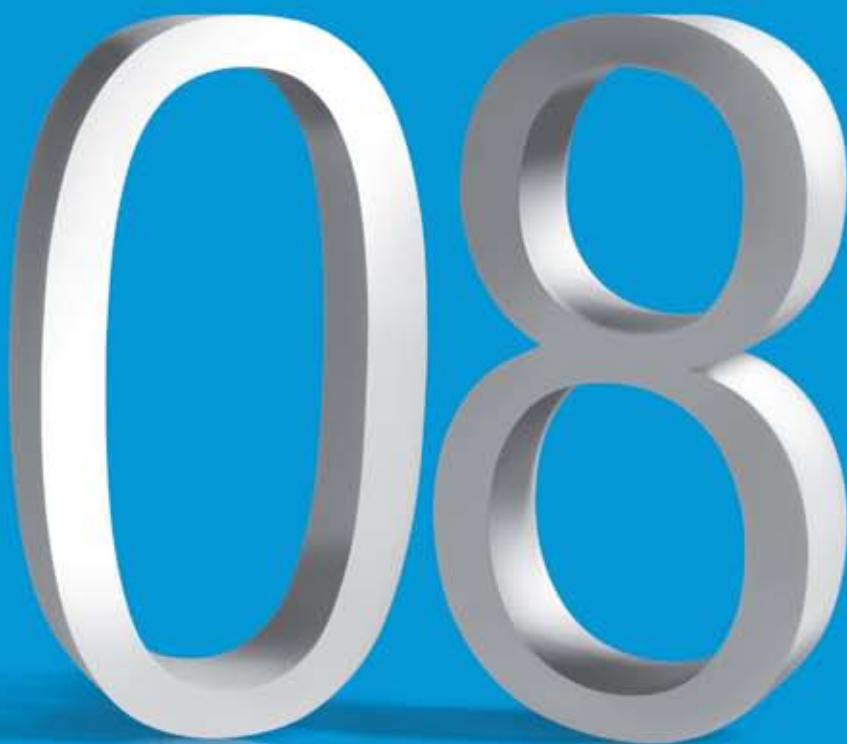


The **co-operative** insurance
good with money

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

Financial statements 2008



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Business and financial review

The long term business of Co-operative Insurance Society Limited (CIS), covering life insurance, pensions and unit trusts, continues to be transacted on a mutual basis which means that all profits are retained for the benefit of policyholders. Profits derived from CIS' other than long term business accrue for the benefit of the shareholder.

Highlights

Long term business

2008 saw the most difficult economic conditions in decades. In response to these market conditions, the solvency of the Co-operative Insurance Society Limited fell during 2008 driven by falls in asset values, but continues to meet its regulatory capital requirements.

Profitability of new business achieved target levels with the present value of New Business Premium for 2008 rising by 1% from 2007 levels to £468.0m. We have seen many customers taking a more cautious attitude to risk during the year and this has led to higher sales of our single premium With-Profits Bond and Investment Bond and lower sales of our equity-based Unit Trusts. Across our range of products we are seeing the effects of rising inflation and tax increases, squeezing disposable income for customers who typically have lower amounts to invest than we saw last year.

We are continuing our initiative to expand the distribution of our Unit Trusts to Independent Financial Advisors and other intermediaries in the wider investment market, and believe this represents an exciting opportunity over the medium to long term.

Gross earned insurance premiums for life and pensions business in 2008 was £497.9m compared to £534.9m for the corresponding period last year. The fall in gross premium income is due to a reduction in regular premiums from in-force with-profits business as policies reach maturity or retirement, partly offset by new business.

2008 saw negative returns on equity and property asset classes. The FTSE All-share return produced a return of minus 26%, whilst the FTSE World index produced minus 20%. Property returns were poor with the IPD Property index yielding minus 22% over the period. Corporate bonds suffered as a result of widening spreads and returned around minus 5% over the period. Government bonds were the only main asset class that performed well with returns of around 12%.

Co-operative Insurance has nearly 3 million with-profits policies in force. We continue to add value for 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). The latest version of the PPFM can be found on our website. Returns for with-profits policyholders were minus 11.6% for 2008, reflecting the difficult economic conditions. However, 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. Payouts on benchmark 25-year traditional with-profits endowment policies remain in the second quartile.

The amount of money managed on behalf of long term business customers fell from around £19.4 billion to £17.1 billion, as a result of the negative returns in the period and the reduction in the with-profits portfolio.

The CIS Sustainable Leaders Trust, Co-operative Insurance's flagship Socially Responsible Investment (SRI) fund, recorded first quartile performance for the last 12 months. Despite tough economic conditions, the performance of the UK Growth and UK Income with Growth trusts have produced favourable performance compared to their peer group due in particular to the funds being underweight in the UK banking sector during 2008.

All surpluses arising on the 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 remained relatively robust despite the downturn in markets, and the UDS fell by £423m (2007: £110m). The value of interest rate swaps and options held to back guaranteed annuity options on with-profits personal pension policies have increased relative to the liabilities they are matching, as a result of long term swap spreads falling. There has also been a release of technical provisions to the UDS in respect of reduced future expense inflation risk, resulting from the implementation of the administration outsourcing deal with Capita arranged in 2007, and also in respect of higher transfer rates experienced on personal pension policies. These increases have partly offset losses that were made from negative investment returns.

At 10 January 2009 the realistic working capital within the Co-operative Insurance long term business fund, being the excess of the realistic value of assets over the realistic value of liabilities stood at £573m compared to £1,009m at the start of the financial year. Excluding the effect of gilt repos, this represents a working capital ratio of 3.7% (2007: 5.7%). The decrease has arisen primarily from an increase in provisions for with-profit policies, as a result of falls in equity markets and from current equity market volatility.

As the arrangement with Capita enters its second year, strong progress has been made on embedding the administration services provided with the relocation of colleagues to new Capita premises in Manchester, and the migration of all print and post handling services to Capita's central UK hub. As we move forward this deal will deliver improved service propositions, better product capability and a reduced overall cost base.

Other than long term business

CIS has not transacted general insurance business during 2007 or 2008. 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 Ltd (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 2008 represents net investment return arising from assets backing shareholder reserves.

Investment in the future

Co-operative Financial Services (CFS) started the journey in 2006 to better serve its 6 million customers through transforming its business and technology capabilities.

CFS has commenced a substantial investment in new technology in 2008, via an Enterprise Platform Programme, to replace our retail and corporate banking system. This investment will allow CFS to re-engineer its customer facing and internal processes, and will provide an opportunity for further integration of our Banking infrastructure with that of the Insurance businesses so that we can be truly customer centric in the way we sell to and serve our customer base. This investment supports our customer relationship strategy across Banking, Insurance and Investments to deliver attractive, fair, accessible products on a scaleable multi-channel basis.

The investments so far have delivered a number of notable successes. Since early 2007, CFS has delivered significant underlying cost reductions. This has been realised through a range of activities including headcount reduction, improved procurement contracts, simplified business processes, enhanced capabilities, and an element of premises rationalisation.

People in our customer-facing roles were unaffected by these headcount reductions and CFS has re-affirmed its commitment not to off-shore any of its customer-facing sales and service operations.

The extensive restructuring and modernisation of the business has necessitated substantial investment resulting in significant items of £46.3m in 2008. (2007: £37.6m).

Summary and outlook

CIS, as a significant element of CFS, has made good progress towards our vision 'to be the UK's most admired financial service business'.

Our strategy is serving us well and our business performance highlights the underlying strength and sustainability of our business, which is seeing increasing numbers of customers recognising our brand commitment to value, fairness and social responsibility.

2009 will bring its own challenges and the economic outlook is uncertain. We will continue to deliver change initiatives, which will deliver immediate benefits, meet regulatory requirements and further improve the control environment. Managing our cost base will continue to be a priority.

Whilst we are not immune from the economic changes, we have a robust business model, strong brand and a clear path for the future of our business, including our proposed merger with Britannia Building Society. If approved, this will provide our customers with access to an expanded network of more than 300 branches and will create a strongly capitalised business with £70 billion of assets and nine million customers.

Key performance indicators

1. Profit generation to create a sustainable model

The key financial performance measures are:

- Shareholder profitability for the other than 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 & Savings business written during the year, allowing for the cost of capital. Our Life & Savings business is written solely for the benefit of our Life & 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. In these circumstances, our target for 2008 was broadly to break even. Our 2008 performance was slightly better than those plans.

Maintenance expenses are the costs of servicing activities for the in-force Life & Savings business. In 2008, our costs of £69.5m were better than our target of £72.2m.

2. Market leading colleague satisfaction

At the Co-operative Financial Services we are very aware that our success is driven by our people, and throughout 2008 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 – in our case, the survey is called ECHO (Every Colleague Has Opinions) to measure how many of our people are engaged with the business.

