

The **co-operative** insurance
good with money

Co-operative Insurance Society Limited
Support and security in the community.

Financial statements 2009

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Business and financial review

The Co-operative Insurance Society (CIS) and its parent group the Co-operative Financial Services (CFS) have emerged relatively unscathed from the global crisis prompted by the credit crunch and the ensuing worldwide recession. This was no accident – our business is underpinned by a set of principles we call givens, amongst which is an absolute commitment to be financially prudent and strong.

Indeed, that financial strength is essential if we are to deliver on our pledge to put our members and customers first in all that we do if we did not maintain that financial strength. This is reflected in our continued strong levels of liquidity, capital and profitability. As many competitors are forced to consider retrenchment, both CIS and the Co-operative Financial Services have been able to set out a strategy for growth, underpinned by strong capital reserves. Our business model demonstrates that ambition and prudence are not mutually exclusive.

The merger of CFS with Britannia Building Society has created the UK's most diversified, mutual financial services provider. Merging two complementary businesses driven by shared givens and values, offers the UK consumer a member-owned, customer-led and ethically-guided alternative to the shareholder-owned or increasingly state-owned model so publicly called into question by the 'credit crunch'. Moreover, the merger delivers increased reach, diversity and opportunity without impairing the financial stability of the business or the interests of our customers.

Highlights

Long term business

2009 saw further turbulence with equity and credit markets reaching a six year low in early March. Markets subsequently recovered and strong growth in the second half of 2009 saw the FTSE 100 end the year around 50% higher than the lows in March. The rate of deterioration in economic data has slowed with business expectations starting to improve, and investors becoming more confident that government policy measures will prevent a slump in economic activity.

Long term business, run in the interests of policyholders, saw sales figures increase 13% on 2008 levels, with new business profitability of £10.3m compared to only £1.6m in 2008. The present value of new business premiums for 2009 rose to £606m, an increase of 30% compared to 2008. We have seen customers continue to take a more cautious attitude to risk during 2009 and sales of our single premium With-Profits Bond and Investment Bond have increased significantly from 2008 volumes. Improved sales were achieved through increased productivity, against a backdrop of a strategic reduction in the number of financial advisers over the year from 900 to 600.

Maintenance expenses have fallen by 8.5% from £69.5m in 2008 to £63.6m in 2009, as a result of cost efficiencies and a reduction in financial advisor numbers.

We are continuing our initiative to expand the distribution of our unit trusts to independent financial advisers and other intermediaries in the wider investment market, and believe this represents an exciting opportunity.

Gross earned insurance premiums for life and pensions business fell slightly in 2009 from £497.9m to £490.8m. The fall in premium income is lower than in previous years, stemmed by strong single premium sales offsetting the reduction in regular premium from in-force with-profits business as policies reach maturity or retirement. Net policyholder claims paid fell from £1,315.9m to £1,015.9m as a result of fewer maturing endowments than in previous years.

CIS has nearly three million with-profits policies in force and continues to add value for its with-profits policyholders and to ensure that a competitive return is achieved on their savings. In determining bonuses that are payable on with-profits policies, directors follow the Principles and Practices of Financial Management (PPFM), which can be found on our website. Returns for traditional with-profits policyholders were 14% for the financial year, reflecting the recovery in economic conditions. Traditional with-profits policyholders continue to benefit from the smoothing of investment returns as well as in some cases having guaranteed benefits or cost-effective life cover.

Despite showing a mixed performance over the short term, the UK Income with Growth Trust continues to show top quartile over a rolling five year period. Total unit trust funds under management grew in 2009 from £2.1bn to £2.6bn.

The CIS Sustainable Leaders Trust, our flagship Socially Responsible Investment (SRI) fund, also recorded top quartile performance for a rolling five year period, despite the absence of exposure, for environmental reasons, to the strongly performing mining and oil sectors.

Two new funds, the Sustainable Diversified Trust and the Sustainable World Trust, were launched this year to broaden our range of unit trusts for our customers. The initiative was extremely successful with more than £40m invested in the five months since launch. The new funds follow the same SRI policy as the Sustainable Leaders Trust, but are targeted at investors with a more cautious attitude to risk and will invest in a wider range of asset classes to provide investors with greater diversification and reduced exposure to stock market volatility.

All surpluses arising on the long term business are applied for the sole benefit of policyholders by transfer from the income statement to the Unallocated Divisible Surplus (UDS). During the period, the amount of free surplus represented by the UDS increased significantly, and the UDS rose by £430.6m to return to end-2007 surpluses. The main reasons for the increase in UDS were positive returns on equities and corporate bonds in 2009, and a reduction in the assumed volatility of future investment returns.

At 31 December 2009 the realistic working capital within the CIS long-term business fund, being the excess of the realistic value of assets over the realistic value of liabilities, stood at £1,008m compared to £573m at the start of the financial year. Excluding the effect of gilt repurchase and reinsurance collateral arrangements, this represents a working capital ratio of 7.2% compared to 3.7% at 10 January 2009.

During 2009, excellent progress has been made on embedding the arrangement with Capita to provide administration services, with the migration of the annuity payment administration system on to Capita systems. As we move forward this deal will deliver improved service propositions, a more contemporary product range and a reduced overall cost base.

CIS was top quartile for customer advocacy in the 2009 Association of British Insurers (ABI) Customer Impact Survey, where two-thirds of customers were 'very likely' or 'extremely likely' to recommend CIS to others. Advocacy was even more emphatic amongst recent customers where the level rose to 80%. This reflects the particularly strong brand enjoyed by CIS.

Other than long term business

CIS has not transacted general insurance business during 2008 or 2009. Furthermore all risks and rewards associated with the run-off of general insurance contracts written prior to 15 January 2006 now reside with CIS General Insurance Limited (CISGIL), a related company, under the terms of an indemnification agreement. As a result, the whole of the profit derived from other than long term business during 2009 represents net investment return arising from assets backing shareholder reserves.

Investment in the future

Following the 'merger from strength' between Britannia Building Society and CFS, the business has revisited its purpose, givens, vision and values. CFS has restated its vision of becoming the UK's most admired financial services business, and is reinforcing that vision with significant investment in its people, processes, products and services.

A significant investment has been agreed over the next three years to create the process infrastructure the business requires, to deliver an easy, responsible, fair and personal service to all customers, however they access those services. The banking transformation programme will help transform our customer proposition over the next three years.

In tandem with this programme of investment, the business continues to deliver significant underlying cost reductions. Simplified business processes, enhanced cross-selling and service capabilities and rationalisation of service functions will help drive down operating costs while delivering first-class service.

The development of a single organisation from two heritage businesses has progressed at a fast pace, with a joint executive and senior management structure already in place. The process will continue through the first half of 2010.

Summary and outlook

CIS has had an excellent year in 2009 with a significant increase in new business sales, lower operating expenses, excellent returns for its with-profits policyholders and solid growth in working capital.

With new EU rules on solvency to be launched in 2012 (Solvency 2), CIS has initiated a major project to build on the developments already made in risk and capital management over recent years, and implement and embed Solvency 2 throughout the business. CIS has contributed to each of the Quantitative Impact Studies issued by the Committee of European Insurance and Occupational Pensions Supervisors so far, and is closely monitoring the impact of the new rules.

As a core member of the CFS group of businesses, and supported by the strong brand presence of the Co-operative Group, CIS continues to play a key role in delivering an easy, responsible, fair and personal service to customers however they choose to access that service.

Co-operative Insurance Society Limited

Non-executive directors:

- Steve Watts** (MA (Cantab), MA (Econ), BA (Hons)). Age 58. Joined the Board in 2000 and appointed chair in 2009. Member of the Central and Eastern Regional Board. Pricing, research and information officer within the Directorate of Employment and Skills at Cambridge Regional College. Deputy chair of Co-operative Group Limited and Co-operative Financial Services Limited. Non-executive director of The Co-operative Bank plc and chair of CIS General Insurance Limited.
- Rodney Baker-Bates** (MA, FCA, AIMC, FCIB). Age 65. Joined the Board in 2009*. Directorships also held at Assura Group plc, Bedlam Asset Management plc, Dolphin Square Trust Limited, EG Solutions plc, G's Group Holding Limited, Stobart Group plc. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Duncan Bowdler** (BSc (Hons)). Age 51. Joined the Board in 2009. Trade liaison manager. Member of the Co-operative Group North West and North Midlands Regional Board. Non-executive director of Co-operative Group Limited, Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Bob Burlton** (BSc (Hons), Cert Dip). Age 61. Joined the Board in 2003. President of Consumer Co-operatives Worldwide since 2005. Chair of Co-operative Financial Services Limited, The Co-operative Bank plc and non-executive director of CIS General Insurance Limited.
- David Davies** (BSc (Econ), FIA). Age 62. Joined the Board in 2003 and is the senior independent director. Chair of Sun Life Assurance Company of Canada (UK) and Nortel Networks Pension Scheme in the UK and non-executive director of Interglobal Insurance Company Limited. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Paul Flowers** (BA (Hons)). Age 59. Superintendent Methodist minister/Bradford city councillor. Joined the Board in 2009. Member of the Co-operative Group North Regional Board. Non-executive director of Co-operative Group Limited, Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Peter Harvey** (ACIB, Dip FS). Age 54. Joined the Board in 2009*. Consultant to Berwin Leighton Paisner LLP. Also non-executive director at Marshalls Holdings Limited and a member of the supervisory board and audit committee of Surrey Cricket Club Limited. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Paul Hewitt** (MA, ACA, Dip German (Open)). Age 54. Joined the Board in 2003. Non-executive director of Kiln Group, Collins Stewart plc and the Personal Accounts Delivery Authority. Chairman of Portrait Software plc and the Good Care Group Limited. Industrial partner with Lyceum Capital, a mid market private equity firm. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Chris Jones** (LLB). Age 57. Joined the Board in 2009*. Member of the Institute of Credit Management, the Law Society and a Fellow of the Royal Society of Arts and of the Association of Business Recovery Professionals. Runs Tourmalet Consulting, specialising in business turnaround. Non-executive director of Agenda Management Services Limited, Trango Limited, The Business Desk and Armitage Jones LLP. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited. Chair of Illius Properties Limited.
- Stephen Kingsley** (BSc (Hons), FCA). Age 57. Joined the Board in 2009*. Over 35 years' experience in financial services primarily auditing and consulting. Has held senior positions at Arthur Andersen and AON Corporation. Currently a senior managing director at FTI Consulting, the global expert services firm. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Peter Marks** Age 60. Joined the Board in 2009. Chief executive of Co-operative Group Limited. Named Orange Leader of the Year 2009 in the National Business Awards. Entire working life spent within the co-operative movement. Instrumental in bringing about a number of major co-operative mergers over the past decade. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.
- Bob Newton** (BSc, FIA, CDir). Age 60. Joined the Board in 2007. Retired from the insurance industry in 2006, since when he has built a portfolio of business and pro bono interests. Holds non-executive directorships with UIA (Insurance) Limited and AI Claims Solutions plc. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Ben Reid (FCCA). Age 55. Joined the Board in 2009. Chief executive of the Midcounties Co-operative. Regional chair of the Learning and Skills Council and also chair of Walsall Hospitals NHS Trust. Non-executive director of Co-operative Group Limited, Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Len Wardle (BA). Age 65. Joined the Board in 2001. Chair of Co-operative Group Limited and member of the South East Regional Board. Held management positions in local government and latterly was a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Martyn Wates (ACA, ATII, BA (Hons)). Age 43. Joined the Board in 2007. Chief financial officer, Co-operative Group Limited. Has held various senior finance positions within the co-operative movement. Director of various internal subsidiaries and non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Piers Williamson (BA (Hons) ACIB, MCT). Age 48. Joined the Board in 2005. Over 25 years' experience of the UK, US and European financial markets. Holds non-executive directorships with various Industrial and Provident Societies and funding vehicles associated with the Housing Finance Corporation, where he is chief executive. Non-executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Executive directors:

Neville Richardson (BA (Hons), FCA). Age 52. Joined the Board in 2009*. Chief executive. Prior to joining the group was chief executive of Britannia Building Society. Director of Mutuo (Communicate Mutuality Limited). Member of the Court of the University of Lancaster and of the Building Societies Association Council. Also chief executive of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Rod Bulmer (BA (Hons) MSc). Age 40. Joined the Board in 2009. Managing director, retail. Joined Co-operative Financial Services in October 2007 and became sales director in July 2008. Executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited. Also chair of The Co-operative Academy of Manchester.

Tim Franklin (ACIB). Age 48. Joined the Board in 2009*. Chief operating officer. Formerly managing director of Member Business at Britannia Building Society. Executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

Phil Lee (BSc, CA). Age 54. Joined the Board in 2009*. Integration and change director. Formerly managing director of Britannia Capital Investment Group. Executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

John Reizenstein (MA (Cantab)). Age 53. Joined the Board in 2003. Managing director, corporate and markets. Member of the Financial Reporting Review Panel. Executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited. Chair of The Co-operative Asset Management Limited.

Barry Tootell (BA, FCA). Age 48. Joined the Board in 2008. Chief financial officer. Qualified accountant with over 20 years of finance and control experience. Chair of CFS Management Services Limited. Executive director of Co-operative Financial Services Limited, The Co-operative Bank plc and CIS General Insurance Limited.

*Formerly on the Board of Britannia Building Society

Report of the Board of directors

Business review

A review of the development and performance of the Society and its operating subsidiaries during the financial period and any significant events since the year end, are set out on pages 2 and 3. The principal risks and uncertainties facing the Society are set out in the risk management section on pages 27 to 35. The Society's key financial and non-financial performance indicators are described below. Note 15 of the financial statements provides details of the Society's principal subsidiaries and the nature of each organisation's business.

Principal activities

The principal activity of the Society is to provide life insurance, pensions and savings products and solutions. Formerly the Society wrote general insurance business; however, with effect from the commencement of the 2006 financial period, all new general insurance business is transacted by CIS General Insurance Limited (a fellow subsidiary of the CFS Group). The Society continues to be responsible for the run-off of liabilities arising from general insurance business transacted prior to 15 January 2006. However, all risks and rewards arising from the run-off of this business have been transferred to CIS General Insurance Limited under the terms of an indemnification agreement. The Society and its subsidiaries also invest in and manage stocks, shares, loans and properties.

Change in accounting reference date

Following the merger of CFS and Britannia Building Society on 1 August 2009 and in line with the ultimate parent company, Co-operative Group Limited, the Society has changed its accounting reference date to 31 December.

The 2009 year reflects 355 days which has been stated as 51 weeks. 2008 reflects a 52 week period (365 days).

Changes to the Board

The names of the present members of the Board and their biographies and details of length of service are set out on pages 4 and 5.

The directors of the Society during the financial year are listed below. They were appointed for the full period unless otherwise indicated:

Non-executive directors:	Date of appointment	Date of resignation
Steve Watts (chair)		
Rodney Baker-Bates	1 August 2009	
Graham Bennett		6 June 2009
Duncan Bowdler	8 July 2009	
Bob Burlton		
Simon Butler		6 June 2009
David Davies		
Paul Flowers	8 June 2009	
Peter Harvey	1 August 2009	
Paul Hewitt		
Chris Jones	1 August 2009	
Stephen Kingsley	1 August 2009	
Peter Marks	9 June 2009	
Terry Morton		6 June 2009
Bob Newton		
Ben Reid	8 June 2009	
Kathryn Smith		6 June 2009
Graham Stow		31 May 2009
Len Wardle		
Martyn Wates		
Piers Williamson		
Executive directors:		
David Anderson		31 July 2009
Neville Richardson (chief executive)	1 August 2009	
Rod Bulmer	1 August 2009	
Tim Franklin	1 August 2009	
Phil Lee	1 August 2009	
Dick Parkhouse		31 July 2009
John Reizenstein		
Barry Tootell		

Election of directors

The directors of the Board are elected by the members in accordance with the Rules of the Society.

Re-appointment of directors

Under the Rules of the Society, with the exception of the executive directors, the directors are appointed for a three year term starting on the day after the Annual General Meeting (AGM) at which they are appointed. The Rules of the Society were amended in July 2009, to make provisions for the merger with Britannia, including the appointment arrangements for the former non-executive Britannia directors (Rodney Baker-Bates, Peter Harvey, Chris Jones, Stephen Kingsley). None of the former Britannia directors are required to put themselves forward for re-appointment during the three years following the merger date (1 August 2009). At the AGM in May 2010, David Davies, Paul Hewitt, Bob Newton and Piers Williamson will be eligible for re-appointment.

The Rules were also amended to provide that if any former Britannia director ceases, for whatever reason, to be a director during the period of three years following the merger date no person will be appointed as a former Britannia director to fill that vacancy without the prior approval of a majority of the former Britannia directors who are still directors at that time.

All directors eligible for re-appointment continue to demonstrate commitment to their roles.

The Annual General Meeting will be held on 12 May 2010.

Directors' and officers' liability insurance and indemnity

The Society maintains appropriate directors' and officers' liability insurance cover, through the ultimate parent organisation, in respect of legal action against its directors and officers. The arrangements for this are currently under review.

The directors, the secretary and any of the Society's approved persons under the Financial Services and Markets Act 2000 from time to time have entered into a contract of indemnity with the Society in respect of certain liabilities they may incur whilst discharging their functions.

Directors and their interests

No director had a material interest at any time during the year in any contract of significance, other than a service contract, with the Society or any of its subsidiary undertakings.

No director had a beneficial interest in any shares in the Co-operative Group Limited, which is the ultimate holding organisation, or in any other entity controlled by the Co-operative Group Limited.

Results and distributions

A detailed review of the business is contained in the business review.

Annual bonuses have been declared for traditional with-profits policies as follows:

- Assurances (ordinary section): 0.4% of basic benefits and 0.5% of attaching normal annual bonuses granted since 31 December 1983;
- Series A Additional Voluntary Contributions (AVCs): 0.25% of basic benefits and 0.3% of attaching bonuses;
- Other annuities and retirement benefits (non – Series A): 2.0% of basic benefits; and
- Assurances (industrial section): 0.2% of basic benefits and 0.25% of normal reversionary bonuses granted since 31 December 1983.

Interim bonuses on accumulating with-profits policies are as follows:

- Platinum Bond Plus effected before 1 April 2004: 0.75% of the bond value per annum;
- Platinum Bond Plus effected on or after 1 April 2004 and before 31 March 2009: 2.0% per annum;
- Platinum Bond Plus effected on or after 1 April 2009: 3.25% per annum;
- Platinum Plus (within an Individual Savings Account): 1.5% of the policy value per annum;
- Platinum Plus (outside an Individual Savings Account): 1.25% of the policy value per annum;
- Funeral Prepayment Plan: 1.25% of the policy value per annum; and
- Funeral Investment Plans: 1.5% of the policy value per annum.

Final bonuses have also been declared in both the ordinary and industrial sections.

Long term business recorded a transfer to the unallocated divisible surplus of £430.6m (2008: transfer from the unallocated divisible surplus of £433.4m).

An interim dividend of £21.2m was paid to the shareholder, CFS Limited, during 2009 (2008: nil). The directors do not recommend the payment of a final dividend (2008: £49.1m – paid in 2009).

The directors recommend that interest on the paid-up share capital be paid at the rate of 12.0% per annum for the period ended 31 December 2009.

Report of the Board of directors

Key performance indicators

The CFS Group has introduced a balanced scorecard that reflects its goals as a business over its three-year corporate plan. The balanced scorecard is used to measure our success in delivering our strategy, by measuring each business area's performance across four areas: financial, customer, people and process. This ensures we all measure our performance and management across the whole breadth of the strategy, rather than just one aspect of it.

Financial

For CIS the key financial performance measures are:

- shareholder profitability for funds other than the long term business fund; and
- new business profit and maintenance expenses for the long term business funds.

Profitability is defined as profit before significant items and tax and is the key financial performance measure in the CFS Group.

New business profit is the value of new life and savings business written during the year, allowing for the cost of capital. Our life and savings business is written solely for the benefit of our life and savings customers. Our aim, therefore, is to provide products and services at a price which passes the benefits of writing the business back to customers.

Maintenance expenses are the costs of servicing activities for the in-force life and savings business. In 2009, our costs of £63.6m were better than our target of £68.9m.

Customer

Our current measurement of overall customer satisfaction is derived from GFK NOP's syndicated Financial Research Survey (FRS). The FRS is the largest survey in the marketplace (with 60,000 financial services customers interviewed each year).

Customers register their satisfaction levels with their providers at product level on a seven point scale; these are then weighted by customer numbers to produce business unit level scores and an overall measure for CFS. To ensure a statistically robust sample per CFS product area and to even out any seasonal variations in scores, a rolling 12 months worth of data is used.

Customer satisfaction for December 2009 stands at 71.1% compared to 74.3% at the end of 2008 and below the 2009 target of 75.3%, in line with the industry level for 'general satisfaction'. Life and savings finished 2009 at 66.1% compared to 69.7% at the end of 2008 and against a 2009 target of 71.4%.

People

At the CFS we are very aware that our success is driven by our people, and throughout 2009 we pursued a number of strategies to increase the engagement levels among colleagues.

In common with many businesses across the world, we use a colleague opinion survey (*the voice*) to measure how many of our people are engaged with the business.

Engagement is based on emotional attachment to the organisation, willingness to stay with the organisation and discretionary effort – how much colleagues are motivated to go beyond their normal duties to help the organisation achieve its aims. These measures are often referred to as 'Say, Stay and Strive', and our survey shows us what proportion of our colleagues feel positive across all three elements.

This proportion is known as our Engagement Index (EI), and, in 2009, the EI score was 87%, an increase of 23 percentage points from the previous year. This represents remarkable progress against our strategic plan, which was to increase the EI score by five percentage points per year, and demonstrates the effectiveness of the corporate strategies in 2009.

Process

The CFS Group has a key initiative to limit risks across the business. Risk limits are thresholds we should operate within if we want our business to be effective. Risk limits can be set on some of our financial measures (like bank and general insurance capital buffers and liquidity) or on processes (like our adherence to the business continuity policy). This measure monitors our compliance with these limits; success means we do not breach any of them. Further details of CIS' risk management indicators can be found on pages 27 to 35.

Staff

On 6 April 2006 all contracts of employment between CIS and its employees were transferred to CFS Management Services Limited (CFSMS), a fellow subsidiary of the CFS Group. As a result the Society no longer has any employees and all sales have been effected through financial advisers and staff of CFS Management Services Limited, which also provides administrative and other services. A management charge is payable to cover the costs of these services.

