counterparties must either be held or readily available In this context, the Company's annuities portfolio held eligible assets worth 10 times the outstanding collateral as at 31 December 2010

Within the overall fund of investment assets held to meet the long term liabilities arising from annuity business, £334m is held in cash and other highly liquid investment types for general liquidity purposes at 31 December 2010

The ultimate holding company, Legal & General Group Plc's treasury function manages the Company's banking relationships, capital raising activities, overall cash and liquidity position and the payment of dividends The Company seeks to manage its corporate funds and liquidity requirements on a pooled basis and to ensure the Company maintains sufficient liquid assets and standby facilities to meet a prudent estimate of its net cash outflows In addition, it ensures that, even under adverse conditions, the Company has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities

In addition, the parent company Society is committed to financing operating losses, should they arise, through a contingent loan arrangement

25.9 Sensitivity analysis

The objective of embedded value is to provide shareholders with realistic information on the financial position and current performance of the Company

The methodology requires assets of an insurance company, as reported in the primary financial statements, to be attributed between those supporting the covered business and the remainder The method accounts for assets in the covered business on an European Embedded Value (EEV) basis and the remainder of the Company's assets on the UK GAAP basis adopted in the primary financial statements

Cash flow projections are determined using realistic assumptions for each component of cash flow and for each policy group Future economic and investment return assumptions are based on conditions at the end of the financial year Future investment returns are projected based on an assumed investment return attributed to assets at their market value The assumed discount and inflation rates are consistent with the investment return assumptions

25. Financial risk management (continued)

25.9 Sensitivity analysis (continued)

The table below shows the effect of alternative assumptions on the long term embedded value, prepared in accordance with the guidance issued by the CFO Forum in October 2005, and are different to the numbers reported on a UK GAAP basis

The Group uses embedded value (EV) financial information to manage and monitor performance, and hence the financial risks, as it is believed to provide information about the value which is being created from Society's insurance business

Opposite sensitivities, where not given, are broadly symmetrical

Effect of embedded value

	As published £m	1% lower risk discount rate £m	1% higher risk discount rate £m	1% lower interest rate £m	1% higher interest rate £m
As at 31 December 2010	**2,807**	**287**	**(244)**	**157**	**(131)**
As at 31 December 2009	1,989	221	(187)	(18)	(3)

	1% higher equity returns £m	10% lower equity returns £m	10% lower maintenance expenses £m	10% lower lapse rates £m	5% lower mortality / morbidity £m
As at 31 December 2010	**41**	**(28)**	**46**	**9**	**(155)**
As at 31 December 2009	44	(36)	37	8	(128)

Detailed projection assumptions including mortality, persistency, morbidity and expenses, reflect recent operating experience and are reviewed annually Allowance is made for future improvements in annuitant mortality based on experience and externally published data Favourable changes in operating experience are not anticipated until the improvement in experience has been observed

25. Financial risk management (continued)

25.9 Sensitivity analysis (continued)

All costs relating to the covered business, whether incurred in the covered business or elsewhere in the Company, are allocated to that business The expense assumptions used for the cash flow projections therefore include the full cost of servicing this business

UK assumptions in EEV calculations

(i) The assumed future pre-tax returns on fixed interest and RPI linked securities are set by reference to the portfolio yield on the relevant backing assets held at market value at the end of the reporting period The calculated return takes account of derivatives and other credit instruments in the investment portfolio Indicative yields on the total portfolio, after allowance for long term default risk, are shown below

For annuities, separate returns are calculated for new and existing business Indicative combined yields, after allowance for long term default risk and the following additional assumptions, are also shown below These additional assumptions are

i Where cash balances are held at the reporting date in excess or below strategic investment guidelines, then it is assumed that these cash balances are immediately invested or disinvested at current yields

ii Where interest rate swaps are used to reduce risk, it is assumed that these swaps will be sold before expiry and the proceeds reinvested in corporate bonds with a redemption yield 0 70% p a (2009 0 70% p a) greater than the swap rate at that time (i e the long term credit rate)

iii Where reinvestment or disinvestment is necessary to rebalance the asset portfolio in line with projected outgo, this is also assumed to take place at the long term credit rate above the swap rate at that time