Engagement is based on three core elements:

- 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 ECHO 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 2008, the EI score was 64%, an increase of 11 percentage points from the previous year. This represents remarkable progress against our strategic plan, which was to increase the EI score by 5 percentage points per year, and demonstrates the effectiveness of the corporate strategies in 2008. These included:

- The Leadership Challenge – an in-depth development programme for more than 1,100 people managers across the organisation to develop understanding of best practice around the behavioural aspects of leadership; and
- The good with money event – a one-day workshop for all colleagues to develop their understanding of our brand proposition and their role in delivering this.

Our strategic target will continue to be based on the average EI for the Hay Group Insight High Performance Norm Group – a group of top-performing global organisations across all sectors that work with Hay Group Insight, our partner organisation in the administration and interpretation of the ECHO Survey. In 2008, the High Performance Norm Group EI was 77%.

In 2009, we will work to further improve our engagement score, and also look at how, as an organisation, we make the most of this high level of engagement by making sure our processes and support allows these engaged colleagues to be as effective as they can be in providing products and services to our customers and members.

3. Market leading customer satisfaction

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 – Extremely, Very, Fairly, Neither/Nor, Fairly Dissatisfied, Very Dissatisfied, Extremely Dissatisfied. Product level scores (based on Extremely & Very Satisfied responses) 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 month's worth of data is used.

A target measure of 64.6% was set at the start of 2008 against which CFS has performed well, achieving the targeted score (64.6%) at the end of December. There has been a trend of improvement for the Life & Savings business with a score for Extremely/Very Satisfied of 44.2%, compared to 44.8% for the rest of the market.

4. Market leading social responsibility approach

In 2008, CFS measured its progress towards its goal of a market leading social responsibility approach using the following three indicators. Two of the three targets set for attainment in 2008 have been achieved, and one has been partially achieved.

The first indicator looks at unprompted public awareness of the Bank and Co-operative Insurance/Investments as financial services businesses that take social responsibility into account. This measure derives from an independent survey of 1,000 members of the general public, which, in 2008, was undertaken in March. Targets set for 2008 sought a number one ranking for the Bank and number two ranking for Co-operative Insurance/Investments. Against these, the Bank retained the number one ranking, with a score of 8% (2007:11%), and Co-operative Insurance/Investments ranked joint third, recording unprompted awareness of 2% (2007: 3%).

The second and third indicators look at performance in Business in the Community's Corporate Responsibility Index and Environment Index. The Indexes are voluntary self-assessment surveys that benchmark Corporate Responsibility and Environmental strategy (and their integration), management, reporting and performance across a range of issues. The 2008 targets were to seek a Platinum (leading group) ranking for CFS by achieving a score of 95% or more in both Indexes. In the Corporate Responsibility Index 2007, which was published in May 2008, CFS achieved a Platinum ranking, attaining a score of 98% and emerging as a sector leader. In the Environment Index, CFS achieved a Platinum ranking, attaining a score of 99%. In relation to 2008 index, CFS will be seeking to maintain its Platinum ranking.

5. Growing and engaging membership

Increase in active members

The Co-operative Group is jointly owned and democratically controlled by its members. Members of our Co-operative enjoy a share in our profits and can exercise their democratic control, with equal rights and benefits. Growing a strong and committed membership base is integral to our vision and beliefs and is an integral part of our brand. Growing engagement with our customers via membership is a key element in delivering a competitive advantage and achieving our social goals.

Whilst we are committed to growing our membership base, we recognise the importance of ensuring that our members are engaged with the Co-operative. True engagement will be reflected in both transactional and democratic participation. The focus of 2009 is therefore to drive active engagement from our members. This will be demonstrated by increasing participation rates across the diverse range of businesses offered by the Co-operative Group, so that individual members transact with multiple businesses. Inevitably, this type of activity will also attract new members. In 2008, the number of Co-operative members trading with The Co-operative Financial Services increased by over 140,000, which was a massive increase of 33% on 2007's performance.

Growth in total points earned

A key element of the brand and membership programmes has been the introduction of a true dividend where members receive a share of our profits by way of a cash dividend, the scale of which is directly determined by the value of trade that they have carried out across our various businesses.

As part of our aim to grow and engage membership, therefore, we track the total value of points earned by members through their trade across our businesses. Members earn points for every £1 they spend with all of our businesses, from holidays and food to insurance and banking. The total points earned by members are captured within our dividend system and determine, for each individual member, the size of their share of our profits. In 2008 members earned 1,912 million points, an increase of 35% on the prior year.

Co-operative Insurance Society Limited

Non-Executive Directors:

- Simon Butler** (BEd (Hons)). Age 54. Joined the Board in 1999 and was appointed Chair in 2002. Member of the Central & Eastern Regional Board of Co-operative Group Limited and has been involved with consumer co-operatives for over 20 years. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited and The Co-operative Bank p.l.c., and Chair of CIS General Insurance Limited.
- Graham Bennett** (CCMI). Age 58. Joined the Board in 2000. Spent his management career with Southern Co-operatives where he was the Society's Chief Executive for 25 years, and is now the Head of Investment Property. Vice Chairman of Unity Trust Bank plc. Chair of The Co-operative Bank p.l.c., and Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited and CIS General Insurance Limited.
- Bob Burlton** (BSc (Hons), Cert Dip). Age 60. Joined the Board in 2003. Strategic Projects Executive at Midcounties Co-operative. Elected President of Consumer Co-operatives Worldwide in 2005. Non-Executive Director of Co-operative Group Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited and Chair of Co-operative Financial Services Limited.
- David Davies** (BSc (Econ), FIA). Age 61. Joined the Board in 2003 and is the Senior Independent Director. Qualified as an actuary. Chair of Sun Life Assurance Company of Canada (UK) and Nortel Network Pension Scheme in the UK. Also holds directorships with Hermes Fund Managers and Policy Mutual Assurance Society. Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.
- Paul Hewitt** (MA, ACA, Dip German (Open)). Age 53. Joined the Board in 2003. Holds non-executive directorships with Kiln, GMT Aviation, and the Personal Accounts Delivery Authority, and is Chair of YSC, an HR consultancy. Professional Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.
- Terry Morton** (BSc (Hons), CEng, MIET, MCMI). Age 63. Joined the Board in 1998. Member of the North East & Cumbrian Regional Board of Co-operative Group Limited. Managing Secretary of Durham Alliance for Community Care, a member co-operative that provides day care for challenged older people. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.
- Bob Newton** (BSc, FIA, CDir). Age 59. Joined the Board in 2007. Retired from the insurance industry in 2006, since when he has built up a portfolio of business and pro bono interests. Holds non-executive directorships with UIA (Insurance) Limited, and AI Claims Solutions plc. Independent Professional Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.
- Kathryn Smith** Age 49. Joined the Board in 2001. Member of the South East Regional Board of Co-operative Group Limited and South London Area Committee where she became Chair in 1990. Also Chair of Co-operative Action Limited and Co-operative Action Foundation. Director of Social Enterprise London, and Chair of Co-operatives London. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.
- Graham Stow** (CBE, FCIB, FCIPD, FRSA). Age 64. Joined the Board in 2003. Former Chief Executive of Britannia Building Society and Chair of Building Societies Association. Chair of IPRISM Underwriting Agency, Member of the Advisory Board of Kiddy & Partners, and Chair of the Governors of Staffordshire University. Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.
- Len Wardle** Age 64. Joined the Board in 2001. Member of the South East Regional Board of Co-operative Group Limited. Held management positions in local government and was latterly a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Chair of Co-operative Group Limited, Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., Co-operative Insurance Society Limited, and CIS General Insurance Limited.
- Martyn Wates** (ACA, ATII, BA (Hons)). Age 42. Joined the Board in 2007. Appointed Chief Financial Officer at Co-operative Group Limited following its merger with United Co-operatives and has held various finance positions within the co-operative movement. Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

Stephen Watts (MA (Cantab)). Age 57. Joined the Board in 2000. Member of the Central & Eastern Regional Board of Co-operative Group Limited. Works for Cambridge Regional College as Pricing, Research, and Information Officer within the Directorate of Employment & Skills. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

Piers Williamson (BA (Hons), ACIB, MCT). Age 47. Joined the Board in 2005. Holds non-executive directorships with various Industrial and Provident Societies and funding vehicles associated with the Housing Finance Corporation where he is Chief Executive. Independent Professional Non-Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

Executive Directors:

David Anderson (MA (Oxon)). Age 53. Joined the Board in 2005. Chief Executive of Co-operative Insurance Society Limited. Prior to joining the group, was Chief Executive of Jobcentre Plus and Yorkshire Building Society. Also Chief Executive of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

Dick Parkhouse (LLB, MBA, CIB). Age 54. Joined the Board in 2008. Managing Director, Retail Division. Also Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

John Reizenstein (MA (Cantab)). Age 52. Joined the Board in 2003. Managing Director, Corporate & Markets. A member of the Financial Reporting Review Panel, an advisory Board member of Bridges Ventures and a Vice President of Save the Children. Chair of The Co-operative Asset Management Limited. Also Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

Barry Tootell (BA (Hons), FCA). Age 48. Joined the Board in 2008. Chief Financial Officer. Qualified accountant with over 20 years' finance and control experience. Chair of CFS Management Services Limited. Also Executive Director of Co-operative Financial Services Limited, The Co-operative Bank p.l.c., and CIS General Insurance Limited.