Corporate responsibility and the environment

The Co-operative Group Sustainability Report, which was published towards the latter half of the 2009 financial period, describes how the Co-operative and CFS Group of companies including Co-operative Insurance Society Limited, CIS General Insurance Limited and The Co-operative Bank plc, manage their social, ethical and environmental impacts.

Political and charitable donations

The Society is not directly responsible for the making of charitable donations as this is undertaken by CFSMS, a fellow subsidiary of the CFS Group. The Society contributes to the cost through the recharge of costs and services provided by CFSMS. It is the Society's policy that no donations are made for political purposes.

Market value of land and buildings

Land is included in the balance sheet of the Society under the heading of investment property. Fair value details may be found in note 13 of the financial statements.

Supplier payment policy and practice

All supplies and services are sourced through CFSMS. A management charge is payable to cover the costs of these services.

Financial statements

So far as the directors are aware, there is no relevant audit information of which the Society's auditors are unaware: and the directors have taken all steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Society's auditors have been made aware of that information. A statement by the directors as to their responsibilities for preparing the financial statements is included in the statement of directors' responsibilities.

Statement of directors' responsibilities in respect of the report of the Board of directors and the financial statements

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

Industrial and Provident Society Law, as modified by the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 (the Regulations), requires the directors to prepare financial statements for each financial period. In accordance with the Regulations the directors have elected to prepare both the consolidated and Society financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

The consolidated and Society financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position of the Group and the Society and the performance for that period. The Regulations, which apply the provisions of the Companies Act 2006, provide in relation to such financial statements that references in the relevant part of the Regulations to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the consolidated and Society financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Society and the Co-operative Group will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Society and enable them to ensure that its financial statements comply with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, which modified the Industrial and Provident Societies Acts 1965 to 2003. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Society and the Group and to prevent and detect fraud and other irregularities.

Under applicable law, the directors are also responsible for preparing a directors' report that complies with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) 2008, which modified the Industrial and Provident Societies Acts 1965 to 2003.

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

Statement of going concern

After making all appropriate enquiries, the directors have a reasonable expectation that the Society has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Society's financial statements.

Auditors

In accordance with Section 5 of the Friendly and Industrial and Provident Societies Act, 1968, a resolution for the re-appointment of KPMG Audit Plc as auditor of the Society and a resolution to authorise the directors to fix their remuneration are to be proposed at the next Annual General Meeting.

By order of the Board
Moirá Lees, secretary,
16 March 2010

Independent auditors' report

Independent auditors' report to the members of Co-operative Insurance Society Limited

We have audited the group and Society financial statements (the financial statements) of Co-operative Insurance Society Limited (the Society) for the period ended 31 December 2009, which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the Society balance sheet, the consolidated and Society cashflow statement, the consolidated and Society statement of changes in equity and the related notes. These financial statements have been prepared under the accounting policies set out therein and in accordance with the Industrial and Provident Societies Acts 1965 to 2003 as applied to the Society by and as modified by the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008.

This report is made solely to the Society's members, as a body, in accordance with the Industrial and Provident Societies Acts 1965 to 2003 and to facilitate compliance with section 496 of the Companies Act 2006, all as applied to the Society by and as modified by the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and to facilitate compliance by the Society's directors with the requirement relating to section 496 of the Companies Act 2006, as applied to the Society by Regulation 3 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Society's directors' responsibility for the preparation of the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the statement of directors' responsibilities on page 9.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, have been properly prepared in accordance with the relevant financial reporting framework and have been prepared in accordance with the Industrial and Provident Societies Acts 1965 to 2003 as applied to the Society by and as modified by the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, which modified the Industrial and Provident Societies (Group Accounts) Regulations 1969. In order to facilitate compliance by the Society's directors with the requirement relating to section 496 of the Companies Act 2006, as applied to the Society by Regulation 3 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, we also report to you whether, in our opinion, the information given in the Directors' Report is consistent with the financial statements. The information given in the directors' report includes that information presented in the business review and principal risks and uncertainties that is cross referred from the business review section of the report of the Board of directors.

In addition we report to you if, in our opinion, the Society has not kept adequate accounting records, if we have not received all the information and explanations we require for our audit, or if certain disclosures of directors' remuneration specified by law are not made.

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the Society's affairs as at 31 December 2009 and of the group's profit for the period then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the Society's financial statements have been properly prepared in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, which apply the provisions of chapters 4 and 5 of part 15 of the Companies Act 2006;
- the financial statements have been prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, which modify and apply the Industrial and Provident Societies Acts 1965 to 2003 and the Industrial and Provident Societies (Group Accounts) Regulations 1969; and
- the information given in the report of the Board of directors is consistent with the financial statements.

Jonathan Holt (senior statutory auditor)

for and on behalf of KPMG Audit Plc, statutory auditor

Chartered Accountants, Manchester

16 March 2010

Consolidated income statement

For the 51 week period to 31 December 2009

All amounts are stated in £m unless otherwise indicated

	Notes	Before significant items 2009	Significant items 2009	After significant items 2009	Before significant items 2008	Significant items 2008	After significant items 2008
Income							
Gross earned premiums		490.8	–	490.8	497.9	–	497.9
Less premiums ceded to reinsurers		(16.2)	–	(16.2)	(19.1)	–	(19.1)
Net earned premiums	2	474.6	–	474.6	478.8	–	478.8
Fee and commission income and income from service activities	3	46.6	–	46.6	46.4	–	46.4
Investment income	4	692.1	–	692.1	724.5	–	724.5
Gains less losses arising from financial instruments and other assets	5	457.6	–	457.6	(1,761.5)	–	(1,761.5)
Other operating income	6	5.0	–	5.0	21.2	–	21.2
Net income		1,675.9	–	1,675.9	(490.6)	–	(490.6)
Benefits, losses and expenses							
Claims paid and benefits	7	(1,227.9)	–	(1,227.9)	(1,562.3)	–	(1,562.3)
Less amounts receivable from reinsurers	7	212.0	–	212.0	246.4	–	246.4
Net policyholder claims and benefits	7	(1,015.9)	–	(1,015.9)	(1,315.9)	–	(1,315.9)
Change in insurance and participating contract liabilities	24	247.7	–	247.7	1,806.2	–	1,806.2
Change in reinsurance assets	24	(177.1)	–	(177.1)	(189.0)	–	(189.0)
Net policyholder claims and benefits incurred		(945.3)	–	(945.3)	301.3	–	301.3
Change in fair value of investment contract liabilities	26	(47.1)	–	(47.1)	54.2	–	54.2
Change in unallocated divisible surplus	25	(448.2)	17.6	(430.6)	395.6	37.8	433.4
Fees and commissions	8	(31.0)	–	(31.0)	(28.3)	–	(28.3)
Operating expenses	9	(100.0)	(20.9)	(120.9)	(111.7)	(46.3)	(158.0)
Investment expenses	10	(79.2)	–	(79.2)	(72.2)	–	(72.2)
Profit before taxation		25.1	(3.3)	21.8	48.3	(8.5)	39.8
Tax attributable to policyholders' returns		(9.6)	3.3	(6.3)	43.6	8.5	52.1
Profit before taxation attributable to shareholder's profits		15.5	–	15.5	91.9	–	91.9
Income tax (expense)/credit	11	(9.6)	3.3	(6.3)	23.8	8.5	32.3
Less tax attributable to policyholders' returns	11	9.6	(3.3)	6.3	(43.6)	(8.5)	(52.1)
Tax attributable to shareholder's profits		–	–	–	(19.8)	–	(19.8)
Profit for the financial period		15.5	–	15.5	72.1	–	72.1

The further analysis provided in note 1 provides an analysis of the income and expense flows from discontinued and continuing activities.

Profits for the financial period are attributable to the equity shareholder and relate to continuing activities.

2009 and 2008 significant items relate to a non-recurring expenditure associated with a CFS Group programme of restructuring.

Consolidated statement of comprehensive income

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

	Before significant items 2009	Significant items 2009	After significant items 2009	Before significant items 2008	Significant items 2008	After significant items 2008
Net profit for the period	15.5	–	15.5	72.1	–	72.1
Revaluation of owner occupied property	–	–	–	(4.8)	–	(4.8)
Revaluation of owner occupied property transferred to assets held for resale	–	–	–	14.8	–	14.8
Amounts taken to unallocated divisible surplus	–	–	–	(10.0)	–	(10.0)
Tax on revaluation of owner occupied property	–	–	–	1.3	–	1.3
Tax on revaluation of owner occupied property transferred to assets held for resale	–	–	–	(4.1)	–	(4.1)
Tax on amounts taken from unallocated divisible surplus	–	–	–	2.8	–	2.8
Total other comprehensive income	–	–	–	–	–	–
Total comprehensive income	15.5	–	15.5	72.1	–	72.1

Total comprehensive income for the financial period is attributable to the equity shareholder and relates to continuing activities.

Consolidated balance sheet

At 31 December 2009

All amounts are stated in £m unless otherwise indicated

	Notes	2009	2008
Assets			
Property, plant and equipment	12	43.1	–
Investment property	13	1,440.4	1,483.8
Intangible assets	14	12.0	11.4
Reinsurance assets	24	3,181.1	3,358.2
Financial investments at fair value through profit or loss	16	16,143.3	16,446.1
Loans at amortised cost	17	7.8	9.7
Derivative financial instruments	18	681.2	1,027.4
Income tax assets	33	33.1	–
Insurance receivables and other assets	19	247.6	365.8
Assets classified as held for sale	20	–	50.0
Cash and cash equivalents	21	55.9	50.8
Total assets		21,845.5	22,803.2
Capital and reserves attributable to the Society's equity holders			
Share capital	22	0.1	0.1
Retained earnings	23	77.9	113.0
Other reserves	23	317.0	317.0
Total equity		395.0	430.1
Liabilities			
Insurance and other participating contracts liabilities	24	16,069.1	16,316.8
Unallocated divisible surplus	25	1,052.8	622.2
Investment contract liabilities	26	259.9	190.9
Net asset value attributable to unit holders	15	42.1	–
Derivative financial instruments	18	502.9	396.8
Loans and borrowings	27	172.0	277.0
Amounts owed to credit institutions	28	1,071.2	1,814.4
Deferred tax liabilities	33	121.3	87.4
Other provisions	30	9.1	6.6
Insurance and other payables	31	156.7	291.8
Other reinsurance liabilities	32	1,993.4	2,268.9
Income tax liabilities	33	–	100.3
Total liabilities		21,450.5	22,373.1
Total equity and liabilities		21,845.5	22,803.2

Approved by the Board of directors on 16 March 2010 and signed on its behalf by:

Steve Watts, chair

Neville Richardson, chief executive

Moira Lees, secretary

Society balance sheet

At 31 December 2009

All amounts are stated in £m unless otherwise indicated

	Notes	2009	2008
Assets			
Property, plant and equipment	12	43.1	–
Investment property	13	1,416.9	1,452.1
Reinsurance assets	24	3,181.1	3,358.2
Investments in group undertakings	15	332.1	306.5
Financial investments at fair value through profit or loss	16	15,811.8	16,145.9
Loans at amortised cost	17	7.8	9.7
Derivative financial instruments	18	681.2	1,027.4
Income tax assets	33	33.5	–
Insurance receivables and other assets	19	226.4	323.0
Assets classified as held for sale	20	–	50.0
Cash and cash equivalents	21	6.3	1.7
Total assets		21,740.2	22,674.5
Capital and reserves attributable to the Society's equity holders			
Share capital	22	0.1	0.1
Retained earnings	23	77.9	113.0
Other reserves	23	317.0	317.0
Total equity		395.0	430.1
Liabilities			
Insurance and other participating contracts liabilities	24	16,069.1	16,316.8
Unallocated divisible surplus	25	1,029.7	598.8
Investment contract liabilities	26	259.9	190.9
Derivative financial instruments	18	499.8	363.9
Loans and borrowings	27	172.0	277.0
Amounts owed to credit institutions	28	1,071.2	1,814.4
Deferred tax liabilities	33	110.2	76.9
Other provisions	30	9.0	6.6
Insurance and other payables	31	130.9	231.2
Other reinsurance liabilities	32	1,993.4	2,268.9
Income tax liabilities	33	–	99.0
Total liabilities		21,345.2	22,244.4
Total equity and liabilities		21,740.2	22,674.5

Approved by the Board of directors on 16 March 2010 and signed on its behalf by:

Steve Watts, chair

Neville Richardson, chief executive

Maira Lees, secretary

Consolidated and Society cashflow statement

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

	Consolidated		Society	
	2009	2008	2009	2008
Cash flows from operating activities				
Profit before taxation	21.8	39.8	21.0	39.2
Adjustment for:				
Interest payable on intra-group borrowing	8.3	11.5	8.3	11.5
Depreciation of property, plant and equipment	–	0.5	–	0.5
Amortisation of deferred acquisition costs	5.0	9.4	–	–
Profit on sale of property, plant and equipment	–	(0.2)	–	(0.2)
Impairment of investment in group undertakings	–	–	–	50.8
Loss on disposal of investment in group undertaking	–	–	11.7	–
Impairment on shares in group undertakings	–	–	(35.9)	–
(Increase)/decrease in property, plant and equipment	(43.1)	42.1	(43.1)	42.1
Decrease in investment property	43.4	493.8	35.2	498.5
Decrease in financial instruments at fair value through profit and loss	302.8	2,411.1	334.1	2,707.2
Decrease in loans at amortised cost	1.9	3.0	1.9	8.4
Decrease/(increase) in derivative financial instruments	452.3	(90.8)	482.1	(123.7)
Increase in intangible assets	(5.6)	(2.9)	–	–
Decrease in reinsurance assets	177.1	189.0	177.1	189.0
Decrease/(increase) in assets held for sale	50.0	(50.0)	50.0	(50.0)
Net movement in other assets and other liabilities	(290.0)	470.8	(276.8)	484.6
Decrease in insurance and participating contract liabilities	(247.7)	(1,806.2)	(247.8)	(1,806.2)
Increase/(decrease) in unallocated divisible surplus	430.6	(423.4)	430.9	(429.3)
Increase/(decrease) in investment contracts liabilities	69.0	(29.2)	69.0	(29.2)
Decrease in amounts owed to credit institutions	(743.2)	(1,168.8)	(743.2)	(1,168.8)
Increase in net asset value attributable to unit holders	42.1	–	–	–
Purchase of shares in group undertakings	–	–	(141.4)	(320.0)
Income tax paid	(86.0)	(99.8)	(84.9)	(99.0)
Net cash flows from operating activities	188.7	(0.3)	48.2	5.4
Cash flows from investing activities				
Proceeds from sale of investments in group undertakings	–	–	140.0	–
Proceeds from sale of property, plant and equipment	–	0.2	–	0.2
Net cash flow from investing activities	–	0.2	140.0	0.2
Cash flows from financing activities				
Dividend paid	(70.3)	–	(70.3)	–
Interest paid on intra-group borrowing	(8.3)	(11.5)	(8.3)	(11.5)
Repayment of loan	(105.0)	–	(105.0)	–
Net cash flow from financing activities	(183.6)	(11.5)	(183.6)	(11.5)
Net increase/(decrease) in cash and cash equivalents	5.1	(11.6)	4.6	(5.9)
Cash and cash equivalents at the beginning of the financial period	50.8	62.4	1.7	7.6
Cash and cash equivalents at the end of the financial period	55.9	50.8	6.3	1.7

Cash flows from operating activities

CIS classifies the cash flows for the acquisition and disposal of financial assets as operating cash flows, as the purchases are funded from the cash flows associated with the origination of insurance and investment contracts, net of the cash flows for payments of benefits and claims incurred for insurance and investment contracts, which are respectively treated under operating activities. Additionally, operating cash flows include dividend income of £138.0m (2008: £172.5m) and interest income of £435.9m (2008: £430.2m).

Consolidated and Society statement of changes in equity

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

	2009	2009	2009	2009	2008	2008	2008	2008
	General	Retained	Share	Total	General	Retained	Share	Total
Consolidated and Society	reserve	earnings	capital		reserve	earnings	capital	
At the beginning of the period	317.0	113.0	0.1	430.1	317.0	40.9	0.1	358.0
Profit for the period	–	15.5	–	15.5	–	72.1	–	72.1
Total comprehensive income	–	15.5	–	15.5	–	72.1	–	72.1
Dividend paid	–	(70.3)	–	(70.3)	–	–	–	–
Tax on dividend	–	19.7	–	19.7	–	–	–	–
At the end of the financial period	317.0	77.9	0.1	395.0	317.0	113.0	0.1	430.1

Basis of preparation and significant accounting policies

For the period ended 31 December 2009

CIS is a co-operative society registered in England under the Industrial and Provident Societies Acts and not a company registered under the Companies Act. The consolidated financial statements consolidate the financial statements of CIS and its wholly-owned subsidiaries. The financial statements were authorised for issue by the directors on 16 March 2010. The insurance specific accounting policies are set out on pages 24 to 26.

Statement of compliance

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, which modified the Industrial and Provident Societies Acts 1965 to 2003. The Regulations require CIS to prepare its financial statements substantially as though it were a company registered under the Companies Act 2006 (the Act), and they apply, with certain exemptions, the provisions of Parts XV and XVI of the Act.

Basis of preparation

The consolidated and Society financial statements have been prepared and approved by the directors in accordance with IFRSs adopted by the EU (Adopted IFRS). On publishing the Society's financial statements here, together with the consolidated financial statements, CIS is taking advantage of the exemption in s408 of the Companies Act 2006 to not present an individual profit and loss account for the Society (applied by virtue of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008). The financial statements also follow the provisions of the Revised Statement of Recommended Practice on Accounting for Insurance Business (SORP) issued by the Association of British Insurers in December 2005 (as amended in December 2006) and FRS 27 *Life Assurance* insofar as these are compatible with the requirements of IFRS.

Going concern

CIS' business activities together with its financial position, capital resources and the factors likely to affect its future development and performance are set out in the business review on pages 2 and 3. In addition the risk management section of the accounts includes CIS' objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk and liquidity risk. The capital management section provides information on CIS' capital policies and capital resources.

In common with many financial institutions, CIS is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. CIS' forecasts and objectives, taking into account a number of potential changes in trading performance, insurance and investment risk, show that CIS should be able to operate at an adequate level of regulatory capital for the foreseeable future. CIS has also considered a number of stress tests on capital and these provide assurance that CIS is sufficiently capitalised.

Consequently, after making enquiries, the directors are satisfied that CIS has sufficient resources to continue in business for the foreseeable future and have, therefore, continued to adopt the going concern basis in preparing the financial statements.

The financial information has been prepared on the basis of IFRSs in issue that are endorsed by the EU and effective at 31 December 2009.

The financial statements are prepared on the historical cost basis except that the following assets are stated at their fair value: derivative financial instruments, investments valued at fair value through profit or loss and investment property.

In preparing these consolidated financial statements, the Society has adopted the following pronouncements during the year that are new or revised:

- IAS 1 (Presentation of Financial Statements (revised)) which revises the format of the financial statements; and
- amendments to IFRS 7 (Financial Instruments, Improving Disclosures about Financial Instruments) which requires the Society to make additional disclosures as follows:
 - fair value disclosures for each class of financial instrument by valuation method (refer to pages 41 to 44).
 - reconciliation of movements in fair value of instruments with significant unobservable inputs (refer to page 45).
 - liquidity risk disclosures on a behavioural basis for both derivative and non-derivative financial instruments (refer to pages 32 and 33).

In preparing these consolidated financial statements, the Society has elected not to adopt IFRS 8 (Operating Segments), which requires that information on operating segments is reported based on how it is reported and evaluated internally. CIS has elected not to adopt IFRS 8 as it does not hold debt or equity instruments that are traded in a public market and the level of segmentation in management information provided to the chief operating decision maker can not be presented at a statutory level. To assist the reader, further analysis of CIS has been provided (see note 1).

Standards and interpretations issued and effective

The following standards and interpretations which have been issued and are effective are not considered relevant to CIS' operations:

- revised IFRS 1 (First Time Adoption of International Reporting Standards (2009));
- amendment to IFRS 2 (Share-based Payment – Vesting Conditions and Cancellations);
- revised IAS 23 (Borrowing Costs);
- IAS 1 (Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation);
- IFRIC 9 (Embedded Derivatives (2008));

- IFRIC 12 (Customer Concession Arrangements);
- IFRIC 13 (Customer Loyalty Programmes); and
- IFRIC 14 and IAS 9 (The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction).

Standards and interpretations issued but not yet effective

CIS has not adopted the following standards and interpretations:

- Revised IFRS 3 (Business Combinations (2008)).

This standard incorporates the following changes:

- the definition of a business has been broadened, which may result in more acquisitions being treated as business combinations;
- contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss;
- transaction costs, other than share and debt issue costs, will be expensed as incurred;
- any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised in profit or loss; and
- any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction-by-transaction basis.

Revised IFRS 3 is effective prospectively for annual accounting periods beginning on or after 1 July 2009.

- Revised IAS 27 (Consolidated and Separate Financial Statements (2008)).

This standard requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When CIS loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

Revised IAS 27 is effective prospectively for annual accounting periods beginning on or after 1 July 2009.

- Revised IAS 39 (Financial Instruments: Recognition and Measurement – Eligible Hedged Items (2008)).

The standard was amended to clarify how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.

Revised IAS 39 is effective prospectively for annual accounting periods beginning on or after 1 July 2009.

In April 2009, the IASB issued Improvements to IFRSs 2009, which comprises 15 amendments to 12 standards. Effective dates, early application and transitional requirements are addressed on a standard-by-standard basis. The majority of the amendments will be effective from 1 January 2010. The amendments are unlikely to have a material impact on CIS' financial statements.

The following standards and interpretations which have been issued but not yet effective are not considered relevant to CIS' operations:

- amendment to IFRS 2 (Share-based Payment – Group Cash-settled Share-based Payment Transactions);
- amendments to IAS 32 (Classification of Rights Issues);
- IFRIC 15 (Agreements for the Construction of Real Estate);
- IFRIC 16 (Hedges of a Net Investment in a Foreign Operation);
- IFRIC 17 (Distributions of Non-cash Assets to Owners); and
- IFRIC 18 (Transfer of Assets from Customers).

CIS is not expecting the above standards and amendments to existing standards to have a material impact on the information reported in the financial statements.

Basis of preparation and significant accounting policies

For the period ended 31 December 2009

Change in accounting reference date

Following the merger of CFS and the Britannia Building Society on 1 August 2009 and in line with the ultimate parent company, Co-operative Group Limited, the Society has changed its accounting reference date to 31 December.

The 2009 period reflects 355 days which has been stated as 51 weeks. 2008 reflects a 52 week period (365 days).