The returns on fixed and index-linked securities are calculated net of an allowance for default risk which takes account of the credit rating, outstanding term of the securities, and increase in expectation of credit defaults over the economic cycle The allowance for corporate securities expressed as a level rate deduction from the expected returns was 29bps at 31 December 2010 (2009. 42bps)

25. Financial risk management (continued)

25.9 Sensitivity analysis (continued)

Economic assumptions

	2010 % pa	2009 % pa
Equity risk premium	**3.5**	3 5
Property risk premium	**2.0**	2 0
Investment return		
Long term rate of return on non profit annuities	**5.5**	6 1
Risk free rate[1]	**4.0**	4 5
Risk margin	**3.3**	3 5
Risk discount rate (net of tax)	**7.3**	8 0
Inflation		
- Expenses/earnings	**4.1**	4 6
- Indexation	**3.6**	3 6

1 The risk free rate at 2010, is the gross redemption yield on the 15 year gilt index (2009 20 year gilt index)

UK life and pensions

(i) Assets are valued at market value

(ii) The value of in-force business reflects the cost, including administration expenses, of providing for benefit enhancement or compensation in relation to certain products

(iii) Other actuarial assumptions have been set at levels commensurate with recent operating experience, including those for mortality, morbidity, persistency and maintenance expenses (excluding the development costs referred to below) These are normally reviewed annually

An allowance is made for future improvements in annuitant mortality based on experience and externally published data Male annuitant mortality is assumed to improve in accordance with 100% of CMI2009 Working Paper 41, with a minimum annual improvement of 1 5% for future experience, and 2 0% for statutory reserving Female annuitant mortality is assumed to improve in accordance with 100% of CMI2009, with a minimum annual improvement of 1 0% for future experience and 1.5% for statutory reserving In each case, the annual improvement is assumed to reduce linearly after age 85 to zero at age 120

On this basis, the best estimate of the expectation of life for a new 65 year old Male CPA annuitant is 24 0 years (2009 24 5 years) The expectation of life on the regulatory reserving basis is 25.6 years (2009 25 7 years)

(iv) Development costs relate to investment in strategic systems and development capability

26. Contingent liabilities, guarantees and indemnities

The Company has given indemnities and guarantees, including interest rate guarantees, as a normal part of their operating activities or in relation to capital market transactions

27. Management of capital resources

The financial strength of the Company is measured by reference to its accounts prepared under UK GAAP due to its status as an ISPV The Company's total capital resources of £1,572m (2009 £1,679m) comprise ordinary equity holders capital £981m (2009 (£698m)) and £591m (2009 £981m) in respect of the contingent loan

The Company aims to manage its capital resources to maintain financial strength, policyholder security and the Group's relative external financial strength ratings advantage The Company also seeks to maximise its financial flexibility by maintaining strong liquidity and by utilising a range of alternative sources of capital including equity, senior debt, subordinated debt and reinsurance

Capital measures

The Company measures its capital on a number of different bases, including those which comply with the regulatory framework within which the Company operates, and those which the directors consider most appropriate for managing the business The measures used by the Company include

Accounting bases
Management manage capital and cash flow usage and to determine dividend paying capacity in accordance with the primary financial statements prepared under UK GAAP

In addition, the directors believe that the supplementary accounts to the Legal & General Group Plc report and accounts, prepared using EEV principles, provide an alternative view of the Group's long-term operations and the value of the business to shareholders Accordingly the Company's net asset value and total capital employed are also analysed and measured on this basis and form part of the EEV Group accounts

Regulatory bases
The financial strength of the Company is measured by reference to its accounts prepared under UK GAAP due to its status as an ISPV

Available regulatory capital resource risks

The Company's available capital resources are sensitive to change in market conditions, due to both changes in the value of the assets and to the effect that changes in investment conditions may have on the value of the liabilities Capital resources are also sensitive to assumptions and experience relating to mortality and morbidity and, to a lesser extent, expenses and persistency

The most significant sensitivities arise from the following two risks

- market risk in relation to the UK annuity business, which would crystallise if the return from the fixed interest investments supporting this business were lower than that assumed for reserving

- mortality risk in relation to the UK annuity business, which would crystallise if the mortality of annuitants improved more rapidly than the assumptions used for reserving