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 year 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 25 to 33, The Society's key financial and non-financial performance indicators are described on pages 4 and 5. Note 15 of the financial statements provide details of the Society's principal subsidiaries and the nature of each organisation's business.

Principal activities

Formerly the Society wrote general insurance business; however, with effect from the commencement of 2006 financial year, 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.

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 6 and 7. Barry Tootell was appointed to the Board with effect from 4 April 2008. Dick Parkhouse and Gerry Pennell were appointed to the Board with effect from 22 August 2008 when Stephan Pater resigned from the Board. Gerry Pennell resigned from the Board with effect from 3 October 2008.

Election of Directors

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

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.
- 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: 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.
- 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 from the unallocated divisible surplus of £433.4m (2007: transfer from the unallocated divisible surplus of £107m).

No interim dividend was paid during 2008 (2007: £12.0m). The Directors recommend the payment of a final dividend of £49.1m and will be paid to the shareholder, CFS Limited, on 6 April 2009.

The Directors recommend that interest on the paid-up share capital be paid at the rate of 12.5% per annum for the year ended 10 January 2009.

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 CIS or any of its subsidiary undertakings.

Staff

On 6 April 2006 all contracts of employment between CIS and its employees were transferred to CFS Management Services Limited (CFMSMS), a fellow subsidiary of the CFS group. As a result the Society no longer has any employees and all sales have been affected 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 will be published towards the latter half of the 2009 financial year, 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 p.l.c., 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 Directors' report 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 1993 and 2005 (Amendment) (the Regulations), requires the Directors to prepare financial statements for each financial year. In accordance with the Regulations the Directors have elected to prepare both the consolidated and Society financial statements in accordance with 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 1985, 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 judgements 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 1993 and 2005 (Amendment), which modified the Industrial and Provident Societies Acts 1965 to 2002. 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) Regulations 1993 and 2005 (Amendment), which modified the Industrial and Provident Societies Acts 1965 to 2002.

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.

Auditor

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
2 April 2009

Independent auditors' report

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

We have audited the consolidated and Society financial statements of Co-operative Insurance Society Limited ('the Society') for the 52 week period ended 10 January 2009 which comprise the consolidated income statement, the consolidated and Society balance sheets, the consolidated and Society cash flow statements, the consolidated and Society statement of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Society's members, as a body, in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 and 2005 (Amendment), which modified the Industrial and Provident Societies Acts 1965 to 2002. 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 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 Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) 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 and are properly prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 and 2005 (Amendment), which modified the Industrial and Provident Societies Acts 1965 to 2002. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the financial statements. In addition we report to you if, in our opinion, the Society has not kept proper accounting records or if we have not received all the information and explanations we require for our audit, or if the information specified by law regarding Directors' remuneration and other transactions is not disclosed.

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 mis-statements 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 judgements 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 mis-statement, 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 consolidated financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the Group's affairs as at 10 January 2009 and of its profit for the 52 week period then ended;
- the Society's financial statements give a true and fair view, in accordance with IFRS as adopted by the EU as applied in accordance with the provisions of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 and 2005 (Amendment), which apply the provisions of Part VII of the Companies Act 1985, of the state of the Society's affairs as at 10 January 2009;
- the financial statements have been properly prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 and 2005 (Amendment), which modified the Industrial and Provident Societies Acts 1965 to 2002; and
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Manchester
2 April 2009

Consolidated income statement

For the year ended 10 January 2009

All amounts are stated in £m unless otherwise indicated

	Notes	Before significant items 2008	Significant items 2008	After significant items 2008	Before significant items 2007	Significant items 2007	After significant items 2007
Income							
Gross earned premiums		497.9	–	497.9	534.9	–	534.9
Less premiums ceded to reinsurers		(19.1)	–	(19.1)	(1,819.8)	–	(1,819.8)
Net earned premiums	2	478.8	–	478.8	(1,284.9)	–	(1,284.9)
Fee and commission income and income from service activities	3	46.4	–	46.4	48.0	–	48.0
Investment income	4	724.5	–	724.5	781.2	–	781.2
Gains less losses arising from financial instruments and other assets	5	(1,761.5)	–	(1,761.5)	(371.9)	–	(371.9)
Other operating income	6	21.2	–	21.2	6.4	–	6.4
Net income		(490.6)	–	(490.6)	(821.2)	–	(821.2)
Benefits, losses and expenses							
Claims paid and benefits	7	(1,562.3)	–	(1,562.3)	(1,732.4)	–	(1,732.4)
Less amounts receivable from reinsurers	7	246.4	–	246.4	272.6	–	272.6
Net policyholder claims and benefits	7	(1,315.9)	–	(1,315.9)	(1,459.8)	–	(1,459.8)
Change in insurance & participating contract liabilities	24	1,806.2	–	1,806.2	715.0	–	715.0
Change in reinsurance assets	24	(189.0)	–	(189.0)	1,736.2	–	1,736.2
Net policyholder claims and benefits incurred		301.3	–	301.3	991.4	–	991.4
Change in fair value of investment contract liabilities	26	54.2	–	54.2	(2.1)	–	(2.1)
Change in unallocated divisible surplus	25	395.6	37.8	433.4	76.1	30.9	107.0
Fees and commissions	8	(28.3)	–	(28.3)	(21.4)	–	(21.4)
Operating expenses	9	(111.7)	(46.3)	(158.0)	(111.5)	(37.6)	(149.1)
Investment expenses and charges	10	(72.2)	–	(72.2)	(61.9)	–	(61.9)
Profit before tax		48.3	(8.5)	39.8	49.4	(6.7)	42.7
Tax attributable to policyholders' returns		43.6	8.5	52.1	(20.7)	6.7	(14.0)
Profit before tax attributable to shareholder's profits		91.9	–	91.9	28.7	–	28.7
Income tax expense	11	23.8	8.5	32.3	(12.8)	6.7	(6.1)
Less tax attributable to policyholders' returns	11	(43.6)	(8.5)	(52.1)	20.7	(6.7)	14.0
Tax attributable to shareholder's profits		(19.8)	–	(19.8)	7.9	–	7.9
Profit for the financial year		72.1	–	72.1	36.6	–	36.6

CIS ceased writing general insurance business with effect from the end of 2005 financial year. The segmental analysis provided in note 1 provides an analysis of the income and expense flows from discontinued and continuing activity.

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

2008 and 2007 significant items relate to a non-recurring expenditure associated with a CFS Group programme of restructuring.

Consolidated balance sheet

At 10 January 2009

All amounts are stated in £m unless otherwise indicated

	Notes	2008	2007
Assets			
Property, plant and equipment	12	–	42.1
Investment property	13	1,483.8	1,977.6
Intangible assets	14	11.4	17.9
Reinsurance assets	24	3,358.2	3,547.2
Financial investments at fair value through profit or loss	16	16,446.1	18,857.2
Loans at amortised cost	17	9.7	12.7
Derivative financial instruments	18	1,027.4	545.7
Insurance receivables and other assets	19	365.8	662.8
Assets classified as held for sale	20	50.0	–
Cash and cash equivalents	21	50.8	62.4
Total assets		22,803.2	25,725.6
Capital and reserves attributable to the Society's equity holders			
Share capital	22	0.1	0.1
Retained earnings	23	113.0	40.9
Other reserves	23	317.0	317.0
Total equity		430.1	358.0
Liabilities			
Insurance and participating contracts liabilities	24	16,316.8	18,123.0
Unallocated divisible surplus	25	622.2	1,045.6
Investment contracts liabilities	26	190.9	220.1
Derivative financial instruments	18	396.8	5.9
Loans and borrowings	27	277.0	277.0
Amounts owed to credit institutions	28	1,814.4	2,983.2
Deferred tax liabilities	33	87.4	281.0
Other provisions	30	6.6	5.3
Insurance and other payables	31	291.8	550.6
Other reinsurance liabilities	32	2,268.9	1,837.1
Income tax liabilities	33	100.3	38.8
Total liabilities		22,373.1	25,367.6
Total equity and liabilities		22,803.2	25,725.6