Accounting policies

(a) Consolidation

i) Subsidiaries

Subsidiaries are those entities controlled by CIS. Control exists when CIS has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of assets transferred.

ii) Special purpose entities

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective, for CIS this would include Goldman Sachs Multi-Strategy Portfolio COIS Limited, established during 2008 to manage certain investments on behalf of the long term business fund (refer to note 15 for further information). An SPE is consolidated if, based on an evaluation of the substance of its relationship with CIS and the SPE's risks and rewards, CIS concludes that it controls the SPE. The following circumstances may indicate a relationship in which, in substance, CIS controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of CIS according to its specific business needs so that CIS obtains benefits from the SPE's operation;
- CIS has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- CIS has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; and
- CIS retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether CIS has control over an SPE is carried out at inception and normally no further assessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between CIS and the SPE.

iii) Associates and joint ventures

Associates and joint ventures are all entities over which CIS has influence but not control, typically accompanied by a shareholding of less than 50% of the voting rights. CIS has elected not to apply IAS 28 (Investments in Associates) and IAS 31 (Accounting for Joint Ventures) in respect of associates and joint ventures owned by its long term business fund as they are held by a mutual fund and are designated as fair value through profit or loss on initial recognition.

Such investments are accounted for in accordance with IAS 39 (Financial Instruments: Recognition and Measurement) and are designated as fair value through profit or loss.

(b) Foreign currencies

The functional and presentational currency for CIS is sterling. Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates ruling at the dates the values were determined.

(c) Property, plant and equipment

Property, plant and equipment consist of owner occupied property and, in accordance with the Group accounting policy for property, plant and equipment which is under shareholder ownership, it is carried at cost less accumulated depreciation and any impairment. Previously where owner occupied property was owned by the policyholder it was stated at revalued amount less accumulated depreciation and any impairment to ensure that the policyholder could enjoy the benefit of any capital appreciation.

Depreciation is charged to the income statement on a straight-line basis to allocate the difference between cost (or revalued amount) and residual value over the estimated useful lives. Land is not depreciated. Estimated useful lives for buildings are 10 to 50 years. All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. Any impairment identified would be charged to the income statement.

(d) Intangible assets

Intangible assets comprise deferred acquisition costs. The basis for deferral of acquisition costs is detailed at (p(vii)).

Amortisation is charged to the income statement on a straight-line basis to allocate the cost over the expected term of the related contract.

(e) Investment property

Property held to earn long term rentals or for long term capital appreciation or both and that is not occupied by CIS is classified as investment property. Investment property comprises freehold land and buildings. Initial measurement is at cost inclusive of transaction costs. It is subsequently carried at fair value, where fair value is based on current prices in an active market for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in the income statement.

Acquisitions are recognised on unconditional exchange of control or completion. Investment properties are derecognised on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal. If an investment property becomes owner-occupied it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

Subsequent costs associated with adding to or replacing parts of investment property are recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

(f) Investments in group undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment. Pre-acquisition dividends are treated as income and, where necessary, tested for impairment.

(g) Financial instruments**i) Financial assets at fair value through profit or loss**

CIS designates financial assets as fair value through profit or loss where they are held to match investment contracts or other financial liabilities whose values are linked to the performance of these assets. Initial measurement is at fair value, which equates to cost, and subsequent valuation is at fair value.

Financial assets at fair value through profit or loss are initially recognised at fair value, being purchase price upon the date on which CIS commits to purchase, and are subsequently carried at fair value. Directly attributable transaction costs are expensed immediately on recognition. Realised and unrealised gains and losses arising from changes in fair value of the financial assets are included in the income statement in the period in which they arise.

The fair value of listed investments is their quoted clean bid price at the balance sheet date. If the market for a financial asset is not active, fair value is established using appropriate valuation techniques. Further information is provided on pages 41 to 44.

Stock lending and sale and repurchase arrangements

CIS operates approved stock lending schemes whereby its securities are loaned to other institutions in accordance with the terms of agreements with those institutions. Under these arrangements, ownership of the securities passes to the borrower but CIS has the right to demand the return of the loaned securities at any time. It also retains the right to receive the income to which it would have been entitled had the securities not been loaned. Accordingly, the securities continue to be recognised as investments in the balance sheets.

CIS also participates in sale and repurchase (repo) arrangements in connection with its portfolio of government guaranteed securities (gilts). Under these arrangements, CIS sells gilts but is contractually obliged to repurchase them at a fixed price on a fixed future date. Securities which are the subject of repo arrangements at the balance sheet date are included in investments in the balance sheets at their bid value and the associated liability is recognised, being the capital amount owing under the repo arrangements.

CIS requires all stock lending and reverse repo transactions to be fully collateralised in an agreed form for their duration and equivalent collateral is returned at the completion of the loan period. Authorised collateral for stock lending arrangements comprises Delivery By Value (DBV) or certificates of deposit. For repo arrangements, collateral is required in the form of cash.

ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the group does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently these are measured at amortised cost using the effective interest method. The amortised cost is the initial amount at recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise secured loans and insurance receivables and other assets.

Basis of preparation and significant accounting policies

For the period ended 31 December 2009

iii) Derivative financial instruments

Derivatives are accounted for as trading instruments. Derivatives are initially recognised at fair value on the date upon which the derivative contract is entered into and are subsequently re-measured at their fair value. Any resultant gain or loss is recognised in the income statement.

iv) Financial liabilities

Financial liabilities whose value is linked to the performance of, and measured by reference to, the fair value of a matching portfolio of assets are designated at fair value through profit or loss at inception. Fair value measurement is based upon the carrying value of the underlying assets.

All other financial liabilities are initially measured at fair value being consideration received plus any directly attributable transaction costs. Subsequent measurement is at amortised cost using the effective interest method.

v) Recognition of financial assets and financial liabilities

Financial assets are recognised by CIS on the trade date which is the date it commits to purchase the instruments. Loans and receivables are recognised when the funds are advanced. All other financial instruments are recognised on the date that they are originated.

vi) Derecognition of financial assets and financial liabilities

A financial asset is derecognised when the right to receive cash flows from the assets have expired or are transferred through the sale of the asset or where a transfer of substantially all the risks and rewards and/or control of the financial asset has occurred. A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expired. When an existing liability is replaced by the same counterparty on substantially different terms or the terms of an existing liability are substantially modified, the original liability is derecognised and a new liability is recognised, with any difference in the carrying amounts recognised in the income statement.

vii) Impairment of financial assets

At the balance sheet date CIS assesses its financial assets not carried at fair value through profit or loss for objective evidence that an impairment loss has been incurred.

Objective evidence that financial assets are impaired can include default by a borrower or issuer, indications that a borrower or issuer will enter bankruptcy or the disappearance of an active market for that financial asset because of financial difficulties.

The amount of impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the fair value of the financial asset is recognised through the use of an allowance account.

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable effective interest rate for amortised cost assets).

The carrying amount of the impaired financial asset is measured by calculating the present value of future cash flows at the financial instrument's effective interest rate. Any adjustment in value is recognised in the income statement within investment income and represents the unwind of the discount.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

viii) Loans and borrowings

Loans and borrowings are initially measured at fair value plus directly attributable transactions costs, and subsequently at amortised cost using the effective interest method.

(h) Offsetting

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

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits of less than 90 days. Bank overdrafts that are repayable on demand and form an integral part of CIS' cash management are included as a component of cash and cash equivalents for the purpose of the cashflow statement.

(j) Impairment of non-financial assets

The carrying values of CIS' assets, with the exception of investment properties and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use assessed by reference to discounted future cash flows) is estimated. An impairment loss is recognised in the income statement to the extent that the carrying value of an asset exceeds its recoverable amount.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent of the asset's carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Impairment is not considered for those assets held at fair value through profit or loss.

(k) Income tax

Tax on the profit or loss for the year comprises current and deferred tax which is recognised in the income statement except to the extent that it relates to items recognised directly in equity (in which case it is recognised in equity).

Tax comprises the tax attributable to both policyholders' returns and shareholder's profit or loss. The returns of the long term business and its subsidiaries are attributable to the long term business policyholders. The profit or loss of the other than life business is attributable to the shareholder.

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

The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profits and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(l) Employee benefits – pension obligations*Defined contribution basis*

With effect from 6 April 2006, the Society, along with other businesses within the Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group-wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred based on a fixed percentage as agreed with the trustees.

(m) Provisions

A provision is recognised in the balance sheet if CIS has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(n) Revenue recognition

Revenue principally comprises:

Premium income from insurance and participating contracts

The Society's accounting policy in respect of revenue arising from insurance and participating contracts is set out within the insurance specific accounting policies.

Fee and commission income and income from service activities

Commissions and fees in respect of fund management activity and sales of units are recognised in the period in which the services are provided. Revenue from management fees is recognised in the income statement when the associated services are provided.

Investment income

Interest income is recognised in the income statement as it accrues. Dividend income is recognised in the income statement when the right to receive payment is established. Rental income from investment properties is recognised in the income statement as it accrues.

Basis of preparation and significant accounting policies

For the period ended 31 December 2009

(o) Leases

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

(p) Insurance accounting policies

i) Classification of contracts

Contracts under which CIS accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts.

Contracts under which the transfer of insurance risk to CIS from the policyholder is not significant are classified as investment contracts.

A contract that qualifies as insurance remains an insurance contract until all the risks and obligations are extinguished or expire. However, an investment contract, classified as such on inception, could be reclassified as an insurance contract if it subsequently meets the definition provided above.

ii) General insurance business

CIS no longer writes general insurance business however the following accounting policies relate to the run-off of general insurance business previously written.

All contracts of general insurance business previously written by CIS are classified as insurance contracts. General insurance business is accounted for on an annual basis.

(1) Claims incurred

Insurance claims incurred comprises claims paid during the year together with related handling costs and the movement in the gross liability for claims in the period net of related recoveries including salvage and subrogation.

(2) Claims outstanding

Claims outstanding comprise provisions representing the estimated ultimate cost of settling:

- estimates on claims reported by the balance sheet date (claims reported); and
- expected additional cost in excess of 'claims reported' for all claims occurring by the balance sheet date (claims incurred but not reported).

Claims provisions include attributable claims handling expenses and are set at a level such that no adverse run-off deviations are envisaged. Adverse run-off deviations, which are material in the context of the business as a whole, are separately disclosed.

Anticipated reinsurance recoveries and estimates of salvage and subrogation recoveries are disclosed separately within assets under the headings of 'reinsurance assets' and 'insurance receivables and other assets' respectively.

iii) Long term insurance business

(1) Insurance and participating contracts

CIS has adopted FRS 27 (Life Assurance), in so far as it is compatible with the requirements of IFRS. Accordingly participating insurance contract liabilities are stated on a realistic basis.

(2) Premiums

Premiums are accounted for on a due basis.

(3) Claims

Claims incurred include maturities, deaths, surrenders and annuity payments. Maturity and annuity claims are recognised as they fall due for payment.

Deaths and surrenders are accounted for upon notification. Consistent treatment exists between the recognition of a claim in the income statement and the calculation of future contractual liabilities. Claims incurred include related internal and external claims handling expenses.

(4) Insurance contract provisions

Insurance provisions are calculated twice yearly having regard to the principles laid down in Chapter 1.2 of the Prudential Sourcebook for Insurers (INSPRU). The provisions principally comprise the realistic value of CIS' participating contract liabilities, calculated by determining asset shares and the cost of options, guarantees and smoothing of investment returns. Major classes of non-participating business are valued using a gross premium valuation method. This approach meets the minimum requirements of the liability adequacy test. Further details of the methods used to value long term insurance contract liabilities are given in note 24.

iv) Participating contracts

A contract with a participation feature is a contract which gives the policyholder a right to receive, as a supplement to guaranteed minimum payments, additional payments: (a) that are likely to form a significant portion of the total contractual payments and (b) whose amount or timing is contractually at the discretion of the issuer and that are contractually based on: (i) the performance of a specified pool of contracts or a specified type of contract, (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer or (iii) the profit or loss of the company that issued the contracts.

(1) Insurance contracts

The unallocated divisible surplus comprises the excess long term business net assets over the policyholder liabilities of the long term business. As long term business is transacted on a mutual basis the unallocated divisible surplus represents amounts due to participating contract holders the allocation of which has yet to be determined. Insurance contracts with participation features are valued in accordance with the accounting policy in p(iii) (4) above.

(2) Investment contracts

These contracts are valued and presented in the same way as insurance contracts with participation features.

(3) Unallocated divisible surplus (UDS)

Long term business is transacted on a mutual basis and all surpluses arising on long term business are allocated, as appropriate, to participating contract holders. Its mutual status means that the long term business fund has no equity and the UDS represents amounts due to policyholders, the allocation of which is yet to be determined. Accordingly the UDS is classified as a liability.

v) Non-participating contracts

Insurance contracts without participation features are non-participating contracts. The value of future profits that are expected to arise on non-participating contracts (being the present value of future cash flows under these contracts) has been deducted when assessing the value of liabilities in respect of participating contracts.

vi) Investment contracts**(1) Revenue**

Amounts received from and paid to holders of investment contracts are accounted for as deposits received (or repaid) and are not included in premiums and claims in the income statement. For unit-linked business the due date for payment is taken as the date the related liability is established. Other revenue associated with investment management and other services is recognised in the income statement in the period in which services are provided.

(2) Liability measurement

The initial measurement amount of a financial liability is the fair value of the consideration received. The liabilities are designated at fair value at inception on the basis that the liabilities are managed on a fair value basis. Subsequent to initial recognition fair value is measured by reference to the carrying value of the assets supporting the liabilities.

As stated above, unit-linked investment contract liabilities are subsequently carried at fair value.

vii) Acquisition costs

Cost directly associated with the acquisition of new business, including commission are capitalised and amortised in accordance with the rate at which the gross premiums written associated with the underlying contract are earned.

Incremental costs incurred by CIS in the provision of investment management services are not deferred but are recognised when the related service is provided. Incremental costs directly related to the costs of acquiring new business in relation to unit trust management are deferred and recognised over the average contract life. The carrying amount is tested for impairment at each reporting date.

viii) Reinsurance

Contracts with reinsurers that give rise to a significant transfer of insurance risk are accounted for as reinsurance contracts. Amounts recoverable under such contracts are recognised in the same period as the related claim.

Basis of preparation and significant accounting policies

For the period ended 31 December 2009

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsurance contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. If there is objective evidence of impairment, the carrying amount of the reinsurance asset is reduced accordingly resulting in a charge to the income statement.

(q) Significant items

Items which are material by both size and nature (i.e. outside of the normal operating activities of the Society) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps provide an indication of the Society's underlying business performance. Events which may give rise to the classification of items as significant include individually significant restructuring costs.

(r) Assets held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with CIS' accounting policies.

Thereafter, the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in the income statement. Gains are not recognised in excess of any cumulative impairment loss.

CIS issues contracts that transfer insurance risk and is exposed to financial risk through its holdings of financial assets and liabilities. This section summarises these risks and the way the Society manages them.

Our approach to risk management

The Society operates in regulated markets and is subject to significant government regulation.

The CFS group of companies including Co-operative Financial Services Limited, Co-operative Insurance Society Limited, CIS General Insurance Limited, and The Co-operative Bank plc have a common Board composition.

CFS has developed and implemented a common governance and organisation structure, with the same committee structure supporting each Board within the CFS Group.

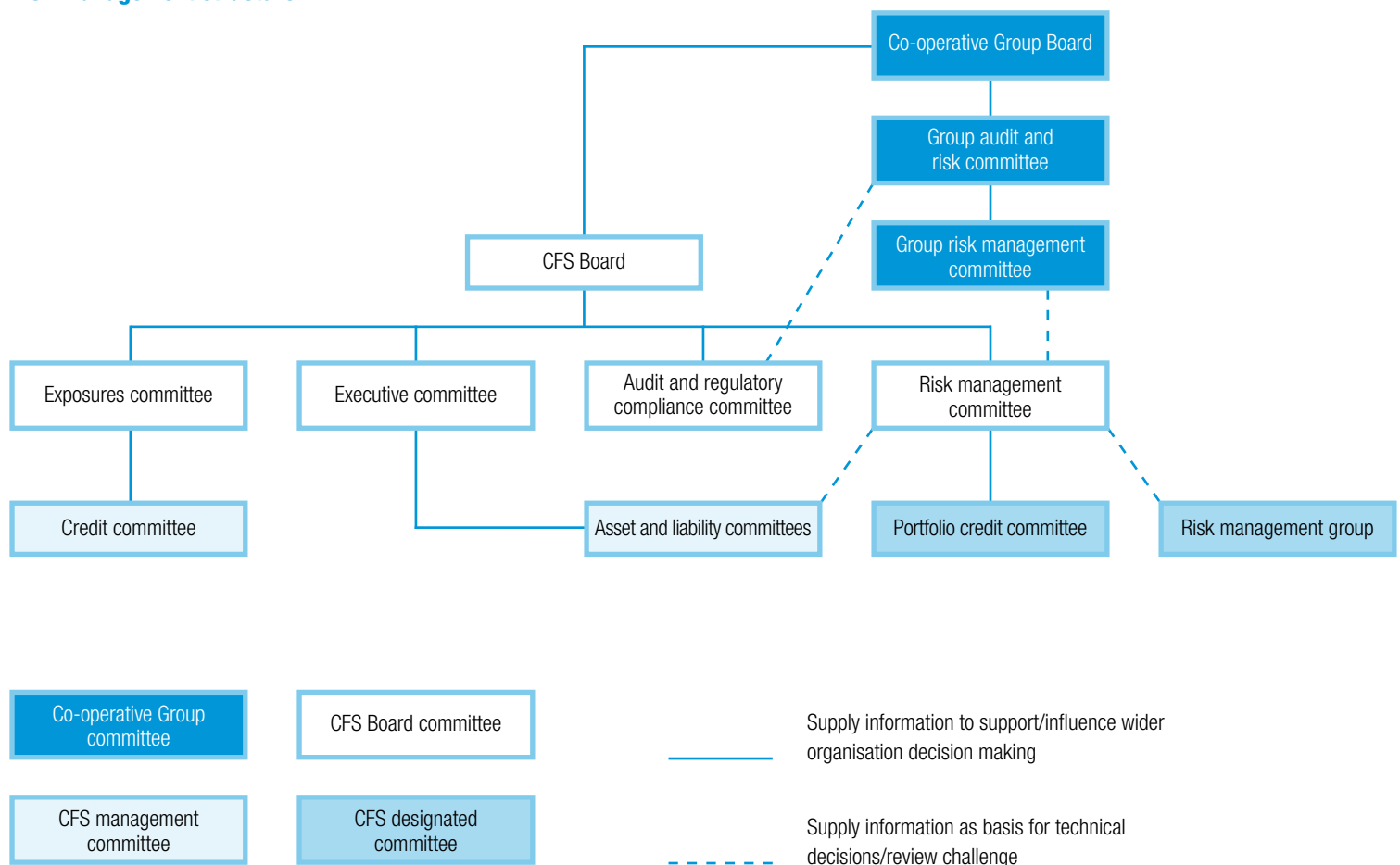
The CFS Board has ultimate responsibility for the management of all risks across CFS.

The Board is responsible for approving the CFS strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system of risk management and that the level of capital held is consistent with the risk profile of the business.

The Board has established Board committees and senior management committees to administer, oversee and challenge the risk management process, identifying the key risks facing the business and assessing the effectiveness of planned management actions.

Specific Board authority has been delegated to Board committees and the chief executive who may, in turn, delegate elements of his discretions to appropriate executive directors and their senior line managers.

Risk management structure



Risk management

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated.

Risk management structure (continued)

The CFS Board delegates authority to the CFS risk management committee (RMC) (senior Board committee) for monitoring compliance with the Board-approved risk appetite statements. This includes:

- setting limits for individual types of risk; and
- approving (at least annually) and monitoring compliance with risk policies and delegated levels of authority.

CFS risk management committee (RMC): this committee is responsible for review and challenge of the adequacy of capital for all risks (including operational risk); and for technical risk management activities and portfolio exposures across CFS including:

- operation of mandates and limits;
- technical risk management policy approval;
- risk management information reporting and integrity of relevant data;
- risks adequately identified and measured;
- risk and portfolio exposure management strategy;
- adequacy of the risk mitigation process; and
- review and discussion of technical risk issues identified as a result of internal audit work.

CFS audit and regulatory compliance committee (ARCC): this committee provides independent oversight in relation to financial reporting; internal control and risk management; regulatory compliance; and external and internal audit. It is responsible for approval of policies and review of adequacy of risk management activities in relation to operational risk.

CFS exposures committee: this committee ensures that non-executive directors are actively involved in major credit decisions (including sanctioning large counterparty transactions), monitor large exposures and review the adequacy of individual credit provisions.

CFS executive committee: this committee manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.

CFS asset and liability committees (ALCO): these committees are management committees of the Board which are chaired by the chief financial officer. They are primarily responsible for overseeing the management of interest rate, market, liquidity and funding risks and to advise on capital utilisation, in addition to, the composition and sourcing of adequate capital.

CFS risk management group (RMG): this committee is a designated committee reporting to RMC and chaired by the chief financial officer. Its purpose is to provide a mechanism to ensure that CFS-wide technical risk management requirements, developments and processes are approved, (with escalation to RMC where required) and embedded within and across CFS. The committee also monitors all significant and emerging risks, and oversees the development and implementation of stress testing and risk appetite across CFS.

CFS portfolio credit committee (PCC): this committee is a designated committee reporting to RMC and chaired by the business leader banking risk. It is responsible for defining Bank Group credit risk appetite; providing oversight and timely action in relation to credit risk management; agreeing appropriate and timely action to ensure continued adherence with regulatory requirements; and monitoring, challenge and approval of material changes to and performance of the Basel Internal Rating Based Systems.

CFS credit committee: this committee is chaired by the business leader banking risk. The chair has delegated authority for sanctioning individual counterparty credit transactions, and management action as appropriate where breaches of facility may have/potentially may occur.

CFS operational risk committee: this committee interfaces with both the executive committee and ARCC and is chaired by the business leader regulatory compliance and operational risk. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level and/or transfer them. This includes business continuity arrangements and insurance cover to protect the CFS business. Each division within CFS is represented on the committee. The committee is not shown on the previous diagram as it is an information sharing committee, designed to increase understanding and transparency of significant operational risks and reporting is via the operational risk department.

There is also a framework of sector specific management committees supporting risk and capital management, and implementing changes in business strategy, optimising performance, adherence to and setting of policy, and development of management information and training.

Insurance risk

The risk under any contract derives from the possibility that the insured event occurs and the uncertainty of the amount and timing of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

Insurance risk (continued)

The principal risk that CIS faces under its insurance contracts is that the actual claims and the benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amount of claims and benefits will vary from year to year from the estimates established.

Other than long term business

This includes the run-off of existing general insurance business and investment activity attributable to the shareholder. CIS ceased writing new general insurance business with effect from 15 January 2006. The major classes of general insurance business formerly written were motor and property, together with some liability, pecuniary loss and personal accident risks. Almost all risks under general insurance policies covered a 12 month duration and all risks directly underwritten were confined to the UK market.

All the benefits and burdens of the general insurance business in run-off were transferred to CISGIL, a fellow subsidiary society within the CFS Group, under the terms of an indemnification agreement.

Long term business

The majority of the long term business consists of participating savings business, including deferred pensions. In addition, cover is provided in respect of mortality risk (both term insurance and whole of life) and critical illness. Principal risks associated with these policies arise from policyholder mortality or longevity, morbidity and persistency.

Improvements in pensioner longevity pose a potential risk of increases in the cost of annuities in payment, guaranteed benefits under deferred annuity contracts and cost of guaranteed annuity options (GAOs) on personal pension contracts.

Persistency risk arises where more policies than expected reach their investment guarantee dates resulting in a potential increase in the cost of guarantees. This is particularly significant in relation to personal pension contracts where the risk is that more policyholders than expected reach their retirement date, which is the date on which GAOs become available.

Frequency and severity of claims

Factors that could increase the overall frequency of claims include epidemics (such as AIDS and SARS) for term assurance products, increased healthcare screening (such as cancer screening) resulting in earlier or more claims than expected for critical illness products, and more rapid improvements in longevity than expected for in-payment and deferred annuity business (for example from developments in medical science).

For participating policies, a significant amount of the insurance risk is shared with the participating contract holders. Insurance risk is also shared on critical illness and waiver of premium policies, both of which allow for premium rate reviews to enable changes in actual experience from expectation to be reflected in future premiums. A premium review has been conducted in 2009 resulting in a general reduction to premium rates for term and critical illness policies. For all other policies, there are no mitigating terms and conditions that reduce the insurance risk accepted.

Insurance risk is affected by the policyholders' rights to terminate the policy, pay reduced or no future premiums or to take up a guaranteed annuity option. Consequently, the amount of insurance risk is subject to policyholder behaviour.

Risk management objectives and strategy

CIS' objective in managing long term business insurance risk is to ensure that insurance risks are understood and accepted in accordance with its documented underwriting policy and that policy pricing appropriately reflects the underlying risk. CIS manages long term business insurance risk through the use of appropriate underwriting, product design and pricing and the use of reinsurance arrangements. Risk is managed and monitored across the portfolio. The majority of term assurance and critical illness policies are reinsured on a quota share basis. A significant proportion of in-payment annuity business and deferred annuity business is also reinsured.

Sources of uncertainty in the estimation of future benefit payments and premium receipts

Uncertainty in the estimation of future benefit payments and premium receipts arises from the uncertainty regarding long term changes in mortality levels and variability in policyholder behaviour regarding termination and alteration of policies.

The amount of insurance risk under contracts with guaranteed annuity options depends upon the number of policyholders who exercise their option. The lower the current market interest rate is in relation to the rates implicit in the guaranteed annuity option, the greater the likelihood that policyholders will choose to exercise the option.

Concentration of insurance risk

The existence of guaranteed annuity options on personal pension products gives rise to a significant concentration of financial risk and insurance risk.

Risk management

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated.

Financial risk

CIS is exposed to risk through its financial assets, financial liabilities (including investment contracts, borrowings and derivatives). In particular a key financial risk is that the proceeds from financial assets and property are insufficient to fund the obligations arising under long term insurance, investment contracts and general insurance business in run-off. CIS manages this risk separately for general insurance business in run-off and long term business and then according to the categories of market risk, credit risk and liquidity risk. An analysis of the assets and liabilities held by segment is provided in the further analysis in note 1.

Financial risk management objective and strategy

The principal objective of CIS' financial risk management strategy is to optimise the return on investments commensurate with an acceptable level of financial and insurance risk. Financial risk is managed within an asset and liability management framework (ALM) to ensure that this objective is achieved. An over-riding constraint on the fund's investment strategy is to ensure that at all times the fund has sufficient assets to meet its solvency and capital requirements.

The whole of the profits of the long term business must be applied for the sole benefit of the long term business policyholders. This includes the creation of reserves with the aim of preserving the strength of the fund for the benefit of the current and future long term business policyholders. Similarly any losses incurred within the fund are borne by the long term business policyholders, either through a reduction in the working capital of the fund or through a reduction in their benefits. The working capital of the fund is the excess of assets within the fund over the amount needed to meet liabilities, including those arising from the regulatory requirement to treat customers fairly when setting discretionary benefits. The working capital is managed to ensure that the long term business fund can meet its solvency requirements under a range of adverse conditions and to meet business plans. In exceptional circumstances, assets held outside the fund (share capital and general reserve) may, if available, be used to help meet the long term business fund's solvency requirements.

Risks that may affect the long term business fund are managed according to documented risk management policies, which require risks and capital to be regularly monitored and reported, and decisions made according to delegated authorities. Actions to control risk and manage the working capital of the fund include the use of reinsurance, matching assets and liabilities (including using derivatives) and setting discretionary benefits at appropriate levels, as described in the Principles and Practices of Financial Management (PPFM).

The risk management committee specifically monitors ALM exposures and controls the effectiveness of the market and credit policies. Exposures to market and credit risk are managed through diversifying investments across asset classes, issuers and markets.

The principal ALM technique of CIS' long term business fund is to match the assets to the insurance and investment contract liabilities with reference to the type of benefits payable to contract holders. Separate asset portfolios and funds are maintained for linked-liabilities and each participating investment sub-fund.

As part of its ALM framework, CIS sets a strategic asset allocation range with reference to a suitable benchmark for each asset class taking account, separately, of the shareholder and long term insurance and investment liabilities, long term investment performance and the financial risks. Controls and limits are set for each risk and sub-risk type and managed within the risk management procedures accordingly. CIS considers the capital adequacy and solvency of each insurance fund when establishing and controlling the assets and risk limits.

Market risk

Market risk is the risk that the fair value or cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk is particularly relevant in the long term business fund where a significant proportion of assets is held in equities, property and alternative investments such as hedge funds.

Financial risk within the long term business fund is managed as follows:

- long term insurance liabilities in respect of non-participating policies are closely matched with fixed interest securities. This close matching is achieved by holding assets whose cash flows correspond to the expected aggregate cash flow on the non-participating business;
- interest rate swaps and swaptions are held to meet the expected guaranteed annuity option liabilities;
- for unit linked investment contracts, assets are matched with liabilities;
- equity options and futures are held to reduce a proportion of the equity price risk arising from backing guaranteed benefits on participating contracts with equities;
- financial assets held to meet expected participating policy guarantee costs (other than equity options), and the working capital of the fund, are invested in fixed interest securities to reduce cash flow interest rate risks; and
- portfolio of gilt total return swaps and interest rate swaps are held to hedge the risk of adverse movements in swaps spreads.

Borrowings at variable interest rates expose CIS to cash flow interest rate risk, whereas borrowings at fixed rates create an exposure to fair value interest rate risk. CIS' policy is to maintain the majority of borrowings in instruments of duration less than three years.

CIS manages its cash flow interest rate risk by using interest rate swaps and deposits. CIS enters into interest rate swaps and gilt repurchasing arrangements to manage borrowing requirements.

Financial risk (continued)*Sensitivity analysis*

The only significant aspect of market risk to which the other than long-term business fund is exposed is equity price risk as it has no material holdings in interest bearing securities. The market value of the assets in this fund fluctuate in accordance with underlying equity market values. However, this risk has been significantly reduced by selling equity futures. An increase of 10% in equity values would increase the balance sheet carrying value of equities in the other than long term business fund at the end of the financial period by £48.5m (2008: £43.7m). This would be largely offset by an increase in the value of financial liability in respect of financial futures contracts. However, the futures do not provide a perfect hedge against changes in value of the equities portfolio, and the change in the liability would be expected to lie within the range £56.0m to £41.0m (2008: £30.6m to £56.8m) giving a net profit impact, pre-tax, of between +/- £7.5m (2008: +/- £13.1m). A 10% reduction in equity values would produce the same impact on pre-tax profit as the movement would be offset by a movement in equity futures. This sensitivity analysis is based upon a change in one assumption while holding all other assumptions constant.

Fluctuations in asset values within long term business participating investment sub-funds will be met by an equivalent change to policyholder benefits subject to any guarantees provided under such policies. Where policy guarantees mean that such fluctuations cannot be met by a change to policyholder benefits, changes to asset values will be met by the working capital of the long term business fund. In addition, fluctuations in financial assets backing non-participating policies and participating policy guarantees will also impact the working capital of the fund. Examples of how particular market risk scenarios impact the working capital of the fund are illustrated in note 24 e) (xii).

Credit risk

CIS' principal credit risk exposure arises in connection with default of debt securities and reinsurance counterparties, as a result of either failing to meet financial obligations when due or entering into restructuring arrangements that may adversely affect the market value of the debt security or reinsurance recoverable.

A credit policy and exposure framework has been established to monitor counterparty and credit risk exposures on an ongoing basis through the use of appropriate risk limits. CIS structures the levels of counterparty risk and asset concentration risk it accepts by placing limits and controls over the exposure to a single debt instrument and counterparty, or counterparty group, and seeks to actively diversify investment holdings and counterparty exposures across markets and economic segments. Counterparty exposures are subject to review at least annually and, where concern exists over counterparty credit quality, the exposure is monitored and actively managed.

Where reinsurance is used to manage insurance risk, a risk is created that the reinsurer fails to meet its obligations in the event of a claim. Creditworthiness of reinsurers is considered regularly together with reinsurer exposures. Additionally, in respect of the reinsurance of in-payment and deferred annuity business, CIS has taken a charge over assets to safeguard expected future reinsurance recoveries.

Financial responsibility for the benefits and burdens of the general insurance business of CIS in run-off has been passed to CISGIL, a fellow society within the CFS Group, via an indemnification agreement. If CISGIL were unable to fulfill its contractual obligations, financial responsibility for these claims would revert to CIS.

Other risk mitigation techniques employed to manage exposure to counterparty default include transacting only through a diversified range of authorised counterparties or brokers and the requirement for derivative transactions (including investment and trading in futures, swaptions, stock lending and gilt repo transactions) to be fully collateralised regularly.

CIS makes provision for the possible impairment of policyholder debts where these are more than one month overdue. At the balance sheet date there were no significant concentrations of credit risk. The table provides an analysis at the balance sheet date of the credit rating of financial assets subject to credit risk.

Consolidation

	AAA	AA	A	BBB and below	Not rated	Total
As at 31 December 2009						
Reinsurance assets	3.8	2,002.1	984.3	–	190.9	3,181.1
Financial assets at fair value through profit or loss:						
Listed debt (fixed rate)*	3,032.1	1,029.0	1,919.0	730.4	69.2	6,779.7
Listed debt (floating rate)	–	–	–	–	–	–
Unlisted debt (fixed rate)	3.0	–	–	–	2.5	5.5
Unlisted debt (floating rate)	–	1,992.4	–	–	–	1,992.4
Deposits with approved credit institutions (fixed rate)	–	555.4	937.4	–	4.8	1,497.6
Derivatives	–	252.6	428.6	–	–	681.2
Loans and receivables at amortised cost:						
Loans	–	–	–	–	7.8	7.8
Insurance receivables and other assets	37.4	43.0	67.5	18.3	81.4	247.6
Cash and cash equivalents	9.2	11.2	35.5	–	–	55.9
	3,085.5	5,885.7	4,372.3	748.7	356.6	14,448.8

*Includes £2,052.9m of gilt edged securities

Risk management

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated.

Financial risk (continued)

Consolidated

	AAA	AA	A	BBB and below	Not rated	Total
As at 10 January 2009						
Reinsurance assets	4.0	2,125.7	971.0	–	257.5	3,358.2
Financial assets at fair value through profit or loss:						
Listed debt (fixed rate)*	3,882.9	1,180.5	1,197.0	470.2	50.1	6,780.7
Listed debt (floating rate)	–	–	–	–	–	–
Unlisted debt (fixed rate)	3.6	–	–	–	2.9	6.5
Unlisted debt (floating rate)	–	2,267.7	–	–	–	2,267.7
Deposits with approved credit institutions (fixed rate)	–	895.3	1,597.6	–	71.4	2,564.3
Derivatives	–	61.1	966.3	–	–	1,027.4
Loans and receivables at amortised cost:						
Loans	–	–	–	–	9.7	9.7
Insurance receivables and other assets	82.7	44.5	77.3	21.5	139.8	365.8
Cash and cash equivalents	–	12.1	38.7	–	–	50.8
	3,973.2	6,586.9	4,847.9	491.7	531.4	16,431.1

*Includes £2,130.1m of gilt edged securities

This analysis for the Society produces the same figures stated above with the exception of 'Insurance receivables and other assets' of £226.4m at 31 December 2009 in Society (£323.0m at 10 January 2009) and 'Cash and cash equivalents' of £6.3m at 31 December 2009 in Society (£1.7m at 10 January 2009).

The maximum exposure to credit risk is represented by the carrying value of each financial asset in the table, with the exception of reverse repo balances of £333.8m (2008: £389.6m) reported within deposits with approved credit institutions and the unlisted floating rate debt of £1,992.4m (2008: £2,267.7m), both of which are fully collateralised.

An analysis of insurance receivables and other assets which are overdue but not considered impaired is shown in note 19 on page 61 and is excluded from the tables shown above.

Liquidity risk

Liquidity risk is the risk that cash may not be available at a reasonable cost to pay obligations when due. CIS is exposed to calls on its available cash resources mainly from claims arising and collateral arrangements on derivatives and reinsurance contracts.

A liquidity risk policy has been established and risk is managed through the requirement to hold a proportion of financial assets in cash and liquid stocks to pay claims and other cash flows for a specified time period in stressed conditions, where liquid assets are considered to be:

Asset type	Value included as liquid assets
Gilts	100%
Cash	100%
Corporate bonds:	
AAA	80%
AA	70%
A	60%
BBB	50%
Equity	60%
All other investments	0%

The minimum financial assets proportion is currently approximately 10% of the long term business fund. This is determined using the Society's internal economic capital assessment and is regularly reviewed considering the nature, cause, effect and probability of extreme case scenarios in the light of changing natural, social and economic conditions. The current extreme scenario assumes:

- increase in claims and surrenders by 50%;
- increase in expenses by 10%;
- reduction in asset values by 10%, with no investment income;
- no new business premiums income received; and
- no reinsurance recoveries received.

Financial risk (continued)

In addition, a minimum of £700m of gilts are held to meet extreme collateral payments on derivative contracts.

Based on the latest internal assessment, the liquidity requirement is £1.6bn against actual available liquid assets of £8.0bn.

CIS is active in the gilt repo market as part of its cash management activities and maintains short term borrowing facilities to enable settlement and also maintains a borrowing from its parent.

The following tables indicate the time profile of undiscounted cash flows arising from financial liabilities (based upon contractual maturity) and insurance liabilities (based upon estimated timing of outflow of amounts recognised in the balance sheet):

Consolidated	Carrying value	Gross nominal out flow	Up to 1 year	1 to 5 years	5 to 10 years	10 to 15 years	More than 15 years
As at 31 December 2009							
Insurance and participating contract liabilities	16,069.1	16,069.1	1,833.6	4,500.8	3,560.3	2,514.1	3,660.3
Financial liabilities at fair value through profit or loss (held for trading):							
Derivatives	502.9	502.9	502.9	–	–	–	–
Financial liabilities designated at fair value through profit or loss:							
Investment contract liabilities	259.9	259.9	259.9	–	–	–	–
Other financial liabilities	1,992.4	4,454.2	54.2	262.4	446.4	606.4	3,084.8
Financial liabilities at amortised cost:							
Loans and borrowings	172.0	172.1	172.1	–	–	–	–
Amounts owed to credit institutions (fixed rate)	1,071.2	1,071.8	1,071.8	–	–	–	–
Insurance and other payables	156.7	156.7	147.4	9.3	–	–	–
Other reinsurance liabilities	1.0	1.0	1.0	–	–	–	–
	20,225.2	22,687.7	4,042.9	4,772.5	4,006.7	3,120.5	6,745.1
Other liabilities	1,183.2						
Net asset value attributable to unit holders	42.1						
Total recognised liabilities	21,450.5						

Consolidated	Carrying value	Gross nominal out flow	Up to 1 year	1 to 5 years	5 to 10 years	10 to 15 years	More than 15 years
As at 10 January 2009							
Insurance and participating contract liabilities	16,316.8	16,316.8	1,802.9	4,330.9	3,513.4	2,514.4	4,155.2
Financial liabilities at fair value through profit or loss (held for trading):							
Derivatives	396.8	396.8	396.8	–	–	–	–
Financial liabilities designated at fair value through profit or loss:							
Investment contract liabilities	190.9	190.9	190.9	–	–	–	–
Other financial liabilities	2,267.7	4,528.3	52.8	253.7	430.6	576.6	3,214.6
Financial liabilities at amortised cost:							
Loans and borrowings	277.0	277.1	277.1	–	–	–	–
Amounts owed to credit institutions (fixed rate)	1,814.4	1,817.8	1,817.8	–	–	–	–
Insurance and other payables	291.8	291.8	276.0	15.8	–	–	–
Other reinsurance liabilities	1.2	1.2	1.2	–	–	–	–
	21,556.6	23,820.7	4,815.5	4,600.4	3,944.0	3,091.0	7,369.8
Other liabilities	816.5						
Total recognised liabilities	22,373.1						

This analysis for the Society produces the same figures stated above with the exception of 'derivatives' of £499.8m at 31 December 2009 in Society (£363.9m at 10 January 2009), 'insurance and other payables' of £130.9m at 31 December 2009 in Society (£231.2m at 10 January 2009), 'other liabilities' of £1,148.9m at 31 December 2009 in Society (£781.3m at 10 January 2009) and 'net asset value attributable to unit holders' of £nil at 31 December 2009 in Society.

Risk management

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated.

Financial risk (continued)

Currency risk

Currency risk is the risk that cash flows or fair values fluctuate as a result of changes in foreign exchange rates. CIS writes contracts of insurance in the United Kingdom and insurance and investment liabilities are denominated in sterling. The shareholder funds are invested solely in assets denominated in sterling. The long term business fund invests in an internationally diversified range of assets. Currency futures are used to ensure that the currency risk to the fund is not significant.

Operational risk (unaudited)

Operational risk is defined within CFS as the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.

Examples of such include internal and external fraud, loss or theft of confidential customer information, loss of key personnel, system capacity issues or program failure, process failures affecting payment settlement and external events over which CFS has limited controls such as terrorist attack, floods and contagious disease.

Operational risk framework

Operational risks within CFS are identified, managed and mitigated through ongoing risk management practices including risk assessments, formal internal control procedures, training, segregation of duties, delegated authorities and contingency planning. Operational risks are formally reviewed on a regular basis. Significant operational risks are regularly reported to executive directors, a management operational risk committee, and the ARCC (a Board sub-committee). These meet regularly to monitor the suitability of the risk management framework and management of significant risks within CFS. Capital requirements in relation to operational risk are monitored by the RMC.

Business continuity is managed from within the operational risk team and sets out to take appropriate steps to minimise the risk of disruption in the event of a sudden, unplanned occurrence that could seriously disrupt customer service, or pose a risk to employees, business operations and/or reputation. This includes developing and exercising crisis and incident management teams to maintain appropriate preparedness in the event of a major operational disruption. In 2009, with the emergence of swine flu (H1N1), postal strikes and continued focus on liquidity planning specific focus has been placed on maintaining and developing our capability to respond to these threats.

CFS also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

2009 has seen the merger of CFS with Britannia. Work is underway to ensure that CFS' operational risk framework is consistently applied across the merged organisation, in compliance with the Basel II Standardised Approach to operational risk.

Additional risks (unaudited)

In addition to the significant risks covered above, the following risks are also reported and managed in the CFS risk management framework:

- group-wide risks, to include pensions, reputational and contagion risk;
- business risk; and
- regulation risk.

Group-wide risks (unaudited)

Pensions risk

The risk of the firm being unable to meet pension scheme commitments. Risks are identified at the Co-operative Group level, with the impact of any potential changes to contribution assessed under the bank risk management framework.

The combined entity is exposed to the following pension risk:

- PACE – CFS Management Services Limited (CFSMS) and The Co-operative Bank are participating members of the Co-operative Group Pension (Average Career Earnings) – defined benefit scheme.

The Co-operative Group, alongside the scheme Trustees, are responsible for the risk management arrangements for PACE, agreeing suitable contribution rates, investment strategies, etc. taking professional advice as appropriate.

CIS is therefore exposed to potential future increases in required contributions.

Group-wide risks (continued)

Reputational risk

Failure to proactively develop, protect and optimise the value of the brands of the CFS group of companies through inappropriate strategic decisions, poor business performance, or operational failure. Reputational risks are identified at CIS entity level. As part of the assessment of this risk, we consider the impact of other CFS entities and Co-operative Group entities to CIS.

Contagion risk

Risks originating from elsewhere in the group impacting upon CIS.

Business risk

Business risk arises from changes to CIS' business, specifically the risk of not being able to carry out CIS' business plan and desired strategy, including the ability to provide suitable products and services to customers. In a narrow sense, business risk is the risk CIS suffers losses because income falls or is volatile relative to the fixed cost base. However, in a broader sense, it is CIS' exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks.

Regulatory risk

Regulatory intervention and change is a permanent feature of any financial services business and can have a significant impact on profitability.

Capital management

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

Objectives when managing capital

CIS' primary objective in respect of capital management is to ensure that it has sufficient capital now and in the future to support all the risks in the business to the required level of confidence, thus ensuring policyholder protection.

Capital within the other than long term business fund consists of the excess of assets over and above the accumulated reserves necessary to support the run-off of the existing general insurance business.

Capital within the long term business fund (LTBF) consists of the excess of assets over the amount needed to meet its liabilities (including those that arise from the regulatory duty to treat customers fairly when setting discretionary benefits). In exceptional circumstances, assets outside the LTBF (share capital and general reserve), if available, may be used to meet the LTBF's solvency requirements.

CIS has not changed the manner in which it defines capital to meet regulatory solvency during either the current or prior financial periods.

Required capital

CIS is required to hold regulatory capital for both its long term business and its general insurance business in run-off in compliance with the rules issued by the FSA.