Approved by the Board of Directors on 2 April 2009 and signed on its behalf by:

Simon Butler, Chair

David Anderson, Chief Executive

Maira Lees, Secretary

Society balance sheet

At 10 January 2009

All amounts are stated in £m unless otherwise indicated

	Notes	2008	2007
Assets			
Property, plant and equipment	12	–	42.1
Investment property	13	1,452.1	1,950.6
Reinsurance assets	24	3,358.2	3,547.2
Investments in group undertakings	15	306.5	37.3
Financial investments at fair value through profit or loss	16	16,145.9	18,853.1
Loans at amortised cost	17	9.7	18.1
Derivative financial instruments	18	1,027.4	545.7
Insurance receivables and other assets	19	323.0	650.7
Assets classified as held for sale	20	50.0	–
Cash and cash equivalents	21	1.7	7.6
Total assets		22,674.5	25,652.4
Capital and reserves attributable to the Society's equity holders			
Share capital	22	0.1	0.1
Retained earnings	23	113.0	40.9
Other reserve	23	317.0	317.0
Total equity		430.1	358.0
Liabilities			
Insurance and participating contracts liabilities	24	16,316.8	18,123.0
Unallocated divisible surplus	25	598.8	1,028.1
Investment contracts liabilities	26	190.9	220.1
Derivative financial instruments	18	363.9	5.9
Loans and borrowings	27	277.0	277.0
Amounts owed to credit institutions	28	1,814.4	2,983.2
Deferred tax liabilities	33	76.9	272.1
Other provisions	30	6.6	5.3
Insurance and other payables	31	231.2	506.9
Other reinsurance liabilities	32	2,268.9	1,837.1
Income tax liabilities	33	99.0	35.7
Total liabilities		22,244.4	25,294.4
Total equity and liabilities		22,674.5	25,652.4

Approved by the Board of Directors on 2 April 2009 and signed on its behalf by:

Simon Butler, Chair

David Anderson, Chief Executive

Maira Lees, Secretary

Consolidated and Society statement of recognised income and expense

For the year ended 10 January 2009

All amounts are stated in £m unless otherwise indicated

	2008	2007
Revaluation of owner occupied property	(4.8)	(3.1)
Revaluation of owner occupied property transferred to assets held for sale	14.8	–
Amounts transferred from/(to) unallocated divisible surplus	(10.0)	3.1
Tax on items taken directly to statement of recognised income and expense	–	0.3
Tax on items taken directly to statement of recognised income and expense and transferred (to)/from unallocated divisible surplus	–	(0.3)
Net income and expense recognised directly in equity	–	–
Profit for the financial year	72.1	36.6
Total recognised income and expense for the year	72.1	36.6

The total recognised income and expense is attributable to the shareholder.

Consolidated and Society cash flow statement

For the year ended 10 January 2009

All amounts are stated in £m unless otherwise indicated

	Consolidated		Society	
	2008	2007	2008	2007
Cash flows from operating activities				
Profit before tax	39.8	42.7	39.2	39.6
Adjustment for:				
Interest payable on intra group borrowing	11.5	11.1	11.5	11.1
Depreciation of property, plant and equipment	0.5	0.6	0.5	0.6
Amortisation of deferred acquisition costs	9.4	9.1	–	–
Profit on sale of property, plant and equipment	(0.2)	–	(0.2)	–
Impairment of investment in group undertakings	–	–	50.8	–
Decrease in property, plant and equipment	42.1	–	42.1	–
Decrease in investment property	493.8	240.9	498.5	241.2
Decrease in financial instruments at fair value through profit and loss	2,411.1	3,135.9	2,707.2	3,119.1
Decrease in loans at amortised cost	3.0	3.2	8.4	3.2
(Increase)/decrease in derivative financial instruments	(90.8)	72.8	(123.7)	72.8
Decrease in intangible assets	(2.9)	(3.4)	–	–
Decrease/(increase) in reinsurance assets	189.0	(1,736.2)	189.0	(1,736.2)
Increase in assets held for sale	(50.0)	–	(50.0)	–
Net movement in other assets and other liabilities	470.8	1,856.9	484.6	1,858.0
Decrease in insurance and participating contract liabilities	(1,806.2)	(715.0)	(1,806.2)	(715.0)
Decrease in unallocated divisible surplus	(423.4)	(109.8)	(429.3)	(114.8)
(Decrease)/increase in investment contracts liabilities	(29.2)	27.5	(29.2)	27.5
Decrease in amounts owed to credit institutions	(1,168.8)	(2,703.1)	(1,168.8)	(2,703.1)
Purchase of shares in group undertakings	–	–	(320.0)	–
Income tax (paid)/recovered	(99.8)	31.2	(99.0)	31.0
Net cash flows from operating activities	(0.3)	164.4	5.4	135.0
Cash flows from investing activities				
Proceeds from sale of property, plant and equipment	0.2	–	0.2	–
Net cash flow from investing activities	0.2	–	0.2	–
Cash flows from financing activities				
Dividend paid	–	(21.1)	–	(21.1)
Interest paid on intra group borrowing	(11.5)	(11.1)	(11.5)	(11.1)
Repayment of loan	–	(90.0)	–	(90.0)
Net cash flows from financing activities	(11.5)	(122.2)	(11.5)	(122.2)
Net increase/(decrease) in cash and cash equivalents	(11.6)	42.2	(5.9)	12.8
Cash and cash equivalents at the beginning of the financial year	62.4	20.2	7.6	(5.2)
Cash and cash equivalents at the end of the financial year	50.8	62.4	1.7	7.6

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 £172.5m (2007: £209.0m) and interest income of £430.2m (2007: £451.1m).

Basis of preparation and significant accounting policies

For the year ended 10 January 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 2 April 2009. The insurance specific accounting policies are set out on pages 22 to 24.

Statement of compliance

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 and 2005 (Amendment), which modified the Industrial and Provident Societies Acts 1965 to 2002. The Regulations require CIS to prepare its financial statements substantially as though it were a company registered under the Companies Act 1985 (the Act), and they apply, with certain exemptions, the provisions of Part VII of the Act.

Basis of preparation

The consolidated and Society financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) 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 s230 of the Companies Act 1985 to not present an individual profit and loss account for the society (applied by virtue of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 and 2005 (Amendment)). 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 recognition and measurement requirements of IFRS in issue that are endorsed by the EU and effective at 10 January 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, investments and self occupied property.

In preparing these consolidated financial statements, the Society has adopted Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures – Reclassification of Financial Assets*. The amendments to IAS 39 and IFRS 7 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of CIS.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Standards and Interpretations issued but not yet effective

CIS has not adopted the following standards:

- IFRS 8 *Operating Segments*

This standard introduces the 'management approach' to segment reporting. IFRS 8 will require disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them.

The amendments are effective for accounting periods beginning on or after 1 January 2009.

- Amendments to IAS 1 *Presentation of Financial Statements*

This standard proposes a revised presentation to the income statement and revised changes to the naming of some primary statements. The amendments introduce a comprehensive statement of income that will present non-owner changes in equity in either a single statement of comprehensive income or a separate statement of income and other comprehensive income, initiated with the profit for the period.

The amendments are effective for accounting periods beginning on or after 1 January 2009.

- Further amendments to IFRS 7 *Improving Disclosures about Financial Instruments*

This standard enhances current financial instruments disclosures both for fair value measurement and liquidity risk. The amendments introduce increasing disclosure requirements in relation to fair value measurement particularly when markets are inactive and enhancements to the information provided in relation to the nature and extent of liquidity risk.

The amendments are effective for accounting periods beginning on or after 1 January 2009.

Although CIS is not yet required to comply with the IFRS 7 amendments, CIS has adopted certain amendments to the disclosures reported in the financial statements.

- 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 2010.

- Amended 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.

The amendment is effective for accounting periods beginning on 1 July 2009.

- IFRIC 13 *Customer Loyalty Programmes*

This interpretation addresses the accounting by entities that operate or otherwise participate in customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services.

IFRIC 13 is effective for accounting periods beginning on or after 1 July 2008.

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. CIS is currently in the process of evaluating the potential effect of the IFRIC 13 interpretation.

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 – Vesting conditions and Cancellations*;
- revised IAS 23 *Borrowing Costs*;
- amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation*;
- 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 year ended 10 January 2009

Accounting date

The financial statements relate to the 52 week period to 10 January 2009 (2007: 52 week period to 12 January 2008). As the financial year is virtually coterminous with the calendar year 2008, figures in respect of the financial year are headed 2008 and the corresponding amounts for the 52 weeks to 12 January 2008 are headed 2007.

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.

Intragroup balances and transactions, and any unrealised gains arising from intragroup 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 and 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
- 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 permitted by the scope of the standards in 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 properties which are stated at revalued amount less accumulated depreciation and impairment losses. Revaluation gains on owner occupied property are recognised in the period in which they occur, outside the income statement, and presented within the statement of recognised income and expense.

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.

(d) Intangible assets

Intangible assets comprise deferred acquisition costs and computer software. The basis for deferral of acquisition costs is detailed at (p(vi)).

Amortisation is charged to the income statement on a straight-line basis to allocate the cost over the estimated useful lives.

(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 controls 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 its 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 set against the cost of investment.

(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.

On disposal, gains or losses (being proceeds less carrying amount) are recognised in gains and losses within the income statement.

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 39 and 40.

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 year ended 10 January 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. In addition for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

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 and at the current market rate for available for sale assets).

The written down value of the impaired financial asset is compounded back to the net realisable balance over timing using the original effective interest rate. This is reported through investment income within the income statement and represents the unwind of the discount.

(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 cash flow statement.

(j) Impairment of non-financial assets

The carrying values of CIS' 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

Premium income from insurance and participating contracts

Revenue principally comprises:

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.

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.

(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.

Basis of preparation and significant accounting policies

For the year ended 10 January 2009

(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) Premiums

Gross premiums written comprise premiums receivable on those contracts which incepted during the financial year, irrespective of whether they relate in whole or in part to a later accounting period, together with any necessary adjustments to amounts reported in prior periods.

Gross premiums written:

- are stated gross of commission and exclude any taxes or levies based on premiums; and
- include an estimate of the premiums receivable on those contracts which incepted prior to the year-end but which have not been notified by the balance sheet date ('pipeline premium'). When calculating pipeline premiums it is assumed, where appropriate, that options to renew contracts automatically will be exercised.

Written premium is earned evenly over the period of the contract (usually twelve months). The treatment of outward reinsurance premiums is analogous to gross premiums written.

(2) Unearned premium provision

For general insurance business, the proportion of written premiums relating to periods of risk beyond the year-end is carried forward to future accounting periods. The relevant proportion is calculated, for the overwhelming majority of contracts, using the daily pro-rata basis with the remainder being determined according to the risk profile of the business.

Outward reinsurance premiums are treated as earned in accordance with the profile of the reinsured contracts.

(3) 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.

(4) 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.

(5) Unexpired risk provision

Additional provision is made for unexpired risks where the claims and expenses likely to arise after the end of the financial year in respect of contracts concluded before that date are expected to exceed the unearned premiums carried forward for those contracts. Provision for unexpired risks is calculated separately for categories of business managed together and is determined after taking account of future investment income. Such provisions ensure that the carrying amount of unearned premiums provision less related deferred acquisition costs is sufficient to cover the current estimated future cash flows including claims handling expenses and therefore meet the minimum requirements of the liability adequacy test as set out in IFRS 4 *Insurance Contracts*.

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 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 comprises 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) Contracts with discretionary participation features

A contract with a discretionary 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 discretionary participation features are valued in accordance with the accounting policy in p(iii) (4) above subject to the liability adequacy test.

(2) Investment contracts

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

v) Non-participating contracts

Insurance contracts without discretionary 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.

Basis of preparation and significant accounting policies

For the year ended 10 January 2009

(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. 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 the 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.

Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date. If objective evidence of impairment exists, reinsurance assets are reduced to the level at which they are considered to be recoverable and an impairment loss is recognised in the income statement.

ix) 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.

(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) 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.

(s) 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 recognized 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 (Life & Savings business), CIS General Insurance Limited, and The Co-operative Bank p.l.c. 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.

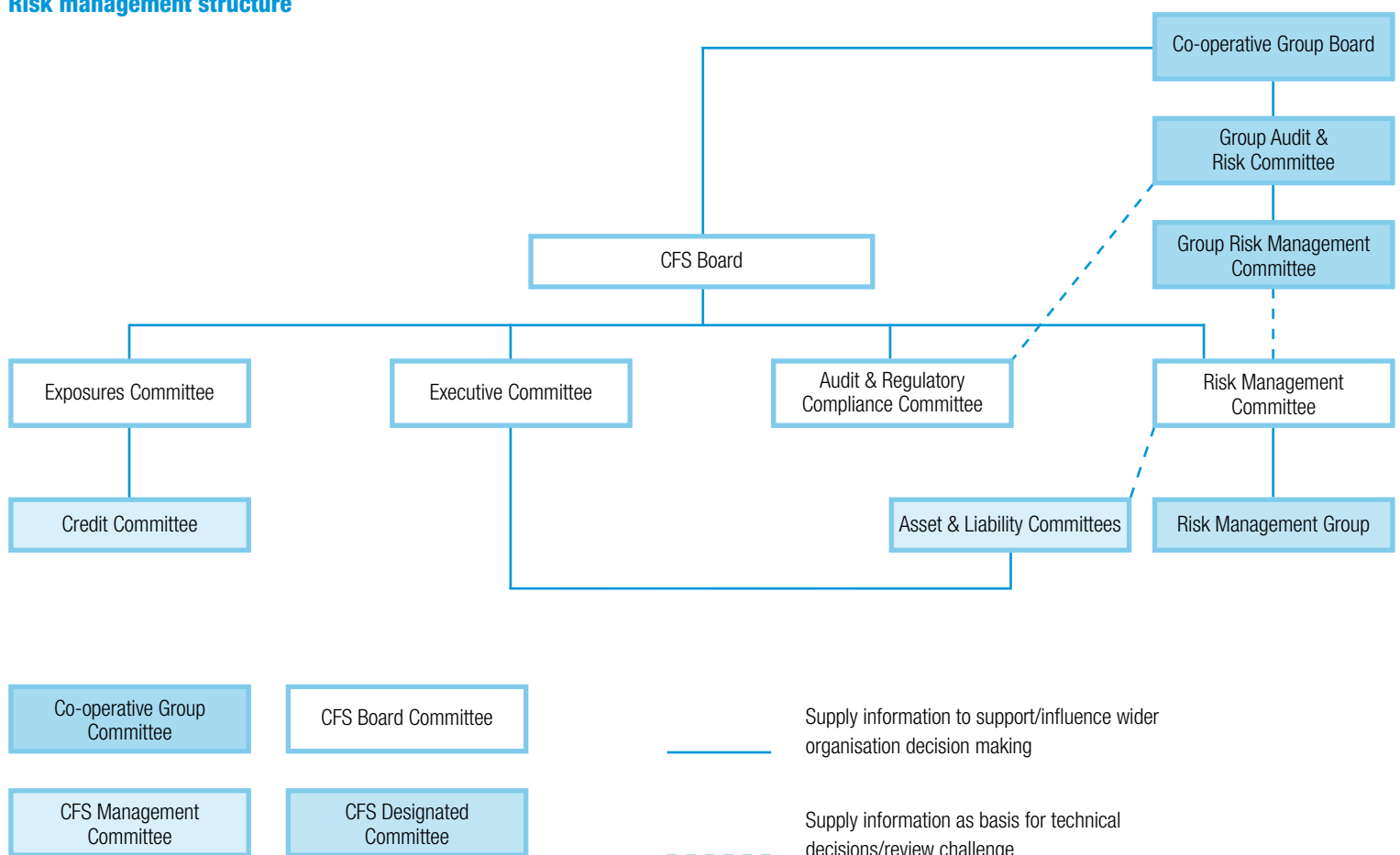
The CFS Board has ultimate responsibility for the management of all risks across CFS.

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 year ended 10 January 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 & 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 & Liability Committees (ALCO): these committees are management committees of the Board which are chaired by the Chief Executive. 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 Credit Committee: this committee is chaired by the Director of Banking Risk and Capital Management. The Chair has delegated authority for approving credit facilities within approved strategies and delegated authorities.

CFS Operational Risk Committee: this committee interfaces with both the Executive Committee and ARCC and is chaired by the Head of 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.

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.

Insurance risk (continued)

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. 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 insurance risk.

Risk management

For the year ended 10 January 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 general insurance business in run-off, long term insurance and investment contracts. 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 segmental 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.

Shareholder funds reflect assets backing reserves and are principally invested in equities. CIS has reduced the exposure to the volatility of equity prices experienced in recent years by selling equity futures whilst retaining the underlying equity holdings.

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. Linked-liabilities are directly linked to the performance of specific asset portfolios and no significant market or credit risk to CIS arises from these contracts.

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 includes the risks that arise from fluctuations in values of, or income from, assets or in interest rates or exchange rates to the extent that there is a mismatch between assets and liabilities. 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 cashflow on the non-participating business;
- interest rate swaptions are held to meet the expected guaranteed annuity option liabilities;
- for unit linked investment contracts, assets are matched with liabilities;
- equity put options 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 put options), and the working capital of the fund, are invested in fixed-interest securities to reduce interest rate risks; and
- portfolio of 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 risk. CIS' policy is to maintain the majority of borrowings in instruments of duration less than three years.