(a) Regulatory required capital

The regulatory requirement is defined in rules issued by the FSA. To summarise, firms must hold the maximum of:

- pillar 1, which is the maximum of the:
 - MCR (Minimum Capital Requirement); and
 - ECR (Enhanced Capital Requirement); and
- pillar 2, which is the ICG (Individual Capital Guidance) determined from CIS' ICA (Individual Capital Assessment) plus any add-ons imposed by the FSA.

CIS, in accordance with FSA requirements, calculates its ICA to be the capital required to be 99.5% confident of meeting liabilities as they fall due over a one-year time horizon.

(b) Internal required capital

The CIS Board has responsibility for deciding the risk appetite that is appropriate for the business. This risk appetite is designed to ensure the following:

- CIS will hold enough capital to meet regulatory requirements.
- CIS will hold a capital margin in excess of the regulatory requirements that the Board deems sufficient to manage the risks of falling below the regulatory capital requirement.

The risk appetite statement influences the strategic direction of the organisation via the strategic planning process.

Submissions to the FSA in the year have shown that CIS has complied with all externally imposed solvency requirements throughout the period.

(c) Capital composition

CIS capital comprises total shareholder's equity, excluding inadmissible assets, subordinated debt and equalisation provisions recognised in equity. Long term business figures also include unallocated divisible surplus (UDS) amounts.

	Long term business 2009	General insurance business in run-off 2009	Long term business 2008	General insurance business in run-off 2008
Capital and reserves per the financial statements	–	395.0	–	430.1
UDS (unconsolidated)	1,029.7	–	598.8	–
Capital allocated to long term business	200.0	(200.0)	200.0	(200.0)
Valuation differences	2,064.3	–	1,659.7	–
Deduction for inadmissible and other assets	(48.3)	(8.6)	(97.9)	(19.2)
Statutory claims equalisation reserve	–	–	–	(14.3)
Proposed dividend	–	–	–	(49.1)
Regulatory capital	3,245.7	186.4	2,360.6	147.5

The Society makes critical judgments and estimates that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances but which may not necessarily be borne out in practice. The most significant areas of estimation and judgment are detailed below and referenced to the appropriate section in the financial statements:

- ultimate liability from claims made under insurance contracts (note 24);
- estimate of future benefit payments from long term insurance contracts (note 24);
- calculation of the Risk Capital Margin (RCM) and the sensitivity of the working capital when sensitivity analysis is applied (note 24);
- fair value of investment contracts (note 26);
- fair value of unlisted financial assets and liabilities (below); and
- impairment (notes 15 and 19).

Financial asset and liability classification

CIS' accounting policies provide scope for assets and liabilities designated at inception into different accounting categories in certain circumstances as outlined on page 24 and defined as follows:

- in designating financial assets or liabilities at fair value through profit or loss, CIS has determined that it has met one of the criteria for this designation as set out in accounting policy (g(i)); and
- in classifying assets as Loans and Receivables at amortised cost, CIS has determined it meets the description as set out in accounting policy (g(ii)).

CIS' financial instruments are presented by IAS 39 categories on pages 42 and 43.

Fair values of financial assets and liabilities

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the financial statements:

(a) Financial investments at fair value through profit or loss

Background

CIS long term business and shareholder investment portfolios are predominantly invested in listed debt, listed equity or government issued securities. There are a small number of unlisted holdings, particularly in the long term business fund, which are valued using either a model valuation or a valuation based upon net asset value (NAV).

Valuation approach

Investment assets are classified as fair value through profit and loss which means that they are fair valued in the balance sheet with valuation movements passing through the income statement.

Holdings of listed debt, listed equity and government issued securities are valued based on observable market price feed data, with all non moving valuations validated against an alternative price source. Where quoted debt values are considered to be stale, an average of market maker quotes is used as the valuation basis. No significant assumptions are required.

Fair value of short term fixed rate deposits is their carrying amount.

Fair value of unlisted debt securities represents the discounted expected principal and interest cash flows. Interest rate assumptions used in the valuation are based upon gilt yields of appropriate maturity.

Where model valuation is used, the valuation is driven by the assumptions used in the model and will be sensitive to changes in these assumptions. The most significant holding for which valuation is based upon a model relates to an unlisted loan note held by the long term business fund which, at the year-end date, is valued at £1,992.4m (2008: £2,267.7m). The floating rate note is structured such that cash flows will fund the discharge of an equivalent financial liability arising from a reinsurance arrangement. The valuation of the loan note is sensitive to changes in the gilt yield curve however any change in value would be offset by an equivalent change in the value of the financial liability.

The long term business fund also has a number of 'over the counter' derivatives for which the valuation is modelled. In all instances model valuations are supplied by counterparties and validated using in-house models. Model inputs are derived from observable market data on interest rates and volatility (interest rate, equity and currency).

A small proportion of the portfolio is invested in unlisted equity securities, participation in collective investment pools and partnerships for which fair values are determined using a range of valuation techniques. These include reference to other recent arm's length transactions, reference to other instruments that are substantially the same, and discounted cash flow techniques.

Critical judgments and estimates

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

CIS derives the fair value of certain holdings based primarily upon net asset values (NAV). In aggregate such investments represent a small proportion of the overall fund and are undertaken as part of a considered, long term investment strategy. CIS considers this approach to be materially representative of fair value for these investments as it reflects CIS' share of rights and obligations under the investment, because:

- the most significant of these investments have been made in open ended funds, where the underlying investment is predominantly in listed stocks and the holding can be readily redeemed, subject to a suitable notice period, with no redemption fees or charges;
- smaller individual investments in various close-ended private equity funds are typically undertaken as part of a long term commitment and CIS does not seek to trade these holdings;
- for the most significant of these holdings appropriate independent oversight and challenge of the underlying valuations which comprise the NAV is provided by market leading fund administrators; and
- as the Society's investment in these holdings forms a small proportion of the overall portfolio, a reasonable adjustment to any of the variables underlying the valuation model would not have a material impact on the financial position.

(b) Loans and receivables at amortised cost

Loans and receivables are net of provisions for impairment. The estimated fair value of loans and receivables represent the discounted amount of future cash flows expected to be received. Expected cash flows are discounted at current market interest rates based on original credit spreads to determine fair value.

(c) Derivatives

Index futures and forward contracts are marked to market using clean bid listed market prices at the balance sheet date without any deduction for transaction costs. All other derivatives are valued at broker quotes, which are validated using pricing models or discounting techniques.

(d) Interest bearing loan receivables

Fair value is calculated based on discounted expected future principal and interest cash flows. Discount rates used are based upon gilt yields of appropriate duration.

(e) Insurance and other receivables and payables

For receivables and payables with a remaining life of less than one year, the nominal amount is deemed to reflect the fair value. All other receivables and payables are discounted to determine the fair value.

(f) Investment contract liabilities

Fair value of investment contract liabilities is measured as the fair value of the underlying assets. The fair value of the underlying assets is stated within section (a) above.

The table below shows a comparison of the carrying value and fair values of financial instruments where there is a significant difference in value. In all other instances fair values are not materially different to carrying values.

	2009		2008	
	Carrying value	Fair value	Carrying value	Fair value
Financial liabilities				
Loans at amortised cost	7.8	8.5	9.7	10.8

Critical judgments and estimates

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

Balance sheet categories

Consolidated 2009

Assets

Financial assets at fair value through profit or loss
Loans at amortised cost
Derivative financial instruments
Insurance receivables and other assets
Cash and cash equivalents

Total financial assets

Non-financial assets

Total assets

Liabilities

Investment contract liabilities
Derivative financial instruments
Loans and borrowings
Amounts owed to credit institutions
Insurance and other payables
Other reinsurance liabilities

Total financial liabilities

Non-financial liabilities

Total liabilities

Capital and reserves

Total liabilities and equity

	Designated at fair value	Loans and receivables	Other amortised cost	Total
Financial assets at fair value through profit or loss	16,143.3	–	–	16,143.3
Loans at amortised cost	–	7.8	–	7.8
Derivative financial instruments	681.2	–	–	681.2
Insurance receivables and other assets	–	247.6	–	247.6
Cash and cash equivalents	–	55.9	–	55.9
Total financial assets	16,824.5	311.3	–	17,135.8
Non-financial assets				4,709.7
Total assets				21,845.5
Investment contract liabilities	259.9	–	–	259.9
Derivative financial instruments	502.9	–	–	502.9
Loans and borrowings	–	–	172.0	172.0
Amounts owed to credit institutions	1,071.2	–	–	1,071.2
Insurance and other payables	–	–	156.7	156.7
Other reinsurance liabilities	1,992.4	–	–	1,992.4
Total financial liabilities	3,826.4	–	328.7	4,155.1
Non-financial liabilities				17,295.4
Total liabilities				21,450.5
Capital and reserves				395.0
Total liabilities and equity				21,845.5

2008

Assets

Financial assets at fair value through profit or loss
Loans at amortised cost
Derivative financial instruments
Insurance receivables and other assets
Cash and cash equivalents

Total financial assets

Non-financial assets

Total assets

Liabilities

Investment contract liabilities
Derivative financial instruments
Loans and borrowings
Amounts owed to credit institutions
Insurance and other payables
Other reinsurance liabilities

Total financial liabilities

Non-financial liabilities

Total liabilities

Capital and reserves

Total liabilities and equity

	Designated at fair value	Loans and receivables	Other amortised cost	Total
Financial assets at fair value through profit or loss	16,446.1	–	–	16,446.1
Loans at amortised cost	–	9.7	–	9.7
Derivative financial instruments	1,027.4	–	–	1,027.4
Insurance receivables and other assets	–	365.8	–	365.8
Cash and cash equivalents	–	50.8	–	50.8
Total financial assets	17,473.5	426.3	–	17,899.8
Non-financial assets				4,903.4
Total assets				22,803.2
Investment contract liabilities	190.9	–	–	190.9
Derivative financial instruments	396.8	–	–	396.8
Loans and borrowings	–	–	277.0	277.0
Amounts owed to credit institutions	1,814.4	–	–	1,814.4
Insurance and other payables	–	–	291.8	291.8
Other reinsurance liabilities	2,267.7	–	–	2,267.7
Total financial liabilities	4,669.8	–	568.8	5,238.6
Non-financial liabilities				17,134.5
Total liabilities				22,373.1
Capital and reserves				430.1
Total liabilities and equity				22,803.2

Critical judgments and estimates

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

Society 2009	Designated at fair value	Loans and receivables	Other amortised cost	Total
Assets				
Financial assets at fair value through profit or loss	15,811.8	–	–	15,811.8
Loans at amortised cost	–	7.8	–	7.8
Derivative financial instruments	681.2	–	–	681.2
Insurance receivables and other assets	–	226.4	–	226.4
Cash and cash equivalents	–	6.3	–	6.3
Total financial assets	16,493.0	240.5	–	16,733.5
Non-financial assets				5,006.7
Total assets				21,740.2
Liabilities				
Investment contract liabilities	259.9	–	–	259.9
Derivative financial instruments	499.8	–	–	499.8
Loans and borrowings	–	–	172.0	172.0
Amounts owed to credit institutions	1,071.2	–	–	1,071.2
Insurance and other payables	–	–	130.9	130.9
Other reinsurance liabilities	1,992.4	–	–	1,992.4
Total financial liabilities	3,823.3	–	302.9	4,126.2
Non-financial liabilities				17,219.0
Total liabilities				21,345.2
Capital and reserves				395.0
Total liabilities and equity				21,740.2
2008				
Assets				
Financial assets at fair value through profit or loss	16,145.9	–	–	16,145.9
Loans at amortised cost	–	9.7	–	9.7
Derivative financial instruments	1,027.4	–	–	1,027.4
Insurance receivables and other assets	–	323.0	–	323.0
Cash and cash equivalents	–	1.7	–	1.7
Total financial assets	17,173.3	334.4	–	17,507.7
Non-financial assets				5,166.8
Total assets				22,674.5
Liabilities				
Investment contract liabilities	190.9	–	–	190.9
Derivative financial instruments	363.9	–	–	363.9
Loans and borrowings	–	–	277.0	277.0
Amounts owed to credit institutions	1,814.4	–	–	1,814.4
Insurance and other payables	–	–	231.2	231.2
Other reinsurance liabilities	2,267.7	–	–	2,267.7
Total financial liabilities	4,636.9	–	508.2	5,145.1
Non-financial liabilities				17,099.3
Total liabilities				22,244.4
Capital and reserves				430.1
Total liabilities and equity				22,674.5

The following table details financial assets held by the Group and Society which are measured at fair value. As per IFRS 7 March 2009, an entity is required to provide a breakdown of such assets and detailing the basis on which the fair value has been determined. The valuations are categorised into a three level hierarchy:

- Level 1 – fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – fair value measurements are those derived from inputs 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 – fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Valuation of financial instruments

Consolidated

2009

Financial assets

Financial instruments at fair value through profit or loss

	Level 1	Level 2	Level 3	Total
Listed equities	5,047.3	–	–	5,047.3
Unlisted equities*	204.0	431.8	185.0	820.8
Listed debt				
– Fixed rate	6,750.0	29.7	–	6,779.7
Unlisted debt				
– Fixed rate	–	5.5	–	5.5
– Floating rate	–	1,992.4	–	1,992.4
Deposits with credit institutions	1,497.6	–	–	1,497.6
Total financial instruments at fair value through profit or loss	13,498.9	2,459.4	185.0	16,143.3
Derivative financial instruments	13.0	668.2	–	681.2
Total financial assets at fair value	13,511.9	3,127.6	185.0	16,824.5

Financial liabilities

Investment contract liabilities

Unit linked	–	259.9	–	259.9
Derivative financial instruments	30.2	472.7	–	502.9
Other financial liabilities				
Gilt repos	1,071.2	–	–	1,071.2
Debt securities	–	1,992.4	–	1,992.4
Total other financial liabilities	1,071.2	1,992.4	–	3,063.6
Total financial liabilities at fair value	1,101.4	2,725.0	–	3,826.4

*Now includes unlisted collective investments where published net asset values reflect price at which units can be issued or redeemed, in 2008 these holdings were classified as listed equity – these have been reanalysed during the year taking into account the most recent Financial Accounting Standards Board (FASB) guidance.

Critical judgments and estimates

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

Valuation of financial instruments

Consolidated

2008	Level 1	Level 2	Level 3	Total
Financial assets				
Financial instruments at fair value through profit or loss				
Listed equities	4,214.5	229.3	85.1	4,528.9
Unlisted equities	–	176.6	121.4	298.0
Listed debt				
– Fixed rate	6,613.9	166.8	–	6,780.7
Unlisted debt				
– Fixed rate	–	6.5	–	6.5
– Floating rate	–	2,267.7	–	2,267.7
Deposits with credit institutions	2,564.3	–	–	2,564.3
Total financial instruments at fair value through profit or loss	13,392.7	2,846.9	206.5	16,446.1
Derivative financial instruments	1.8	1,025.6	–	1,027.4
Total financial assets at fair value	13,394.5	3,872.5	206.5	17,473.5
Financial liabilities				
Investment contract liabilities				
Unit linked	–	190.9	–	190.9
Derivative financial instruments	68.4	328.4	–	396.8
Other financial liabilities				
Gilt repos	1,814.4	–	–	1,814.4
Debt securities	–	2,267.7	–	2,267.7
Total other financial liabilities	1,814.4	2,267.7	–	4,082.1
Total financial liabilities at fair value	1,882.8	2,787.0	–	4,669.8

All debt securities are classified as at fair value through profit or loss.

Valuation of financial instruments**Society****2009****Financial assets**

Financial instruments at fair value through profit or loss

	Level 1	Level 2	Level 3	Total
Listed equities	4,944.2	–	–	4,944.2
Unlisted equities*	196.4	254.2	185.0	635.6
Listed debt				
– Fixed rate	6,706.8	29.7	–	6,736.5
Unlisted debt				
– Fixed rate	–	5.5	–	5.5
– Floating rate	–	1,992.4	–	1,992.4
Deposits with credit institutions	1,497.6	–	–	1,497.6
Total financial instruments at fair value through profit or loss	13,345.0	2,281.8	185.0	15,811.8
Derivative financial instruments	13.0	668.2	–	681.2
Total financial assets at fair value	13,358.0	2,950.0	185.0	16,493.0

Financial liabilities

Investment contract liabilities

Unit linked	–	259.9	–	259.9
Derivative financial instruments	27.1	472.7	–	499.8
Other financial liabilities				
Gilt repos	1,071.2	–	–	1,071.2
Debt securities	–	1,992.4	–	1,992.4
Total other financial liabilities	1,071.2	1,992.4	–	3,063.6

Total financial liabilities at fair value

1,098.3	2,725.0	–	3,823.3
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*Now includes unlisted collective investments where published net asset values reflect price at which units can be issued or redeemed, in 2008 these holdings were classified as listed equity – these have been reanalysed during the year taking into account the most recent FASB guidance.

Critical judgments and estimates

For the period ended 31 December 2009

All amounts are stated in £m unless otherwise indicated

Valuation of financial instruments

Society

2008	Level 1	Level 2	Level 3	Total
Financial assets				
Financial instruments at fair value through profit or loss				
Listed equities	4,212.0	228.9	85.1	4,526.0
Unlisted equities	–	–	121.4	121.4
Listed debt				
– Fixed rate	6,613.9	166.8	–	6,780.7
Unlisted debt				
– Fixed rate	–	6.5	–	6.5
– Floating rate	–	2,267.7	–	2,267.7
Deposits with credit institutions	2,443.6	–	–	2,443.6
Total financial instruments at fair value through profit or loss	13,269.5	2,669.9	206.5	16,145.9
Derivative financial instruments	1.8	1,025.6	–	1,027.4
Total financial assets at fair value	13,271.3	3,695.5	206.5	17,173.3
Financial liabilities				
Investment contract liabilities				
Unit linked	–	190.9	–	190.9
Derivative financial instruments	35.5	328.4	–	363.9
Other financial liabilities				
Gilt repos	1,814.4	–	–	1,814.4
Debt securities	–	2,267.7	–	2,267.7
Total other financial liabilities	1,814.4	2,267.7	–	4,082.1
Total financial liabilities at fair value	1,849.9	2,787.0	–	4,636.9

All debt securities are classified as at fair value through profit or loss.

There have been transfers of financial assets held at the balance sheet date from level 1 to level 2 of £15.4m in the period (2008: £nil) and transfers of financial assets from level 2 to level 1 of £136.0m in the period (2008: £nil) as illustrated below:

**Consolidated and Society
2009**

**Financial
instruments
at fair value
through profit
or loss**

Assets

Transfer from quoted market prices in active markets to valuation techniques using observable inputs	15.4
Transfer from valuation techniques using observable inputs to quoted market prices in active markets	136.0
Closing balance	151.4

Transfers from level 1 to level 2 reflect listed holdings where the quoted price is stale and therefore valuation is by reference to an average of market maker quotes. Holdings are reclassified to level 1 when the market becomes active.

A small proportion of the portfolio is invested in unlisted equity securities, participation in collective investment pools and partnerships for which fair values are determined using a range of valuation techniques. These include reference to other recent arm's length transactions, reference to other instruments that are substantially the same and discounted cash flow techniques.

For the assets held at the balance sheet date and categorised as level 3, utilising 'valuation techniques using significant unobservable inputs', mainly comprise a number of small individual investments in close-ended private equity funds; the table below shows a reconciliation between the opening balance and closing balance for the period:

**Consolidated and Society
2009**

**Financial
instruments
at fair value
through profit
or loss**

Assets

Opening balance	206.5
Gains/(losses) in income and expense	(17.0)
Total gains/(losses)	(17.0)
Purchases	18.5
Settlements	(6.8)
Transfers out	(16.2)
Closing balance	185.0

Transfers out reflect the reclassification of a listed equity holding as level 1. At 2008 balance sheet date pricing was suspended on the holding and fair value was assessed based upon underlying net asset value.

**Consolidated and Society
2009**

**Financial
instruments
at fair value
through profit
or loss**

Assets

Total gains for the period included in income and expense for assets held at the end of the reporting period	151.8
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Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

1. Further analysis

Further information is presented on an unadjusted IFRS basis in respect of the Society's business categories in line with the Society's management and internal reporting structure. However, the Society uses alternative measures to manage the business including new business profit, present value of new business premiums and maintenance expenses (see pages 2 and 3).

The results, assets and liabilities include items directly attributable to a category as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly deferred tax. Capital expenditure is the total cost incurred during the period to acquire assets that are expected to be used for more than one period.

There is no geographic reporting as all business is conducted in the UK.

Business categories

CIS comprises the following categories:

(a) Long term business

Long term business incorporates life assurance and savings and protection products, pensions, unit trust management and investment services.

(b) Other than long term business

This category includes the run-off of existing general insurance business activities (motor and home insurance, liability insurance, pecuniary loss and inwards reinsurance) and investment activity attributable to the shareholder. The run-off business is classified as discontinued for these further reporting purposes.