Financial risk (continued)

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.

Sensitivity analysis

The only significant aspect of market risk to which the shareholder fund is exposed is equity price risk. 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 year by £43.7m (2007: £65.3m). 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 £30.6m to £56.8m (2007: £53.6m to £76.9m) giving a net profit impact, pre-tax, of between +/- £13.1m (2007: +/- £11.7m). 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 (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.

	AAA	AA	A	B etc	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

Risk management

For the year ended 10 January 2009

All amounts are stated in £m unless otherwise indicated

Financial risk (continued)

	AAA	AA	A	B etc	Not rated	Total
As at 12 January 2008						
Reinsurance assets	3.6	2,062.7	1,477.7	0.4	2.8	3,547.2
Financial assets at fair value through profit or loss:						
Listed debt (fixed rate)*	3,990.3	574.3	935.9	611.4	58.5	6,170.4
Listed debt (floating rate)*	381.5	20.3	59.4	–	–	461.2
Unlisted debt (fixed rate)	3.7	–	–	1.2	4.0	8.9
Unlisted debt (floating rate)	1,834.8	7.2	–	–	–	1,842.0
Deposits with approved credit institutions (fixed rate)	100.0	2,227.3	1,365.6	–	351.7	4,044.6
Derivatives	–	525.0	20.8	–	–	545.8
Loans and receivables at amortised cost:						
Loans	–	–	–	–	12.7	12.7
Insurance receivables and other assets	474.8	23.5	46.1	22.7	95.7	662.8
Cash and cash equivalents	–	17.7	44.6	–	0.1	62.4
	6,788.7	5,458.0	3,950.1	635.7	525.5	17,358.0

*Includes £3,088.0m of gilt edged securities

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 £389.6m (2007: 540.9m) reported within deposits with approved credit institutions, which are fully collateralised.

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.

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 for a specified time period in stressed conditions. The minimum financial assets proportion is determined using the Society's internal economic capital assessment, the estimated extreme case net outflows and regularly reviewing the nature, cause, effect and probability of extreme case scenarios in the light of changing natural, social and economic conditions.

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 table indicates 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).

	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						

Financial risk (continued)

	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 12 January 2008							
Insurance and participating contract liabilities	18,123.0	18,123.0	2,144.6	4,579.6	3,848.6	2,641.0	4,909.2
Financial liabilities at fair value through profit or loss (held for trading):							
Derivatives	5.9	5.9	5.9	–	–	–	–
Financial liabilities designated at fair value through profit or loss:							
Investment contract liabilities	220.1	220.1	220.1	–	–	–	–
Other financial liabilities	1,834.8	4,597.9	50.6	315.7	439.4	578.7	3,213.5
Financial liabilities at amortised cost:							
Loans and borrowings	277.0	277.3	277.3	–	–	–	–
Amounts owed to credit institutions (fixed rate)	2,983.2	3,008.6	3,008.6	–	–	–	–
Insurance and other payables	550.6	550.6	535.8	14.8	–	–	–
Other reinsurance liabilities	2.3	2.3	2.3	–	–	–	–
	23,996.9	26,785.7	6,245.2	4,910.1	4,288.0	3,219.7	8,122.7
Other liabilities	1,370.7						
Total recognised liabilities	25,367.6						

Currency risk

Currency risk is the risk that cash flows 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

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.

Operational risk framework

Operational risks 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 Audit and Regulatory Compliance Committee (a formal 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 Risk Management Committee.

2008 has seen continued refinement and embedding of the framework including development of a draft operational risk appetite statement, and reporting enhancements. The framework is subject to regular Internal Audit review in line with CFS' rolling risk-based audit plan.

Responsibilities

Whilst the Board is ultimately responsible for operational risks across CIS and the wider CFS organisation, this is delegated to the Chief Executive and Executive Directors within CFS who are responsible for controlling the operational risks in their direct areas of accountability and for compliance with CFS policies.

Each Executive has a nominated Divisional Risk Co-ordinator who is a member of the Operational Risk Committee and is responsible for ensuring the consistent application of the operational risk framework within their division. Divisional Risk Co-ordinators are supported from within their business division.

The central operational risk team facilitate the consistent identification, management and reporting of operational risks across CFS in line with regulatory and business requirements; support development and testing of business continuity arrangements for the business; and manage the CFS corporate insurance programme.

Risk management

For the year ended 10 January 2009

All amounts are stated in £m unless otherwise indicated

Operational risk (continued)

Risk themes

CFS categorises operational risk into a number of distinct themes for internal management, monitoring and reporting. Key operational risk themes managed by CFS include:

Financial crime

This relates to the effectiveness of controls to minimise financial losses arising from the fraudulent activities of employees, customers and third parties. Specific risks arise from external fraud, including but not limited to computer fraud (computer viruses, key logging tools, Trojan attacks, phishing), anti money laundering (including but not limited to failure to comply with FSA money laundering regulations and to prevent organised crime) and internal fraud.

Data security and confidentiality

CFS has introduced a new theme during 2008 in respect of the potential loss or theft of confidential customer information. This enables the organisation to manage and monitor exposures in this area as a specific theme, recognising the increasing concerns of customers, regulatory authorities and the media in this area, as well as reflecting CFS' risk management culture.

Compliance (with regulatory and legal requirements)

As a regulated business, CFS places great emphasis on maintaining compliance with our regulatory and legal obligations by:

- Regulatory – supporting CFS business objectives through the provision of advice, and the recommendation of solutions where appropriate, in respect of the regulatory implications of business developments, and assisting the business in assessing and addressing new and enhanced regulatory expectations. This is supported by appropriate and effective monitoring, aimed at influencing the business to mitigate or eliminate regulatory risk and demonstrate that we are meeting our regulatory obligations.
- Legal – seeking to pro-actively manage legal issues in relation to commercial, contractual, employment and litigation activities.

Employee practices/workplace safety

It is acknowledged that our people are a key asset. The financial services sector as an industry is reliant on its people and the skills, knowledge and experience that they provide. The risk of failure to maintain employee relations, or provide a safe environment in line with legislative requirements and with the ethical, diversity and discrimination rules is managed with support from our Human Resources division.

Property & facilities

The risk of unforeseen operational disruption caused through the denial of access to major occupancies or other interruptions to business operations is managed through our business continuity framework and corporate insurance programme.

Customer service

As a financial services business, providing fair and high-quality customer service is a must. Controls that could prevent such risks occurring are regularly assessed and monitored. These include customer service levels, getting things right first time, availability of customer facing systems, together with trained and skilled resource to service customer demand.

Supplier

CFS looks to source cost-effective and quality services, both internal and external to the Co-operative Group. Given the reliance on our business partners who provide services and products, a major or prolonged disruption to the supply of their services and products would impact on CFS. Risks are monitored relating to the effectiveness of contracts and relationship management to ensure that CFS' expected performance levels are achieved.

Major IT systems/major payments systems failure

Financial service providers have a heavy reliance on the availability and performance of underlying systems and applications, and the processes and frameworks which underpin these. Consequently the effectiveness of controls over the IT systems and infrastructure supporting IT processes and controls, major payment systems and clearing and business processes are monitored on a regular basis.

Change management

CFS continues to invest in major change programmes in our journey to become the UK's most admired financial services business, through developing and improving our products, systems and processes.

To manage delivery of these change programmes, manage risks, prioritise resources and realise benefits CFS has developed and implemented a Change Management Framework. This is regularly reviewed to maintain its effectiveness.

Principal risks

In addition to the significant risks covered above, the following risks are also reported in the CFS Risk Management Framework:

- Group wide risks, to include pensions, reputational and contagion risk; and
- Business risk.

Pensions risk: the risk of the firm being unable to meet Pension Fund commitments.

Pensions risks are identified at the Co-operative Group level, with the impact of any potential changes to contribution assessed under the CIS Risk Management Framework.

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 the 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: arises from changes to CIS's business, specifically the risk of not being able to carry out CIS's 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's exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks.

Capital management

For the year ended 10 January 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 shareholder 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 years.

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's 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 shareholders' equity, excluding inadmissible assets, subordinated debt and equalisation provisions recognised in equity.

	Long term business 2008	General insurance business in run-off 2008	Long term business 2007	General insurance business in run-off 2007
Capital and reserves per the financial statements	–	430.1	–	358.0
UDS (unconsolidated)	598.8	–	1,028.1	–
Capital allocated to long term business	200.0	(200.0)	200.0	(200.0)
Valuation differences	1,659.7	–	2,372.6	–
Deduction for inadmissible and other assets	(97.9)	(19.2)	(40.4)	(22.7)
Statutory claims equalisation reserve	–	(14.3)	–	(21.6)
Proposed dividend	–	(49.1)	–	–
Regulatory capital	2,360.6	147.5	3,560.3	113.7

Critical judgements

The Society makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements 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 judgement 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).
- Fair value of investment contracts (note 26).
- Fair value of unlisted financial assets and liabilities (below).
- 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 19 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 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 37 and 38.

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 P&L 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 £2,267.7m (2007: £1,834.8m). The floating rate note is structured such that cashflows 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 judgements and fair value methodology

For the year ended 10 January 2009

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's 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 doesn't seek to trade these holdings; and
- 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.

(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 cashflows 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) Trade 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.

Interest rates used for determining fair values

Interest rate assumptions used in the valuation of unlisted debt and loan receivables are based upon gilt yields of appropriate maturity.

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.

	2008		2007	
	Carrying value	Fair value	Carrying value	Fair value
Financial liabilities				
Loans at amortised cost	9.7	10.8	12.7	12.7

Balance sheet categories**Consolidated****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
Liabilities				
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

2007**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	18,857.2	–	–	18,857.2
Loans at amortised cost	–	12.7	–	12.7
Derivative financial instruments	545.7	–	–	545.7
Insurance receivables and other assets	–	662.8	–	662.8
Cash and cash equivalents	–	62.4	–	62.4
Total financial assets	19,402.9	737.9	–	20,140.8
Non-financial assets				5,584.8
Total assets				25,725.6
Liabilities				
Investment contract liabilities	220.1	–	–	220.1
Derivative financial instruments	5.9	–	–	5.9
Loans and borrowings	–	–	277.0	277.0
Amounts owed to credit institutions	2,983.2	–	–	2,983.2
Insurance and other payables	–	–	550.6	550.6
Other reinsurance liabilities	1,834.8	–	–	1,834.8
Total financial liabilities	5,044.0	–	827.6	5,871.6
Non-financial liabilities				19,496.0
Total liabilities				25,367.6
Capital and reserves				358.0
Total liabilities and equity				25,725.6

Critical judgements and fair value methodology

For the year ended 10 January 2009

Society 2008	Designated at fair value	Loans and receivables	Other amortised cost	Total
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
2007				
Assets				
Financial assets at fair value through profit or loss	18,853.1	–	–	18,853.1
Loans at amortised cost	–	18.1	–	18.1
Derivative financial instruments	545.7	–	–	545.7
Insurance receivables and other assets	–	650.7	–	650.7
Cash and cash equivalents	–	7.6	–	7.6
Total financial assets	19,398.8	676.4	–	20,075.2
Non-financial assets				5,577.2
Total assets				25,652.4
Liabilities				
Investment contract liabilities	220.1	–	–	220.1
Derivative financial instruments	5.9	–	–	5.9
Loans and borrowings	–	–	277.0	277.0
Amounts owed to credit institutions	2,983.2	–	–	2,983.2
Insurance and other payables	–	–	506.9	506.9
Other reinsurance liabilities	1,834.8	–	–	1,834.8
Total financial liabilities	5,044.0	–	783.9	5,827.9
Non-financial liabilities				19,466.5
Total liabilities				25,294.4
Capital and reserves				358.0
Total liabilities and equity				25,652.4

The following table analyses financial instruments carried at fair value, by valuation method:

Valuation of financial instruments	Quoted market prices in active markets	Valuation techniques using observable inputs	Valuation techniques using significant unobservable inputs	Total
Consolidated				
2008				
Financial assets				
Financial investments 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	–	190.9	–	190.9
Derivative financial instruments	68.4	328.4	–	396.8
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
2007				
Financial assets				
Financial investments at fair value through profit or loss	16,750.4	1,876.3	230.5	18,857.2
Derivative financial instruments	47.5	498.2	–	545.7
Total financial assets at fair value	16,797.9	2,374.5	230.5	19,402.9
Financial liabilities				
Investment contract liabilities	–	220.1	–	220.1
Derivative financial instruments	–	5.9	–	5.9
Other financial liabilities	2,983.2	1,834.8	–	4,818.0
Total financial liabilities at fair value	2,983.2	2,060.8	–	5,044.0

Critical judgements and fair value methodology

For the year ended 10 January 2009

	Quoted market prices in active markets	Valuation techniques using observable inputs	Valuation techniques using significant unobservable inputs	Total
Society				
2008				
Financial assets				
Financial investments 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	–	190.9	–	190.9
Derivative financial instruments	35.5	328.4	–	363.9
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
2007				
Financial assets				
Financial investments at fair value through profit or loss	16,746.7	1,875.9	230.5	18,853.1
Derivative financial instruments	47.5	498.2	–	545.7
Total financial assets at fair value	16,794.2	2,374.1	230.5	19,398.8
Financial liabilities				
Investment contract liabilities	–	220.1	–	220.1
Derivative financial instruments	–	5.9	–	5.9
Other financial liabilities	2,983.2	1,834.8	–	4,818.0
Total financial liabilities at fair value	2,983.2	2,060.8	–	5,044.0

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

1. Segmental analysis

Segmental information is presented in respect of the Society's business segments in line with the Society's management and internal reporting structure. The segmental results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly deferred tax. Segment capital expenditure is the total cost incurred during the period to acquire segment assets that are expected to be used for more than one period.

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

Business segments

CIS comprises the following segments:

(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 segment 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 segmental reporting purposes.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

1. Segmental analysis (continued)

Segment income statement for the financial year ended 10 January 2009

	Before significant items			Total	Significant items	Total after significant items
	Other than long term business	Long term business	Discontinued			
Income						
Gross earned premiums	–	–	497.9	497.9	–	497.9
Less premiums ceded to reinsurers	–	–	(19.1)	(19.1)	–	(19.1)
Net earned premiums	–	–	478.8	478.8	–	478.8
Fee and commission income and income from service activities	–	–	46.4	46.4	–	46.4
Investment income	–	40.9	683.6	724.5	–	724.5
Gains less losses arising from financial and other assets	–	65.4	(1,826.9)	(1,761.5)	–	(1,761.5)
Other operating income	–	0.9	20.3	21.2	–	21.2
Net income	–	107.2	(597.8)	(490.6)	–	(490.6)
Benefit, losses and expenses						
Claims paid and benefits	(108.0)	–	(1,454.3)	(1,562.3)	–	(1,562.3)
Less amounts receivable from reinsurers	108.0	–	138.4	246.4	–	246.4
Net policyholder claims paid and benefits	–	–	(1,315.9)	(1,315.9)	–	(1,315.9)
Change in insurance & participating contract liabilities	167.2	–	1,639.0	1,806.2	–	1,806.2
Change in reinsurance assets	(167.2)	–	(21.8)	(189.0)	–	(189.0)
Net policyholder claims and benefits incurred	–	–	301.3	301.3	–	301.3
Change in investment contracts	–	–	54.2	54.2	–	54.2
Change in unallocated divisible surplus	–	–	395.6	395.6	37.8	433.4
Fees and commissions	–	–	(28.3)	(28.3)	–	(28.3)
Operating expenses:						
Other than long term business	–	0.9	–	0.9	–	0.9
Long term business	–	–	(112.6)	(112.6)	(46.3)	(158.9)
Investment expenses and charges	–	(16.2)	(56.0)	(72.2)	–	(72.2)
Operating profit before income taxes	–	91.9	(43.6)	48.3	(8.5)	39.8
Tax attributable to policyholders' returns	–	–	43.6	43.6	8.5	52.1
Profit before tax attributable to shareholder's profits	–	91.9	–	91.9	–	91.9
Income tax expense	–	(19.8)	43.6	23.8	8.5	32.3
Less: tax attributable to policyholders' returns	–	–	(43.6)	(43.6)	(8.5)	(52.1)
Tax attributable to shareholder's profits	–	(19.8)	–	(19.8)	–	(19.8)
Profit for the financial year	–	72.1	–	72.1	–	72.1