1. Further analysis (continued)

Income statement for the financial 51 weeks ended 31 December 2009

	Before significant items			Total	Significant items	Total after significant items
	Other than long term business	Discontinued	Continuing			
Income						
Gross earned premiums	–	–	–	490.8	–	490.8
Less premiums ceded to reinsurers	–	–	–	(16.2)	–	(16.2)
Net earned premiums	–	–	–	474.6	–	474.6
Fee and commission income and income from service activities	–	–	–	46.6	–	46.6
Investment income	–	–	48.0	644.1	–	692.1
Gains less losses arising from financial instruments and other assets	–	–	(25.8)	483.4	–	457.6
Other operating income	–	–	4.1	0.9	–	5.0
Net income	–	–	26.3	1,649.6	–	1,675.9
Benefit, losses and expenses						
Claims paid and benefits	(78.4)	–	–	(1,149.5)	–	(1,227.9)
Less amounts receivable from reinsurers	78.4	–	–	133.6	–	212.0
Net policyholder claims and benefits	–	–	–	(1,015.9)	–	(1,015.9)
Change in insurance and participating contract liabilities	67.8	–	–	179.9	–	247.7
Change in reinsurance assets	(67.8)	–	–	(109.3)	–	(177.1)
Net policyholder claims and benefits incurred	–	–	–	(945.3)	–	(945.3)
Change in investment contracts	–	–	–	(47.1)	–	(47.1)
Change in unallocated divisible surplus	–	–	–	(448.2)	17.6	(430.6)
Fees and commissions	–	–	–	(31.0)	–	(31.0)
Operating expenses:						
Other than long term business	–	–	(0.4)	–	–	(0.4)
Long term business	–	–	–	(99.6)	(20.9)	(120.5)
Investment expenses and charges	–	–	(10.4)	(68.8)	–	(79.2)
Profit before taxation	–	–	15.5	9.6	(3.3)	21.8
Tax attributable to policyholders' returns	–	–	–	(9.6)	3.3	(6.3)
Profit before taxation attributable to shareholder's profits	–	–	15.5	–	–	15.5
Income tax (expense)/credit	–	–	–	(9.6)	3.3	(6.3)
Less tax attributable to policyholders' returns	–	–	–	9.6	(3.3)	6.3
Tax attributable to shareholder's profits	–	–	–	–	–	–
Profit for the financial period	–	–	15.5	–	–	15.5

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

1. Further analysis (continued)

Income statement for the financial period ended 10 January 2009

	Before significant items			Total	Significant items	Total after significant items
	Other than long term business	Discontinued	Continuing			
Income						
Gross earned premiums	–	–	–	497.9	–	497.9
Less premiums ceded to reinsurers	–	–	–	(19.1)	–	(19.1)
Net earned premiums	–	–	–	478.8	–	478.8
Fee and commission income and income from service activities	–	–	–	46.4	–	46.4
Investment income	–	–	40.9	683.6	–	724.5
Gains less losses arising from financial instruments and other assets	–	–	65.4	(1,826.9)	–	(1,761.5)
Other operating income	–	–	0.9	20.3	–	21.2
Net income	–	–	107.2	(597.8)	–	(490.6)
Benefit, losses and expenses						
Claims paid and benefits	(108.0)	–	–	(1,454.3)	–	(1,562.3)
Less amounts receivable from reinsurers	108.0	–	–	138.4	–	246.4
Net policyholder claims and benefits	–	–	–	(1,315.9)	–	(1,315.9)
Change in insurance and participating contract liabilities	167.2	–	–	1,639.0	–	1,806.2
Change in reinsurance assets	(167.2)	–	–	(21.8)	–	(189.0)
Net policyholder claims and benefits incurred	–	–	–	301.3	–	301.3
Change in investment contracts	–	–	–	54.2	–	54.2
Change in unallocated divisible surplus	–	–	–	395.6	37.8	433.4
Fees and commissions	–	–	–	(28.3)	–	(28.3)
Operating expenses:						
Other than long term business	–	–	0.9	–	–	0.9
Long term business	–	–	–	(112.6)	(46.3)	(158.9)
Investment expenses and charges	–	–	(16.2)	(56.0)	–	(72.2)
Profit before taxation	–	–	91.9	(43.6)	(8.5)	39.8
Tax attributable to policyholders' returns	–	–	–	43.6	8.5	52.1
Profit before taxation attributable to shareholder's profits	–	–	91.9	–	–	91.9
Income tax (expense)/credit	–	–	(19.8)	43.6	8.5	32.3
Less tax attributable to policyholders' returns	–	–	–	(43.6)	(8.5)	(52.1)
Tax attributable to shareholder's profits	–	–	(19.8)	–	–	(19.8)
Profit for the financial period	–	–	72.1	–	–	72.1

1. Further analysis (continued)

CIS ceased writing general insurance business with effect from the end of the 2005 financial period. The column headed 'discontinued activity' indicates income and expense flows from the run-off of this business. Continuing activity principally relates to investment income and expense flows arising from assets backing shareholder reserves.

The 2009 and 2008 columns headed 'significant items' include non-recurrent expenditure associated with a CFS Group programme of restructuring.

Balance sheet as at 31 December 2009

	Other than long term business	Long term business	Eliminations and unallocated balances	Total
Assets				
Property, plant and equipment	43.1	–	–	43.1
Investment property	6.9	1,433.5	–	1,440.4
Intangible assets	–	12.0	–	12.0
Reinsurance assets	209.6	2,971.5	–	3,181.1
Financial investments at fair value through profit or loss	559.7	15,583.6	–	16,143.3
Loans at amortised cost	–	7.8	–	7.8
Derivative financial instruments	41.8	639.4	–	681.2
Income tax asset	20.1	13.0	–	33.1
Insurance receivables and other assets	16.8	230.8	–	247.6
Cash and cash equivalents	1.0	54.9	–	55.9
Total assets	899.0	20,946.5	–	21,845.5
Capital and reserves attributable to the Society's equity holders				
Share capital	0.1	–	–	0.1
Retained earnings	77.9	–	–	77.9
Other reserves	317.0	–	–	317.0
Total equity	395.0	–	–	395.0
Liabilities				
Insurance and other participating contracts liabilities	209.6	15,859.5	–	16,069.1
Unallocated divisible surplus	–	1,052.8	–	1,052.8
Investment contract liabilities	–	259.9	–	259.9
Net asset value attributable to unit holders	–	42.1	–	42.1
Derivative financial instruments	13.1	489.8	–	502.9
Loans and borrowings	172.0	–	–	172.0
Amounts owed to credit institutions	–	1,071.2	–	1,071.2
Deferred tax liabilities	80.0	41.3	–	121.3
Other provisions	–	9.1	–	9.1
Insurance and other payables	29.3	127.4	–	156.7
Other reinsurance liabilities	–	1,993.4	–	1,993.4
Total liabilities	504.0	20,946.5	–	21,450.5
Total equity and liabilities	899.0	20,946.5	–	21,845.5

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

1. Further analysis (continued)

Balance sheet as at 10 January 2009

	Other than long term business	Long term business	Eliminations and unallocated balances	Total
Assets				
Property, plant and equipment	–	–	–	–
Investment property	–	1,483.8	–	1,483.8
Intangible assets	–	11.4	–	11.4
Reinsurance assets	277.4	3,080.8	–	3,358.2
Financial investments at fair value through profit or loss	780.6	15,665.5	–	16,446.1
Loans at amortised cost	–	9.7	–	9.7
Derivative financial instruments	61.2	966.2	–	1,027.4
Insurance receivables and other assets	18.4	349.9	(2.5)	365.8
Assets classified as held for sale	50.0	–	–	50.0
Cash and cash equivalents	(0.3)	51.1	–	50.8
Total assets	1,187.3	21,618.4	(2.5)	22,803.2
Capital and reserves attributable to the Society's equity holders				
Share capital	0.1	–	–	0.1
Retained earnings	113.0	–	–	113.0
Other reserves	317.0	–	–	317.0
Total equity	430.1	–	–	430.1
Liabilities				
Insurance and other participating contracts liabilities	277.4	16,039.4	–	16,316.8
Unallocated divisible surplus	–	622.2	–	622.2
Investment contract liabilities	–	190.9	–	190.9
Derivative financial instruments	21.2	375.6	–	396.8
Loans and borrowings	277.0	–	–	277.0
Amounts owed to credit institutions	–	1,814.4	–	1,814.4
Deferred tax liabilities	86.5	0.9	–	87.4
Other provisions	–	6.6	–	6.6
Insurance and other payables	60.1	234.2	(2.5)	291.8
Other reinsurance liabilities	–	2,268.9	–	2,268.9
Income tax liabilities	35.0	65.3	–	100.3
Total liabilities	757.2	21,618.4	(2.5)	22,373.1
Total equity and liabilities	1,187.3	21,618.4	(2.5)	22,803.2

Unallocated balances mainly relate to deferred and current tax balances and other borrowed funds.

Other than long term business: operating profit on a long term rate of return basis

In managing its other than long term business, CIS assesses profit based upon a smoothed investment return as an internal measure and to determine a like-for-like result for year-on-year comparison. This involves determining expected longer term rates of investment return and applying these to the fair value of investible assets. Any difference between the longer term rate of return and the actual return is considered to represent a short term investment fluctuation.

CIS has purchased equity futures to eliminate its exposure to market value changes in equity holdings. Furthermore, interest rate swaps are used to eradicate income fluctuations and accordingly the calculation of long term rate of return is based upon the application of the fixed yield to investible assets. During the financial period the assumed fixed interest yield was 5.0% (2008: 5.7%).

1. Further analysis (continued)

The table below illustrates the results assuming longer term rates of return on financial assets.

	2009	2008
Profit for the financial year before shareholder tax based upon longer term rate of return	28.8	31.1
Short term investment fluctuations	(13.3)	60.8
Income tax attributable to shareholder's profits	–	(19.8)
Profit for the financial period	15.5	72.1

Other items included in the income statement or balance sheet are as follows:

	Other than long term business 2009	Long term business 2009	Total 2009	Other than long term business 2008	Long term business 2008	Total 2008
Depreciation	–	–	–	–	0.5	0.5
Amortisation of deferred acquisition costs	–	5.0	5.0	–	9.4	9.4

During the 2008 financial period, the long term business fund transferred to the other than long term business fund, owner occupied properties and investment properties for sale proceeds of £43.1m and £6.9m respectively (see notes 12 and 13). The long term business fund recognised a realised profit on sale of £14.8m. These transactions have been eliminated above within the consolidated and Society analysis.

2. Net earned premiums

	2009	2008
Gross premiums		
Long term insurance contracts:		
Non-participating	36.5	39.1
Participating contracts	454.3	458.8
Gross premium revenue	490.8	497.9
Outward reinsurance premiums		
Long term insurance contracts:		
Non-participating	(16.2)	(19.1)
Premium ceded to reinsurers	(16.2)	(19.1)
Net earned premiums	474.6	478.8
	2009	2008
Analysis of gross earned premiums		
Long term insurance contracts:		
Premiums under individual contracts	475.1	485.6
Premiums under group contracts	15.7	12.3
	490.8	497.9
Premiums from life assurance business	376.3	362.3
Premiums from pension business	112.5	133.4
Premiums from permanent health business	2.0	2.2
	490.8	497.9

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

3. Fee and commission income and income from service activities

	2009	2008
Reinsurance commission earned	0.5	0.6
Other commission	10.9	7.4
Fees from sales of unit trusts	11.4	10.3
Fund management fees	23.8	28.1
	46.6	46.4

4. Investment income

	2009	2008
Rental income from investment properties	118.2	121.8
Interest income from debt securities at fair value through profit or loss	357.3	365.3
Dividend income from equities at fair value through profit or loss	138.0	172.5
Interest income from loans at amortised cost	0.6	1.0
Interest income from derivative financial instruments	63.8	1.4
Interest income from cash and cash equivalents	14.2	62.5
	692.1	724.5

5. Gains less losses arising from financial instruments and other assets

	2009	2008
Net gains/(losses) on remeasurement of financial instruments and other assets at fair value		
Equity financial assets:		
Listed	944.8	(1,758.9)
Unlisted	42.9	(47.0)
	987.7	(1,805.9)
Debt security financial assets:		
Listed	58.8	(304.9)
Unlisted	(224.8)	480.7
	(166.0)	175.8
Derivatives	(587.7)	920.8
Fair value gains less losses on investment property	(1.8)	(557.4)
Fair value gains less losses on other investments	1.5	(11.7)
	(588.0)	351.7
Net gains/(losses) on remeasurement of financial liabilities at fair value through profit or loss	223.9	(483.1)
	457.6	(1,761.5)

Net gains on unlisted equity investments include an unrealised loss of £nil (2008: £nil), which is considered to represent impairment.

Included within gains less losses arising from financial instruments are net gains of £223.9m (2008: £483.1m net losses) relating to financial liabilities designated at fair value through profit or loss. Net gains less losses on remeasurement of financial liabilities relate wholly to liabilities designated at fair value on inception. Further information is provided in note 32, in relation to reinsurance liability.

6. Other operating income

	2009	2008
Rental income from owner occupied property	5.0	5.2
Profit on sale of property, plant and equipment	–	0.2
Foreign exchange gain	–	14.6
Other	–	1.2
	5.0	21.2

7. Net policyholder claims paid and benefits

	2009	2008
Gross claims paid		
Long term insurance contracts:		
Death benefits	134.7	140.9
Surrender benefits	470.7	629.6
Maturity claims	346.1	500.8
Annuity and other benefits	198.0	183.0
	1,149.5	1,454.3
General insurance contracts:		
Prior period claims	78.4	108.0
	78.4	108.0
Gross claims paid and benefits	1,227.9	1,562.3
	2009	2008
Less recovered from reinsurers		
Long term business:		
Death benefits	(11.7)	(13.2)
Annuity and other benefits	(121.9)	(125.2)
	(133.6)	(138.4)
General insurance contracts:		
Prior period claims	(78.4)	(108.0)
	(78.4)	(108.0)
Amounts recovered from reinsurers	(212.0)	(246.4)
Net claims paid and benefits	1,015.9	1,315.9

8. Fees and commissions

	2009	2008
Commissions	31.0	28.3

9. Operating expenses

	2009	2008
Administration expenses	67.9	73.2
Acquisition expenses	32.6	36.1
Non-recurring expenses	20.9	46.3
Other	(0.5)	2.4
	120.9	158.0

Items included on the face of the income statement in the column headed 'significant items' relate to non-recurring expenses associated with a CFS Group programme of restructuring announced in 2007.

CIS does not have any employees; all sales are effected by staff of CFSMS which also provides administration and other services. CFSMS is also responsible for the remuneration of all directors of the CFS Group, including directors of CIS. CIS' share is charged to the company, at cost, by way of a management service charge from CFSMS.

	2009	2008
Operating expenses are classified by nature:		
Depreciation	-	0.5
Management recharges and other operating expenses	120.9	157.5
	120.9	158.0

Specific disclosure of the remuneration of the CFS executive committee in relation to their services to all the CFS Group entities can be found on the 'Investor relations' area of the CFS website (cfs.co.uk).

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

9. Operating expenses (continued)

Management recharges include the following payments to auditors and their associates:

	2009	2008
	£'000	£'000
Audit of these financial statements	192	162
Other services:		
Audit of financial statements of subsidiaries pursuant to legislation	39	38
Other services pursuant to legislation	70	75
Other services relating to taxation	22	14
Services relating to information technology	24	126
Services relating to litigation	3	3
Services relating to recruitment and remuneration	–	2
All other services	44	63
	394	483

10. Investment expenses and charges

	2009	2008
Investment property expenses	24.7	16.0
Investment management cost	15.6	14.8
Investment transaction costs	10.7	15.3
Interest from intra-group borrowing (see note 37)	8.3	11.5
Interest paid on customer deposits	0.1	1.3
Other interest payable	19.8	13.3
	79.2	72.2

Included in the above, £28.2m relates to investment expenses calculated on effective interest basis (2008: £26.1m).

11. Income tax expense

	2009	2008
Current period tax expense		
UK tax for the current period	11.5	162.1
Overseas tax for the current period	2.0	2.4
UK tax adjustments in respect of prior periods	(42.0)	(3.6)
Overseas tax adjustments in respect of prior periods	0.8	–
Total current tax (credit)/expense	(27.7)	160.9
Deferred tax expense		
Origination and reversal of temporary differences	30.0	(193.7)
Change in tax rate	–	–
Adjustment in respect of prior periods	4.0	0.5
Total deferred tax expense/(credit)	34.0	(193.2)
Total income tax expense/(credit) recognised in the income statement	6.3	(32.3)

11. Income tax expense (continued)

Reconciliation of effective tax rate

The tax charge in the income statement differs from the theoretical amount that would arise using the corporation tax rate in the UK, as follows:

	2009	2008
Profit before taxation	21.8	39.8
Tax calculated at domestic corporation tax rate of 28.0% (2008: 28.5%)	6.1	11.4
Effect of:		
Accounting profit not subject to policyholder tax	(1.7)	14.8
Policyholder tax on long term insurance business	6.3	(52.1)
Investment income not subject to tax	(5.1)	(7.2)
Tax rate change on deferred tax	–	0.7
Other adjustments	0.7	0.1
Income tax expense/(credit)	6.3	(32.3)

The tax expense included in the income statement is attributable to both policyholders and the shareholders. The rate of corporation tax applicable to long term business was 20% (2008: 20%). The rate for other than long term business and subsidiary companies was 28.0% for current tax (2008: 28.5%) and 28% for deferred tax (2008: 28%). The tax expense attributable to policyholders' returns in the UK included in the tax charge is as follows:

	2009	2008
Current tax	(34.2)	93.8
Deferred tax	40.5	(145.9)
Total tax attributable to policyholders' returns charged to the income statement	6.3	(52.1)

12. Property, plant and equipment

Consolidated and Society

	Land and buildings 2009	Land and buildings 2008
Cost		
At the beginning of the financial period	–	42.1
Transfer to investment property	–	(8.4)
Transfer from assets held for sale	43.1	–
Revaluation	–	(5.3)
Disposals	–	(28.4)
At the end of the financial period	43.1	–
Depreciation		
At the beginning of the financial period	–	–
Depreciation charge for the year	–	(0.5)
Revaluation	–	0.5
At the end of the financial period	–	–
Carrying amount		
At the end of the financial period	43.1	–
At the beginning of the financial period	–	42.1

During the 2008 financial period, the long term business fund transferred to the other than long term business fund, owner occupied properties and investment properties for sale proceeds of £43.1m and £6.9m respectively. In 2008 the other than long term business classified these on the balance sheet as non current assets held for sale as their carrying amount was expected to be recovered through sale rather than through continuing use. Subsequently in 2009 the sale commitment has been deferred by more than one year; as a result the assets have been reclassified as property, plant and equipment and investment property respectively.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

12. Property, plant and equipment (continued)

Land and buildings were measured under the revaluation model in 2008, amounts that would have been recognised under the cost model would have been:

	Land and buildings 2008
Cost	
At the beginning of the financial period	46.3
Transfer to investment property	(9.8)
Transfer from assets held for sale	–
Disposals	(36.5)
At the end of the financial period	–
Depreciation	
At the beginning of the financial period	(2.6)
Depreciation charge for the year	(0.5)
Transfer to investment property	0.7
Disposals	2.4
At the end of the financial period	–
Carrying amount	
At the end of the financial period	–
At the beginning of the financial period	43.7

An external, independent valuation firm, having appropriate recognised professional qualification and recent experience in the location and category of property being valued, values the portfolio annually.

The Group accounting policy for shareholder owned property, plant and equipment is to carry at cost less accumulated depreciation and any impairment. Accordingly the reclassified owner occupied property is now carried at cost. In 2008 and during the period in which these properties were under policyholder ownership they were revalued annually to ensure the policyholder could enjoy the benefit of any capital appreciation. Revaluation was formerly undertaken by an independent valuation firm, having recognised professional qualification and recent experience in the location and category of property being valued.

13. Investment property

	2009	2008
Consolidated		
At the beginning of the financial period	1,483.8	1,977.6
Acquisitions	31.4	66.1
Disposals	(80.8)	(10.9)
Transfer from property, plant and equipment	–	8.4
Transfer from assets held for sale	6.9	–
Fair value adjustments	1.6	(562.1)
Foreign exchange movements	(2.5)	4.7
At the end of the financial period	1,440.4	1,483.8
Society		
At the beginning of the financial period	1,452.1	1,950.6
Acquisitions	31.4	66.1
Disposals	(80.8)	(10.9)
Transfer from property, plant and equipment	–	8.4
Transfer from assets held for sale	6.9	–
Fair value adjustments	7.3	(562.1)
At the end of the financial period	1,416.9	1,452.1

An external, independent valuation firm, having appropriate recognised professional qualification and recent experience in the location and category of property being valued, values the portfolio annually.

13. Investment property (continued)

The amounts recognised for rental income and direct operating expenses in the income statement are:

	2009	2008
Rental income	118.2	121.8
Direct operating expenses from rented property	10.7	11.9
Direct operating expenses from property not rented	10.5	3.1
Total direct operating expenses on investment property	21.2	15.0

During the 2008 financial period, the long term business fund transferred to the other than long term business fund, owner occupied properties and investment properties for sale proceeds of £43.1m and £6.9m respectively. In 2008 the other than long term business classified these on the balance sheet as non-current assets held for sale as their carrying amount was expected to be recovered through sale rather than through continuing use. Subsequently in 2009 the sale commitment has been deferred by more than one year; as a result the assets have been reclassified as property, plant and equipment and investment property respectively.

14. Intangible assets

Deferred acquisition costs

Consolidated	2009	2008
At the beginning of the financial period	11.4	17.9
Incremental acquisition costs incurred	5.6	2.9
Amortisation	(5.0)	(9.4)
At the end of the financial period	12.0	11.4

Incremental costs directly related to the costs of acquiring new business in relation to unit trust management are deferred and recognised in the same period as the related service income. The deferred costs are stated gross of a related deferred income liability (note 31).

There are no deferred acquisition costs relating to the Society.

Long term insurance business deferred acquisition costs are no longer represented as an explicit asset under the realistic basis of reporting actuarial liabilities. Acquisition costs relating to investment contracts are recognised when incurred as the directors do not consider these costs to be recoverable from future income.

Other deferred acquisition costs of the long term business are expected to be realised over a period of up to six and ½ years (2008: four and ¾ years), being the expected term of a unit trust contract. Of the total value £7.2m (2008: £6.3m) is expected to be recovered after more than one year.

15. Investments in group undertakings

	2009	2008
Shares in group undertakings	332.1	306.5
At the beginning of the financial period	306.5	37.3
Additions	141.4	320.0
Disposals	(140.0)	—
Loss on disposal	(11.7)	—
Reversal of impairment losses	37.9	—
Impairment	(2.0)	(50.8)
At the end of the financial period	332.1	306.5

Impairment arises where the value of the Society's investment is assessed to be lower than cost.

All consolidated subsidiaries are wholly-owned subsidiaries of the long term business fund.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

15. Investment in group undertakings (continued)

	Trading company	Country of incorporation or registration	Accounting reference date
CIS Mortgage Maker Limited	Yes	Great Britain	31 December 2009
CIS Policyholder Services Limited	Yes	Great Britain	31 December 2009
CIS Unit Managers Limited	Yes	Great Britain	31 December 2009
Hornby Road Investments Limited	Yes	Great Britain	31 December 2009
Neale House Holdings Limited	Yes	Great Britain	31 December 2009
Petros Developments (Leeds) Limited	Yes	Great Britain	31 December 2009
CIS Asset Managers Limited	Yes	Great Britain	31 December 2009
Goldman Sachs Multi-Strategy Portfolio COIS Limited	Yes	Cayman Islands	31 December 2009
CIS Sustainable Diversified Trust	Yes	Great Britain	31 January 2010
CIS Sustainable World Trust	Yes	Great Britain	30 September 2010
Leyburn Developments Limited	No	Great Britain	31 December 2009
Primera (Fenchurch Street) Limited	No	Great Britain	31 December 2009
R.O.P.K. (1980) Limited	No	Great Britain	31 December 2009
CIS Home Loans Limited	No	Great Britain	31 December 2009
CIS Mortgage Finance Limited	No	Great Britain	31 December 2009
CIS Limited (formerly CIS Residential Mortgages Limited)	No	Great Britain	31 December 2009
CIS Mortgage Maker Limited	No	Great Britain	31 December 2009

The accounting reference dates of material subsidiaries are coterminous with CIS. Where accounting reference dates are not coterminous, adjustment is made to reflect material transactions occurring between the Society's and the subsidiary's accounting reference date.

CIS owns 100% of the non-voting, participating shares in Goldman Sachs Multi-Strategy Portfolio COIS Limited and has the facility to be able to control the financial and operating policy of the company through the stipulation of investment parameters within which it can operate. Accordingly the investment has been consolidated. Further information on the accounting policy for consolidation and special purpose entities (SPEs) is on page 20.

CIS owns units in two recently launched investment trusts, CIS Sustainable Diversified Trust and CIS Sustainable World Trust, with percentage holdings of 54.1% (2008: nil) and 90.8% (2008: nil) respectively. IAS 27 prescribes that such holdings should be consolidated as CIS has the power to control the entities (although it would not seek to exercise that power). Accordingly CIS has consolidated its investment in these funds and the value of units attributable to minority interest holdings is indicated on the face of the balance sheet. Net income attributable to minority interest holdings is not material and has therefore not been disclosed.

CIS Unit Managers Limited and CIS Policyholder Services Limited are regulated entities. Consequently, distributability of retained reserves is subject to the overriding requirement to ensure capital adequacy.

CIS guarantees the liabilities of some of its subsidiary companies and will provide support to these companies to ensure they remain a going concern. The extent of guarantees provided is not material to CIS. All intra-group guarantees are accounted for in accordance with IFRS 4 (Insurance Contracts).

Investment in associates

At 31 December 2009, the long term business fund held an interest of 20% or more of the nominal value of the issued share capital in three companies which are held as an investment of CIS. The holdings have been accounted for in accordance with IAS 39 (Financial Instruments: Recognition and Measurement) and not IAS 28 (Investments in Associates) as the standard contains a scope exclusion for investments held by mutual funds. CIS maintains these holdings purely for investment purposes and does not seek to exert a significant influence over the operating and financial policy of the companies.

Company	Country of incorporation	Class of share held	Fair value at 31 December 2009	Percentage of class held
Knightsbridge Integrated Limited	Guernsey	Ordinary shares	0.1	22.3%
Rising Star Growth II	England	Ordinary shares	0.8	21.8%
Enterprise Ventures Growth Limited	England	Ordinary shares	0.2	34.2%

16. Financial investments at fair value through profit or loss

Consolidated	2009	2008
Listed equities	5,047.3	4,528.9
Unlisted equities	820.8	298.0
Listed debt securities – fixed rate	6,779.7	6,780.7
Listed debt securities – floating rate	–	–
Unlisted debt securities – fixed rate	5.5	6.5
Unlisted debt securities – floating rate	1,992.4	2,267.7
Deposits with credit institutions – fixed rate	1,497.6	2,564.3
	16,143.3	16,446.1

Of the total value £14,080.0m (2008: £13,913.1m) are expected to be recovered after more than one year.

Society	2009	2008
Listed equities	4,944.2	4,526.0
Unlisted equities	635.6	121.4
Listed debt securities – fixed rate	6,736.5	6,780.7
Listed debt securities – floating rate	–	–
Unlisted debt securities – fixed rate	5.5	6.5
Unlisted debt securities – floating rate	1,992.4	2,267.7
Deposits with credit institutions – fixed rate	1,497.6	2,443.6
	15,811.8	16,145.9

Of the total value £14,411.5m (2008: £13,612.9m) are expected to be recovered after more than one year.

At the balance sheet date, CIS and the Group had securities with a market value of £260.1m (2008: £239.8m) on loan under approved stock lending arrangements. Eligible collateral totalling £266.9m (2008: £254.2m) was held as security.

Government guaranteed securities with a market value of £1,057.1m (2008: £1,512.4m) which were the subject of repurchase contracts are included in debt securities in the analysis above. Collateral is received in the form of cash and deposits with credit institutions include certificates of deposit with a market value of £1,069.6m (2008: £1,828.0m) purchased with the collateral. A liability of £1,071.2m (2008: £1,814.4m) is included within financial liabilities in respect of the associated repurchase liability.

There have been no reclassifications between categories of assets during the current or prior financial period.

17. Loans at amortised cost

Consolidated and Society	2009	2008
Loans:		
Secured by mortgages	3.5	4.0
Secured by insurance policies	4.0	5.4
Other loans	0.3	0.3
	7.8	9.7

Loans to group companies are provided on an arm's length basis with interest charged at commercial rates.

Fair value of loans and receivables is assessed to be the discounted amount of the future cash flows expected to be received. Discount rates used reflect current market rates and produce fair values which are not materially different from those quoted above.

Of the total group value £6.7m (2008: £8.7m) is expected to be recovered after more than one year. Similarly for the Society £6.7m (2008: £8.7m) are expected to be recovered after more than one year.

There have been no reclassifications between categories of assets during the current or prior financial period.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

18. Derivative financial instruments

Consolidated	2009	2008
Derivative financial assets at fair value through profit or loss – held for trading:		
Financial future contracts	11.8	1.7
Interest rate swaptions	290.6	471.4
Interest rate swaps	103.7	208.1
FTSE options	169.9	114.3
Forwards	1.2	–
Total return swaps	104.0	231.9
	681.2	1,027.4
Derivative financial liabilities at fair value through profit or loss – held for trading:		
Financial future contracts	19.0	33.6
Interest rate swaps	310.5	327.0
Total return swaps	162.2	–
Interest rate swaptions	–	1.8
Forwards	11.2	34.4
	502.9	396.8
Society	2009	2008
Derivative financial assets at fair value through profit or loss – held for trading:		
Financial future contracts	11.8	1.7
Interest rate swaptions	290.6	471.4
Interest rate swaps	103.7	208.1
FTSE options	169.9	114.3
Forwards	1.2	–
Total return swaps	104.0	231.9
	681.2	1,027.4
Derivative financial liabilities at fair value through profit or loss – held for trading:		
Financial future contracts	19.0	33.6
Interest rate swaps	310.5	327.0
Total return swaps	162.2	–
Interest rate swaptions	–	1.8
Forwards	8.1	1.5
	499.8	363.9

No arrangements qualify for hedge accounting treatment under IAS 39.

CIS has purchased a series of interest rate swaption contracts as an economic hedge against part of its exposure to guaranteed annuity options. The market value represents the initial margin and the daily variation margin as the contracts are settled on a daily basis in arrears.

FTSE put options are held to mitigate the impact of equity price risk.

Financial futures contracts which were open at 31 December 2009 had the effect of reducing CIS' exposure to UK equities by £713.8m (2008: £446.1m).

19. Insurance receivables and other assets

Consolidated	2009	2008
Receivables arising from insurance contracts:		
Insurance operations	7.2	28.7
Other receivables		
Accrued interest and rent	162.3	196.6
Prepayments and accrued income	7.7	0.4
Outstanding income	6.1	7.8
Amounts receivable for investments sold	18.8	95.8
Amounts receivable from group undertakings	34.9	10.7
Other receivables	10.6	25.8
	247.6	365.8
Society	2009	2008
Receivables arising from insurance contracts:		
Insurance operations	2.7	24.4
Other receivables		
Accrued interest and rent	161.0	196.5
Prepayments and accrued income	4.1	0.4
Outstanding income	6.1	7.8
Amounts receivable for investments sold	6.0	62.8
Amounts receivable from group undertakings	36.1	11.5
Other receivables	10.4	19.6
	226.4	323.0

No amounts are expected to be recovered after more than one year (2008: nil).

Consolidated

Insurance receivables arising from insurance operations are stated net of a provision of £nil (2008: £4.2m) relating to potential impairment of debtor balances held within a subsidiary company.

Consolidated and Society

Insurance receivables arising from insurance operations are stated net of an impairment provision of £2.3m (2008: £2.7m). The provision is calculated based on an assessment of insurance receivables for objective evidence that an impairment loss has been incurred. Objective evidence can include default of payment terms. Any adjustment to the level of the provision is recorded within the income statement as an adjustment to written premium.

Other receivables in respect of accrued interest and rent are stated net of an impairment provision of £5.5m (2008: £4.4m). This represents full provision for rent arrears overdue by more than 12 months. Any adjustment to the provision is recorded in the income statement as an adjustment to rental income.

In addition, insurance receivables and other assets include amounts totalling £9.1m (2008: £39.6m) which are overdue but not considered to be impaired, age analysed as follows:

Amounts overdue	2009	2008
Less than 3 months	7.0	37.5
3 to 6 months	0.1	0.1
6 to 12 months	0.2	0.2
More than 12 months	1.8	1.8

Assets past due but not impaired typically comprise high volume/low value balances for which CIS does not seek collateral but continues to work with counterparties to secure settlement.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

20. Assets held for sale

	2009	2008
Consolidated		
Property, plant and equipment	–	43.1
Investment property	–	6.9
	<u>–</u>	<u>50.0</u>
Society		
Property, plant and equipment	–	43.1
Investment property	–	6.9
	<u>–</u>	<u>50.0</u>

21. Cash and cash equivalents

	2009	2008
Consolidated		
Cash at bank and in hand	<u>55.9</u>	50.8
Society		
Cash at bank and in hand	<u>6.3</u>	1.7

Cash and cash equivalents are measured at amortised cost.

22. Share capital

	2009 £	2008 £
Authorised		
105,000 ordinary shares of £1 each	<u>105,000</u>	105,000
Allotted and called up		
105,000 ordinary shares of £1 each, £0.50 paid	<u>52,500</u>	52,500

Each shareholder has one vote and an additional vote for every 200 shares or fraction or part held by it in excess of the first 200 shares held.

23. Reserves

Reserves include £nil (2008: £10.2m), being an amount (net of tax) calculated in compliance with Chapter 1.4 of the Prudential Sourcebook for Insurers (INSPRU) which requires general insurers to maintain equalisation provisions.

General reserve

The general reserve of £317m is held outside the long term business fund. £200m of the reserve has been hypothecated to support the long term insurance business and the remainder is available to meet the obligations of both the long term and general insurance business as it runs off. CIS had a policy of apportioning a share of the investment return on assets representing the general reserve to the long term business. However, this policy ceased at the end of the 2007 financial period.

24. Insurance and participating contracts liabilities and reinsurance contracts

Consolidated and Society

(a) Analysis of insurance and participating contract liabilities

	2009	2008
Gross		
Long term insurance contracts:		
Insurance contracts	2,426.6	2,388.9
Insurance participating contracts	12,859.6	13,156.5
Investment participating contracts	573.3	494.0
	15,859.5	16,039.4
General insurance contracts:		
Claims reported	169.1	223.1
Claims incurred but not reported	40.5	54.3
	209.6	277.4
Total gross insurance liabilities	16,069.1	16,316.8
Recoverable from reinsurers		
Long term insurance contracts:		
Insurance contracts	(1,822.9)	(1,779.4)
Insurance participating contracts	(1,148.6)	(1,301.4)
	(2,971.5)	(3,080.8)
General insurance contracts:		
Claims reported	(169.1)	(223.1)
Claims incurred but not reported	(40.5)	(54.3)
	(209.6)	(277.4)
Total reinsurers' share of insurance liabilities	(3,181.1)	(3,358.2)
Net		
Long term insurance contracts:		
Insurance contracts	603.7	609.5
Insurance participating contracts	11,711.0	11,855.1
Investment participating contracts	573.3	494.0
	12,888.0	12,958.6
General insurance contracts:		
Claims reported	-	-
Claims incurred but not reported	-	-
	-	-
Total net insurance liabilities	12,888.0	12,958.6

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

(b) General insurance contracts – assumptions, changes in assumptions and sensitivity

i) Basis of assessing liabilities

The Society uses a combination of recognised actuarial and statistical techniques to assess the ultimate cost of claims. These include:

- projecting historic claims payment and recoveries data;
- projecting numbers of claims;
- adjusting case estimates for future inflation and onto a provisioning basis;
- deriving average costs per claim to apply to claim numbers;
- projecting historic claims incurred data (payments plus estimates) – Chain Ladder techniques; and
- Bornhuetter-Ferguson/Cape Cod techniques.

Extensive use of detailed claims data including individual case estimates is made to derive patterns in average claims costs and timings between occurrence and estimated payment of claims. The most common method used is the Chain Ladder method. This technique involves the analysis of historical claims development trends and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims data for each accident year which is not yet fully developed to produce an estimated ultimate claims cost for each accident year. A degree of judgment is required in selecting the most appropriate development factors.

The Chain Ladder method can be quite volatile for relatively undeveloped origin periods so a Bornhuetter-Ferguson/Cape Cod method is often used in such cases. This method uses some prior expectation of the ultimate claims, and stabilises the projected ultimate by weighting between the prior expected ultimate and the projected based on the assumed development factors. The Cape Cod method differs from the Bornhuetter-Ferguson method in that it uses a trending of ratios (such as the average cost) to arrive at a prior expected ultimate for use in the projections.

The work is undertaken and supervised by suitably qualified personnel. Claims provisions are separately computed for each claim type such as bodily injury, accidental damage, storm, flood and subsidence. All provisions are calculated gross with explicit allowance for reinsurance and subrogation recoveries. Provisions are not discounted for investment return other than any required additional provision for unexpired risks, in assessing the liability for periodic payment settlement cases and provisions relating to claims arising from electrical industry insurance 1950s – 1970s.

ii) Key assumptions

Principal assumptions underlying the claims provisions include:

- explicit allowance for future inflation at rates varying from 0% per annum to 8.25% per annum according to the claim type. The range of future inflation rates is largely unchanged from that used at the previous year-end; and
- for bodily injury claims allowance has been made for:
 - use of the Ogden Tables at a discount rate of 2.25%;
 - increased awards for general damages in accordance with the 8th edition of the Judicial Studies Board guidelines;
 - a small proportion of large claims being settled by periodic payments; and
 - improvements in the case estimation techniques resulting in earlier recognition of the size of claims.

iii) Sensitivity analysis

Under the terms of an Indemnification agreement between CIS and CISGIL, a fellow subsidiary of the CFS Group, all general insurance business written by CIS in previous financial periods and now in run-off is reinsured with CISGIL (except to the extent that recoveries can be made under existing third party reinsurance arrangements). Consequently all benefits and burdens of the business in run-off will be experienced by CISGIL and will have no impact upon the financial results of CIS. Accordingly it has not been considered necessary to carry out detailed sensitivity analysis for the general insurance business of CIS. Sensitivity analysis of all general insurance risks in the Group are considered within CISGIL.

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

(c) Change in general insurance liabilities and reinsurance assets

i) General insurance – claims and loss adjustment expenses

	2009 Gross	2009 Reinsurance	2009 Net	2008 Gross	2008 Reinsurance	2008 Net
Notified outstanding claims	223.1	(223.1)	–	272.8	(272.8)	–
Claims incurred but not reported	54.3	(54.3)	–	171.8	(171.8)	–
Claims settlement expenses	–	–	–	–	–	–
At the beginning of the financial period	277.4	(277.4)	–	444.6	(444.6)	–
Claims paid during the period	(77.8)	77.8	–	(108.0)	108.0	–
Increase in liabilities:						
Arising from current period claims	–	–	–	–	–	–
Arising from prior period claims	10.0	(10.0)	–	(59.2)	59.2	–
Total movement	(67.8)	67.8	–	(167.2)	167.2	–
Notified outstanding claims	169.1	(169.1)	–	223.1	(223.1)	–
Incurred but not reported	40.5	(40.5)	–	54.3	(54.3)	–
Claims settlement expenses	–	–	–	–	–	–
At the end of the financial period	209.6	(209.6)	–	277.4	(277.4)	–

ii) General insurance – provisions for unearned premiums

There was no provision for unearned premiums in 2009 or 2008.

iii) General insurance – provisions for unexpired risk

There was no provision for an unexpired risk in 2009 or 2008.

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

(d) Capital position statement 2009

	Long term (excl. stakeholder)	With-profits stakeholder fund	Shareholder funds	Total long term business
Available capital resources				
Shareholders' funds outside fund	–	–	200.0	200.0
Shareholders' funds held in fund	–	–	–	–
Total shareholders' funds	–	–	200.0	200.0
Adjustments onto regulatory basis:				
UDS	1,029.7	–	–	1,029.7
Adjustment to assets	(22.1)	–	–	(22.1)
Total available capital resources	1,007.6	–	200.0	1,207.6
With profits liabilities on realistic basis:				
Options and guarantee	1,101.6	–	–	1,101.6
Other policyholder obligations	10,877.7	198.2	–	11,075.9
Total participating contract liabilities	11,979.3	198.2	–	12,177.5
Non participating life insurance	603.7	–	–	603.7
Insurance and participating contract liabilities per capital position statement	12,583.0	198.2	–	12,781.2

Capital position statement 2008

	Long term (excl. stakeholder)	With-profits stakeholder fund	Shareholder funds	Total long term business
Available capital resources				
Shareholders' funds outside fund	–	–	200.0	200.0
Shareholders' funds held in fund	–	–	–	–
Total shareholders' funds	–	–	200.0	200.0
Adjustments onto regulatory basis:				
UDS	598.8	–	–	598.8
Adjustment to assets	(25.4)	–	–	(25.4)
Total available capital resources	573.4	–	200.0	773.4
With profits liabilities on realistic basis:				
Options and guarantee	1,819.0	–	–	1,819.0
Other policyholder obligations	10,255.0	159.6	–	10,414.6
Total participating contract liabilities	12,074.0	159.6	–	12,233.6
Non participating life insurance	609.5	–	–	609.5
Insurance and participating contract liabilities per capital position statement	12,683.5	159.6	–	12,843.1

	2009	2008
Reconciliation to insurance and participating contracts liability		
Insurance and participating contract liabilities as per capital position statement	12,781.2	12,843.1
Add back reinsurance	2,971.5	3,080.8
Outstanding claims reserves	106.8	115.5
General insurance gross contract liabilities	209.6	277.4
Insurance and participating contract liabilities	16,069.1	16,316.8

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

(e) Long term life insurance contracts – assumptions, changes in assumptions and sensitivity

i) Capital management policies and objectives

The liabilities of the long term business fund shown in the capital position statement are calculated following FSA rules and guidance. CIS has a general reserve of £317m which is available to support both long term business and general insurance business in run-off. The general reserve is shareholder capital and is held outside the long term business fund. However, as at 31 December 2009, £200m of the general reserve was allocated to the long term business fund.

The whole of the profits of the long term business are applied for the sole benefit of the long term business policyholders. This includes the making of reserves with the aim of preserving the strength of the fund for the benefit of current and future life assurance and pensions policyholders. Similarly, any losses incurred within the fund are borne by the policyholders, either through a reduction in the working capital of the fund or through a reduction in their benefits.

The working capital of the fund is the excess of assets within the fund over the amount needed to meet liabilities, including those arising from the regulatory requirement to treat customers fairly when setting discretionary benefits. The working capital is managed to ensure that the long term business fund can meet its solvency requirements under a range of adverse conditions and to meet business plans.

Risks that may affect the long term business fund are managed according to documented risk management policies, which require risks and capital to be monitored and reported regularly, and decisions made according to delegated authorities, details are provided in the risk management section on pages 27 to 35. Actions to control risk and manage the working capital of the fund include the use of reinsurance, the matching of assets and liabilities (including using derivatives) and the setting of discretionary benefits at appropriate levels, as described in the PPFM.

In exceptional circumstances, assets held outside the fund (share capital and general reserve), if available, may be used to help meet the long term business fund's solvency requirements. In some circumstances, this may require a transfer of assets into the fund. In such cases the fund would be managed with the aim of repaying these assets (accumulated with interest at an appropriate level) over time from within the fund.

ii) Policy options and guarantees

Personal and free-standing pension scheme pure endowment contracts issued prior to March 1999 contain options guaranteeing a minimum annuity rate at vesting. The value of the options is calculated using a market consistent stochastic approach. For a representative set of policies, the asset shares are projected to the date of vesting. If, based on projected market interest rates at the date of vesting, the annuity that would then be payable is less than the guaranteed annuity, additional provision is made with the additional costs being calculated on a market consistent basis. Assumptions used in the calculation relating to expenses, mortality experience and the proportion of policies that reach vesting are best estimates based on experience investigations carried out during 2009. At 31 December 2009, provisions amounting to £512.0m (2008: £750.5m) have been made to cover the future cost of meeting guarantees of this type.

For accumulating with-profits business, provision has been made for the guarantee that no market value reduction will apply on death, or on surrender of premiums paid prior to 1 April 2000 if ten or more years prior to the date of surrender. The value of the guarantee is calculated using a market consistent stochastic approach, and assuming that annual bonuses are at expected future levels. Provision has been made for the current value of the excess of the guaranteed payout on surrender over the projected asset share. Expense and mortality assumptions used in the calculation are best estimates based on experience investigations carried out during 2009. At 31 December 2009, provisions amounting to £65.0m (2008: £137.4m) have been made to cover the future cost of meeting guarantees of this type. The cost of meeting maturity guarantees on life and pensions savings products is calculated stochastically using market consistent interest rates. It is assumed that annual bonuses continue to be declared at the levels applicable following the bonus declaration arising out of the current valuation.

Provision has been made for the present value of the excess of the guaranteed payout at maturity over the projected asset share. Expense and mortality assumptions used in the calculation are best estimates based on experience investigations carried out during 2009. At 31 December 2009, provisions amounting to £560.0m (2008: £964.6m) have been made to cover the future cost of meeting guarantees of this type.

iii) Basis of assessing liabilities

The long term business provision is calculated twice a year having regard for the principles laid down in Chapter 1.2 and 1.3 of the Prudential Sourcebook for Insurers (INSPRU). In December 2006, FSA issued a policy statement (PS06/14) allowing insurers to move the capital and reserving requirements of non-profit business to a more realistic basis. CIS adopted the changes under this policy statement at 12 January 2008, and continues to do so at 31 December 2009.

iv) Participating business methodology

Provisions for participating business are calculated as the value of the with-profits benefits reserve plus the cost of options, guarantees and smoothing. Retrospective methods are used to calculate with-profits benefits reserves for all products apart from whole of life policies for which a prospective method is used.

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

Retrospective methods of calculation involve the accumulation of monthly cash flows in respect of premiums plus investment income (including unrealised gains/losses and allowances for allocations in respect of past miscellaneous surplus) less policy charges, expenses and tax.

Prospective methods are used to calculate with-profits benefits reserves for all ordinary and industrial branch whole of life policies. Prospective methods of calculation involve determining the present value of the future cash flows in respect of premiums plus investment return, less policy charges and expenses, benefits payable (including guaranteed benefits, bonuses declared and an element of potential future bonuses) and tax.

The cost of guarantees, options and smoothing is calculated using a market consistent stochastic model. Policies are grouped by similar nature, term and size for each product. Stochastic projections are performed using grouped model points representing individual contracts.

The market-consistent asset model has been used to calculate the costs of guarantees, options and smoothing.

The model is calibrated according to the rules within INSPRU and tests are performed to ensure that the model reproduces current market prices of traded instruments and is arbitrage-free.

v) **Non-participating business methodology**

Reserves for conventional non-participating business are valued prospectively, using a gross premium approach, by subtracting the actuarial value of the estimated future premium income from the value of the future benefit outgo. Prudent assumptions are used in these calculations but some allowance is made for expected future lapses.

The value of future profits that are expected to arise on non-participating contracts (being the present value of future cash flows under these contracts) is calculated using realistic assumptions and is deducted from the reserves to determine the provision for conventional participating business.

Provisions for unit-linked policies are determined by reference to the value of the units allocated to policies at the accounting date.

Although the gross insurance liabilities and the related reinsurance are fairly stated on the basis of the information currently available, the eventual liability may vary as a result of subsequent information and events.

The provisions, estimation techniques and assumptions are periodically reviewed with any changes in estimates reflected in the income statement as they occur.

vi) **Assumptions used in valuing the realistic liabilities**

In general, assumptions used in the valuation of realistic liabilities are based on the results of the most recent experience investigations and are considered to be best estimates of future experience. Where data is not significant enough to make firm conclusions, industry data is also considered.

vii) **Interest rates used in valuing the realistic liabilities**

A risk-free future interest rate of 4.45% (2008: 3.84%) is assumed when calculating prospective asset shares and the value of in-force business on non-participating contracts in compliance with the requirements of INSPRU.

Liabilities for non-participating contracts require a prudent assumption to be made regarding future interest rates and are determined by reference to recent investment returns on assets backing the contracts and consideration of the long term view of these returns.

In calculating the value of in-force business on non-participating contracts, future profits are discounted using an interest rate that is 1% above the risk free rate of return.

In determining the value of options and guarantees, the interest rate is stochastic with an average of the risk free curve across all scenarios. The risk free curve varies by duration.

viii) **Future bonuses**

Prospective asset share calculations and the valuation of options and guarantees use the latest proposed annual rates, and assume they will continue at these levels.

ix) **Expenses and expense inflation**

Expense assumptions for prospective asset shares and value of the in-force business on non-participating contracts are determined based on the latest experience and are adjusted, where appropriate, to reflect any expected changes in patterns in the future.

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

Reserves for non-participating contracts require a prudent explicit allowance to be made for the future expenses of maintaining contracts in force.

The level of future expense inflation is determined with reference to historical trends and expectations of how future per policy expenses will change. The assumption used in determining the provisions is calendar year specific up to 2017, reverting to a long term assumption of 5.1% per annum (2008: 4.2% per annum).

x) Mortality, morbidity and persistency

Wherever appropriate, mortality and persistency assumptions used are based on the results of the most recent experience investigations. Mortality assumptions are based on percentages of standard tables published by the Continuous Mortality Investigation Bureau (CMIB) and vary by product. Persistency assumptions (including early retirement rates on pension policies) vary by product and the number of years that a policy has been in force. Where data is not of a significant enough size to make firm conclusions, industry data is also considered. Critical illness assumptions are also based on percentages of standard tables published by CMIB.

In valuing guaranteed annuity options on personal pension policies, on retirement at the normal retirement age and after allowing for any tax-free cash sums, all guaranteed annuity options that are 'in-the-money' are assumed to be taken.

Mortality, morbidity and persistency assumptions have been updated to reflect the results of the 2009 experience investigations, but these changes have not had a major impact on the insurance contract liabilities.

xi) Tax

It is assumed that the current tax legislation and associated tax rates remain unchanged. The tax rate assumption used for netting interest rates and expenses is 20% (2008: 20%).

xii) Sensitivity analysis

The capital position of the long term business fund is sensitive to a number of economic and insurance variances since the fund contains a number of different policyholder options and guarantees as described in section ii) on page 68. Some of the main sensitivities of the fund can be examined by applying the stress tests prescribed by the FSA in calculating the Risk Capital Margin (RCM). The tests carried out in calculating the RCM and the sensitivity of the working capital to each test are as follows:

RCM stress tests	Reduction in working capital
20% fall in equity values and 12.5% fall in property values	88
17.5% change in long term gilt yields	74
32.5% improvement in persistency rates	62
Increase of 99 basis points in bond yields for credit risk test	96
Total RCM before management actions	320

In calculating the RCM, it has been assumed that no management action would be taken under the stressed conditions.

The RCM has been calculated to be £320m (2008: £147m). The excess working capital of the fund after the RCM is therefore £688m (2008: £426m), or £888m (2008: £626m) if the additional capital available outside the long term business fund is included. The RCM is covered 3.2 times (2008: 3.9 times) times by working capital (excluding the £200m allocated from the general reserve).

Other stress tests	Reduction in working capital
5% fall in assurance mortality rates	0
5% fall in annuitant mortality rates	33
10% increase in renewal expenses	48
1% increase in renewal expense inflation	91

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

(f) Change in long term insurance liabilities and reinsurance assets

	Non-participating insurance contracts	Participating insurance contracts	Reinsurance	Net total
2009				
At the beginning of the period	2,389.1	13,534.8	(3,080.8)	12,843.1
New liabilities	(7.2)	167.3	–	160.1
Changes in liabilities during the period	84.7	(978.1)	–	(893.4)
Effect of changes in non-economic assumptions	(26.1)	(78.8)	–	(104.9)
Effect of changes in asset shares	–	1,213.3	–	1,213.3
Effect of changes in economic conditions	(118.2)	(628.5)	–	(746.7)
Other	104.3	81.1	124.3	309.7
Insurance contract liabilities	2,426.6	13,311.1	(2,956.5)	12,781.2
Outstanding claims	–	121.8	(15.0)	106.8
At the end of the financial period	2,426.6	13,432.9	(2,971.5)	12,888.0

	Non-participating insurance contracts	Participating insurance contracts	Reinsurance	Net total
2008				
At the beginning of the period	2,236.8	15,351.5	(3,102.6)	14,485.7
New liabilities	(5.6)	119.2	–	113.6
Changes in liabilities during the period	144.5	(1,200.5)	–	(1,056.0)
Effect of changes in non-economic assumptions	7.5	(22.7)	–	(15.2)
Effect of changes in asset shares	–	(1,526.2)	–	(1,526.2)
Effect of changes in economic conditions	106.0	858.7	–	964.7
Other	(100.1)	(45.2)	21.8	(123.5)
Insurance contract liabilities	2,389.1	13,534.8	(3,080.8)	12,843.1
Outstanding claims	–	115.5	–	115.5
At the end of the financial period	2,389.1	13,650.3	(3,080.8)	12,958.6

(g) Movement in working capital of the long term business fund

	2009	2008
At the beginning of the period	573.4	1,009.3
Opening adjustments	(17.1)	(23.2)
Changes to insurance assumptions	71.4	17.0
Economic variances	335.1	(504.6)
Insurance variances	20.2	11.1
Other factors	24.6	63.8
At the end of the financial period	1,007.6	573.4

Opening adjustments

Opening adjustments consist of:

- improvements to the actuarial models used to calculate the working capital; and
- improvements in accounting reconciliations (2008 only).

Changes to insurance assumptions

Changes to insurance assumptions include:

- changes to expense, mortality and persistency assumptions to reflect the latest experience investigations.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

24. Insurance and participating contracts liabilities and reinsurance contracts (continued)

Economic variances

Economic variances arise from the following:

- investment returns more than (2008: less than) the assumed risk-free rate helping to reduce (2008: increase) the cost of meeting policy guarantees;
- an increase (2008: decrease) in risk-free rates which has decreased (2008: increased) the cost of policy guarantees; and
- assumed equity and interest rate volatility which has decreased (2008: increased) the cost of policy guarantees.

Insurance variances

Insurance variances include:

- variances between actual and assumed experience during the financial period;
- changes to pension and endowment mis-selling compensation costs;
- new business profits or losses; and
- one-off expenses.

Other factors

Other factors include:

- the effect of asset sales to maintain the Equity Backing Ratio within the range specified in the PPFM; and
- a reduction in annual bonus rates for accumulating with-profits business (2008 only).

25. Unallocated division surplus (UDS)

	2009	2008
Consolidated		
At the beginning of the period	622.2	1,045.6
Transfer to/(from) the income statement	430.6	(433.4)
Transfers (to)/from the statement of comprehensive income (SOCl):		
Revaluation of owner occupied property	–	(4.8)
Revaluation of owner occupied property transferred to assets held for sale	–	14.8
Tax on items through SOCl	–	–
At the end of the period	1,052.8	622.2
Society		
At the beginning of the period	598.8	1,028.1
Transfer to/(from) the income statement	430.9	(439.3)
Transfers (to)/from the statement of comprehensive income (SOCl):		
Revaluation of owner occupied property	–	(4.8)
Revaluation of owner occupied property transferred to assets held for sale	–	14.8
Tax on items through SOCl	–	–
At the end of the period	1,029.7	598.8

26. Investment contract liabilities

Consolidated and Society

All financial liabilities at fair value through profit or loss are designated by CIS to be in this measurement category.

The maturity value of these financial liabilities is determined by the fair value of the underlying assets, at the maturity date. There will be no difference between the carrying amount and the maturity amount at maturity date.

26. Investment contract liabilities (continued)

Investment contract liabilities arising from unit-linked contracts are measured at fair value by reference to the fair value of the underlying portfolio of assets and are designated in this measurement category at inception. None of the change in the liability is attributable to changes in the credit risk of the underlying assets.

The maturity value of these financial liabilities is determined by the fair value of the linked assets at maturity date. There will be no difference between the carrying amount and the maturity amount at maturity date.

Investment contracts – unit-linked

The movement in the liability arising from investment contracts is summarised below:

	2009	2008
At the beginning of the period	190.9	220.1
Contributions	34.1	38.7
Account balance paid on surrender and related benefits	(12.2)	(13.7)
Movement in fair value	47.1	(54.2)
At the end of the period	259.9	190.9
Movement in fair value comprises:		
Investment return credited and related benefits	46.5	(54.9)
Management charges	(2.2)	(2.1)
Other income – management rebate	2.8	2.8
	47.1	(54.2)

27. Loans and borrowings

	2009	2008
Consolidated and Society		
Loans from Group undertakings	172.0	277.0

The loan represents an unsecured, uncollateralised obligation of CIS and is repayable within ten days following written notice of demand. Interest is payable quarterly at a fixed rate of 4% per annum (2008: 4% per annum). Following the end of the previous financial period the loan agreement was modified such that the loan is now repayable within four days following written notice of demand.

There has been no default or breach of contractual obligations attaching to the loan during the financial period.

28. Amounts owed to credit institutions

	2009	2008
Consolidated and Society		
Gilt repo liability	1,071.2	1,814.4

The amounts owed to credit institutions represent repurchase liabilities in respect of government guaranteed securities which are the subject of repurchase contracts. The government guaranteed securities are included within investments. Amounts owed to credit institutions are measured at amortised cost.

29. Employee benefits

Defined contribution basis

With effect from 6 April 2006, the Society, along with other businesses within the Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). The PACE scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group-wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore pension costs shown in these accounts in respect of the PACE scheme for the period after 6 April 2006 are the actual contributions paid by the Society.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

29. Employee benefits (continued)

The key aspects of The Co-operative Group Limited's PACE scheme, which consists of companies that are all under common control, are as follows:

	2009	2008
The principal assumptions used to determine the liabilities of the Group's pension scheme were:		
Discount rate	5.60%	5.70%
Rate of increase in salaries	5.30%	4.75%
Future pension increases where capped at 5.0% per annum	3.80%	3.25%
Future pension increases where capped at 2.5% per annum	2.50%	2.50%
Assumptions used to determine net pension cost for PACE scheme are:		
Discount rate	5.70%	5.65%
Expected long term return on scheme assets	6.40%	6.40%
Rate of increase in salaries	4.75%	5.15%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme at 31 December 2009 are:

	Male	Female
Life expectancy at age 65		
Member currently aged 65 (current life expectancy)	20.4	23.2
Member currently aged 45 (life expectancy at age 65)	21.3	24.1

	2009	2008
The amounts recognised in the balance sheet of the Co-operative Group are as follows:		
Present value of funded obligations	(5,509.0)	(4,799.9)
Present value of unfunded obligations	(3.8)	(3.5)
Fair value of plan assets	5,514.4	5,204.6
	1.6	401.2

To develop the expected long term rate of return on assets assumption, the Co-operative Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.4% assumption for the current reporting period.

30. Other provisions

	2009	2008
Consolidated		
Onerous contract provisions	5.9	5.3
Other provisions	3.2	1.3
	9.1	6.6

	2009 Onerous contract provisions	2009 Other provisions	2009 Total
At the beginning of the period	5.3	1.3	6.6
Additional provisions during the period	2.3	2.4	4.7
Provision released	(1.7)	(0.5)	(2.2)
At the end of the period	5.9	3.2	9.1

	2008 Onerous contract provisions	2008 Other provisions	2008 Total
At the beginning of the period	4.1	1.2	5.3
Additional provisions during the period	1.2	1.1	2.3
Provision released	–	(1.0)	(1.0)
At the end of the period	5.3	1.3	6.6

	2009	2008
Society		
Onerous contract provisions	5.9	5.3
Other provisions	3.1	1.3
	9.0	6.6

	2009 Onerous contract provisions	2009 Other provisions	2009 Total
At the beginning of the period	5.3	1.3	6.6
Additional provisions during the period	2.3	2.3	4.6
Provision released	(1.7)	(0.5)	(2.2)
At the end of the period	5.9	3.1	9.0

	2008 Onerous contract provisions	2008 Other provisions	2008 Total
At the beginning of the period	4.1	1.2	5.3
Additional provisions during the period	1.2	1.1	2.3
Provision released	–	(1.0)	(1.0)
At the end of the period	5.3	1.3	6.6

Onerous contract provisions relate to long term business investment contracts and provide for potential cost overrun where management charges are capped and are expected to unwind over the duration of the investment contract liabilities and unavoidable lease commitments net of amounts receivable under sub-lettings. The additions to 'other provisions' largely relate to potential refunds of State Earnings Related Pension (SERP) premiums to Her Majesty's Revenue and Customs (HMRC) of £2.0m with the remainder being provisions to cover potential exposures arising from further projects which are underway but not complete.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

31. Insurance and other payables

	2009	2008
Consolidated		
Arising out of direct insurance operations	1.1	3.7
Accruals and deferred income	82.5	49.2
Amounts due for investment purchase	4.7	68.5
Amounts owed to other group undertakings	28.9	66.8
Other payables	39.5	103.6
	156.7	291.8
Society		
Arising out of direct insurance operations	1.1	3.7
Accruals and deferred income	66.1	33.2
Amounts due for investment purchase	4.7	68.5
Amounts owed to other group undertakings	24.1	60.4
Other payables	34.9	65.4
	130.9	231.2

Of the total value, £9.3m (2008: £15.8m) is expected to be recovered after more than one year.

32. Other reinsurance liabilities

	2009	2008
Consolidated and Society		
Arising from reinsurance operations	1,993.4	2,268.9

Liabilities arising from reinsurance operations include a financial liability of £1,992.4m (2008: £2,267.7m) which is valued at fair value through profit or loss. The liability is owed to a major reinsurer under a reinsurance arrangement to reinsure the majority of CIS' remaining obligations in respect of annuities in payment and a proportion of those in deferment. Under the reinsurance arrangement, CIS is contracted to pay premiums in accordance with a schedule of payments covering a period up to 2066. At inception of the contract, CIS recognised its premium obligation in full within the income statement by a charge representing the net present value of the contracted payments and continues to recognise a financial liability to the extent that the premium has yet to fall due for payment. At inception of the contract, CIS also purchased a debt security, cash flows from which will fund the discharge of the financial liability as amounts fall due for payment.

The value of the financial liability is linked to the value of the debt security and accordingly both the asset and liability were designated in the measurement category of fair value through profit or loss at inception. All of the change in the fair value of the liability is attributable to changes in the fair value of the debt security and does not reflect changes in the credit risk of the liability.

The maturity value will be determined by the fair value of the debt security at maturity date. There will be no difference between the carrying amount and the maturity value at maturity date. Of the discounted liability value, £53.9m (2008: £50.6m) is to be settled within one year giving rise to a cash outflow of £54.2m (2008: £52.8m), inclusive of interest. The amount to be settled after more than one year is £1,963.8m (2008: £2,218.3m).

33. Income tax

Consolidated	2009	2008
Current tax (asset)/liability		
At the beginning of the financial period	100.3	38.8
Tax charged to the income statement	(27.7)	160.9
Tax credited directly to reserves	(19.7)	–
Tax charged directly to the statement of comprehensive income:		
Revaluation of owner occupied property transferred to assets held for sale	–	0.4
Tax paid during the financial period	(86.0)	(99.8)
At the end of the financial period	(33.1)	100.3

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2008: 28%).

	2009	2008
Deferred tax liability		
At the beginning of the financial period	87.4	281.0
Tax charged/(credited) to the income statement	33.9	(193.2)
Tax credited directly to the statement of comprehensive income:		
Revaluation of owner occupied property	–	(0.4)
At the end of the financial period	121.3	87.4

Analysis of deferred tax liability		
Unrealised appreciation on investments	138.9	98.8
Acquisition costs deferred	(20.5)	(19.1)
Claim registration reserve	–	4.0
Other timing differences	2.9	3.7
At the end of the financial period	121.3	87.4

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

33. Income tax (continued)

Society	2009	2008
Current tax (asset)/liability		
At the beginning of the financial period	99.0	35.7
Tax (charged)/credited to the income statement	(27.9)	161.9
Tax charged directly to reserves	(19.7)	–
Tax credited directly to the statement of comprehensive income:		
Revaluation of owner occupied property transferred to assets held for sale	–	0.4
Tax paid during the financial period	(84.9)	(99.0)
At the end of the financial period	(33.5)	99.0

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2008: 28%).

	2009	2008
Deferred tax liability		
At the beginning of the financial period	76.9	272.1
Tax credited/(charged) to the income statement	33.3	(194.8)
Tax charged directly to the statement of comprehensive income:		
Revaluation of owner occupied property	–	(0.4)
At the end of the financial period	110.2	76.9
Analysis of deferred tax liability		
Unrealised appreciation on investments	127.8	88.3
Acquisition costs deferred	(20.5)	(19.1)
Claim registration reserve	–	4.0
Other timing differences	2.9	3.7
At the end of the financial period	110.2	76.9

No provision has been made for deferred tax on losses carried forward attributable to pension and ISA business as future profits are not anticipated. The deferred tax asset not recognised amounts to £5.5m (2008: £4.6m). No provision has been made for deferred tax on losses attributable to the life business as future profits are not anticipated. The deferred tax asset not recognised amounts to £5.4m (2008: £1.6m).

34. Contingent assets and liabilities

No contingent assets or liabilities have been identified at 31 December 2009 (2008: none).

35. Commitments

	2009	2008
Capital commitments arising from investment in partnership agreements	189.2	185.9

Under the terms of the partnership agreements capital will be drawn down as required.

36. Parent undertaking

Co-operative Insurance Society Limited, a wholly-owned subsidiary of Co-operative Financial Services Limited, is incorporated in Great Britain as an Industrial and Provident Society and is registered in England and Wales.

Co-operative Group Limited is the ultimate parent and is incorporated in Great Britain as an Industrial and Provident Society and is registered in England and Wales. The results of CIS are consolidated in the Group headed by Co-operative Group Limited. The financial statements of the immediate and ultimate holding organisations are available from New Century House, Manchester, M60 4ES.

37. Related party transactions

A number of transactions have been entered into during the course of the year with related parties. These have been conducted in the normal course of business and on normal commercial terms. These include the provision of insurance and investment products to members of the wider Co-operative Group and key management personnel. Key management are considered to include the Board and executive members of the Co-operative Group. Details of transactions and balances during the financial period are provided below.

Balances with related parties	2009	2008
<i>At the beginning of the financial period:</i>		
Due from ultimate parent undertaking	–	1.2
Due to immediate parent undertaking	(277.0)	(277.0)
Due from fellow subsidiaries	200.1	383.6
Movement in capital value	338.1	(184.2)
Fair value movements	–	(0.5)
<i>At the end of the financial period:</i>		
Due from ultimate parent undertaking	–	–
Due to immediate parent undertaking	(172.0)	(277.0)
Due from fellow subsidiaries	433.2	200.1

Net interest payable on these balances during the financial period amounted to £8.3m (2008: £10.5m).

The Society has entered into a loan agreement with its immediate parent, interest of £8.0m has been charged to the income statement during the period (2008: £11.5m).

During 2006 the Society entered into an indemnification agreement with a fellow subsidiary to reinsure its general insurance business in run-off, reinsurance assets at the end of the financial period included amounts recoverable under the agreement of £190.7m (2008: £256.1m).

During 2009 the Society entered into a deposit agreement with The Co-operative Bank plc, a fellow subsidiary, placing £236.6m for a period of 3 months at LIBOR plus 12 basis points (bps). Collateral in the form of floating rate notes (FRNs) has been provided by the Bank in support of the deposit and at the end of 2009 the value of collateral held was £273.3m.

During the year the Society paid dividends of £70.3m (2008: £nil) to its immediate and ultimate parent.

The Society and its subsidiaries have bank accounts with The Co-operative Bank plc, a fellow subsidiary. At the end of 2009, aggregate balances stood at £38.0m (2008: £54.8m). Interest earned on deposits throughout the year totalled £0.3m (2008: £3.6m).

CIS pays the Bank a fee for managing certain stock lending and repo activity on its behalf. The fee paid during 2009 amounted to £1.3m (2008: £0.7m).

	2009	2008
	£	£
<i>Transactions with key management personnel:</i>		
Value of insurance transactions at the beginning of the financial period	65,368	69,077
Movement during the financial period	114,488	(3,709)
Value of insurance transactions at the end of the financial period	179,856	65,368

From 15 January 2006, all staff costs are borne by CFSMS Limited and charged out to other companies within the CFS Group at cost. During the year, management fees (inclusive of certain claims expenses) of £121.9m (2008: £163.0m) were charged to CIS from CFSMS.



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Designed and produced by The Chase, Manchester.

The **co-operative** insurance
Co-operative Insurance Society Limited
Miller Street, Manchester M60 0AL
www.cis.co.uk

Registered Number: IP3615R

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