1. Segmental analysis (continued)

Segmented income statement for the financial year ended 12 January 2008

Income	Before significant items			Total	Significant items	Total after significant items
	Other than long term business	Discontinued	Continuing			
Gross earned premiums	0.7	–	–	534.2	–	534.9
Less premiums ceded to reinsurers	(0.7)	–	–	(1,819.1)	–	(1,819.8)
Net earned premiums	–	–	–	(1,284.9)	–	(1,284.9)
Fee and commission income and income from service activities	–	–	–	48.0	–	48.0
Investment income	–	–	30.9	750.3	–	781.2
Gains less losses arising from financial and other assets	–	–	19.3	(391.2)	–	(371.9)
Other operating income	–	–	–	6.4	–	6.4
Net income	–	–	50.2	(871.4)	–	(821.2)
Benefit, losses and expenses						
Claims paid and benefits	(194.6)	–	–	(1,537.8)	–	(1,732.4)
Less amounts receivable from reinsurers	194.6	–	–	78.0	–	272.6
Net policyholder claims paid and benefits	–	–	–	(1,459.8)	–	(1,459.8)
Change in insurance & participating contract liabilities	304.0	–	–	411.0	–	715.0
Change in reinsurance assets	(304.0)	–	–	2,040.2	–	1,736.2
Net policyholder claims and benefits incurred	–	–	–	991.4	–	991.4
Change in investment contracts	–	–	–	(2.1)	–	(2.1)
Change in unallocated divisible surplus	–	–	–	76.1	30.9	107.0
Fees and commissions	–	–	–	(21.4)	–	(21.4)
Operating expenses:						
Other than long term business	–	–	(0.6)	–	–	(0.6)
Long term business	–	–	–	(110.9)	(37.6)	(148.5)
Investment expenses and charges	–	–	(20.9)	(41.0)	–	(61.9)
Operating profit before income taxes	–	–	28.7	20.7	(6.7)	42.7
Tax attributable to policyholders' returns	–	–	–	(20.7)	6.7	(14.0)
Profit before tax attributable to shareholder's profits	–	–	28.7	–	–	28.7
Income tax expense	–	–	7.9	(20.7)	6.7	(6.1)
Less: tax attributable to policyholders' returns	–	–	–	20.7	(6.7)	14.0
Tax attributable to shareholder's profits	–	–	7.9	–	–	7.9
Profit for the financial year	–	–	36.6	–	–	36.6

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

1. Segmental analysis (continued)

CIS ceased writing general insurance business with effect from the end of 2005 financial year. 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 2008 and 2007 columns headed 'significant items' include non-recurrent expenditure associated with a programme of restructuring announced in 2007.

Segment 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 participating contracts liabilities	277.4	16,039.4	–	16,316.8
Unallocated divisible surplus	–	622.2	–	622.2
Investment contracts 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	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	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

1. Segmental analysis (continued)

Segment balance sheet as at 12 January 2008

	Other than long term business	Long term business	Eliminations and unallocated balances	Total
Assets				
Property, plant and equipment	–	42.1	–	42.1
Investment property	–	1,977.6	–	1,977.6
Intangible assets	–	17.9	–	17.9
Reinsurance assets	444.6	3,102.6	–	3,547.2
Financial investments at fair value through profit or loss	771.4	18,085.8	–	18,857.2
Loans at amortised cost	–	12.7	–	12.7
Derivative financial instruments	45.3	500.4	–	545.7
Insurance receivables and other assets	18.3	646.5	(2.0)	662.8
Cash and cash equivalents	0.1	62.3	–	62.4
Total assets	1,279.7	24,447.9	(2.0)	25,725.6
Capital and reserves attributable to the Society's equity holders				
Share capital	0.1	–	–	0.1
Retained earnings	40.9	–	–	40.9
Other reserves	317.0	–	–	317.0
Total equity	358.0	–	–	358.0
Liabilities				
Insurance and participating contracts liabilities	444.6	17,678.4	–	18,123.0
Unallocated divisible surplus	–	1,045.6	–	1,045.6
Investment contracts liabilities	–	220.1	–	220.1
Derivative financial instruments	1.9	4.0	–	5.9
Loans and borrowings	277.0	–	–	277.0
Amounts owed to credit institutions	–	2,983.2	–	2,983.2
Deferred tax	–	–	281.0	281.0
Other provisions	–	5.3	–	5.3
Insurance and other payables	33.7	518.9	(2.0)	550.6
Other reinsurance liabilities	–	1,837.1	–	1,837.1
Income tax	–	–	38.8	38.8
Total liabilities	757.2	24,292.6	317.8	25,367.6
Total equity and liabilities	1,115.2	24,292.6	317.8	25,725.6

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 year the assumed fixed interest yield was 5.7% (2007: 5%).

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

	2008	2007
Profit for the financial year before shareholder tax based upon longer term rate of return	31.1	40.3
Short term investment fluctuations	60.8	(11.6)
Income tax attributable to shareholder's profits	(19.8)	7.9
Profit for the financial year	72.1	36.6

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

1. Segmental analysis (continued)

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

	Other than long term business 2008	Long term business 2008	Total 2008	Other than long term business 2007	Long term business 2007	Total 2007
Depreciation	–	0.5	0.5	–	0.6	0.6
Amortisation of deferred acquisition costs	–	9.4	9.4	–	9.1	9.1
Capital expenditure	–	–	–	–	–	–

During the 2008 financial year, 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. The long term business fund recognised a realised profit on sale of £14.8m. The other than long term business has classified these on the balance sheet as non current assets held for sale as their carrying amount is expected to be recovered through sale rather than through continuing use. These transactions have been eliminated above within the Consolidated and Society segmental analysis.

2. Net earned premiums

	2008	2007
Gross premiums		
Long term insurance contracts:		
Non-participating	39.1	41.5
Participating contracts	458.8	492.7
	497.9	534.2
General insurance contracts:		
Change in unearned premium provision	–	0.7
	–	0.7
Gross premium revenue	497.9	534.9
Outwards reinsurance premiums		
Long term reinsurance contracts:		
Non-participating	(19.1)	(1,819.1)
	(19.1)	(1,819.1)
General reinsurance contract:		
Premium ceded	–	(0.7)
	–	(0.7)
Premiums ceded to reinsurers	(19.1)	(1,819.8)
Net earned premiums	478.8	(1,284.9)

2. Net earned premiums (continued)

During the previous financial year CIS entered into an arrangement to reinsure the majority of its remaining obligations in respect of annuities in payment and a proportion of those in deferment. The premium charged to the income statement, £1,800.2m, represents payment obligations under the agreement totalling £4.6bn, which have been discounted at rates which average 4.9% pa over the duration of the agreement to produce a net present value. The arrangement significantly reduces insurance risk arising from annuitant longevity. Further details are provided in note 24 covering other reinsurance liabilities.

	2008	2007
Analysis of gross earned premiums		
Long term insurance contracts:		
Premiums under individual contracts	485.6	526.9
Premiums under group contracts	12.3	7.3
	497.9	534.2
Premiums from life assurance business	362.3	383.7
Premiums from pensions business	133.4	147.7
Premiums from permanent health business	2.2	2.8
	497.9	534.2
General insurance contracts:		
Other	–	0.7
	–	0.7

3. Fee and commission income and income from service activities

	2008	2007
Reinsurance commission earned	0.6	0.6
Other commission	7.4	5.2
Fees from sales of unit trusts	10.3	6.8
Fund management fees	28.1	35.4
	46.4	48.0

4. Investment income

	2008	2007
Rental income from investment property	121.8	121.1
Interest income from debt securities at fair value through profit or loss	365.3	418.6
Divided income from equities at fair value through profit or loss	172.5	209.0
Interest income from loans at amortised cost	1.0	0.9
Interest income from derivative financial instruments	1.4	–
Interest income from cash and cash equivalents	62.5	31.6
	724.5	781.2

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

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

	2008	2007
Net gains/(losses) on remeasurement of financial instruments and other assets at fair value		
Equity financial assets:		
Listed	(1,758.9)	75.3
Unlisted	(47.0)	12.7
	(1,805.9)	88.0
Debt security financial assets:		
Listed	(304.9)	(224.4)
Unlisted	480.7	63.2
	175.8	(161.2)
Derivatives	920.8	(76.2)
Fair value gains less losses on investment property	(557.4)	(155.0)
Fair value gains less losses on other investments	(11.7)	4.9
	351.7	(226.3)
Net losses on remeasurement of financial liabilities at fair value through profit or loss	(483.1)	(72.4)
	(1,761.5)	(371.9)

Net gains on unlisted equity investments include an unrealised loss of £nil (2007: £10.0m), which is considered to represent impairment.

Included within gains less losses arising from financial instruments are net gains of £483.1m (2007: £71.8m) relating to financial assets 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

	2008	2007
Rental income from owner occupied property	5.2	4.8
Profit on sale of property, plant and equipment	0.2	–
Foreign exchange gain	14.6	–
Other	1.2	1.6
	21.2	6.4

7. Net policyholder claims paid and benefits

	2008	2007
Gross claims paid		
Long term insurance contracts:		
Death benefits	140.9	135.4
Surrender benefits	629.6	594.8
Maturity claims	500.8	622.1
Annuity and other benefits	183.0	185.5
	1,454.3	1,537.8
General insurance contracts:		
Current year claims	–	–
Prior years claims	108.0	194.6
	108.0	194.6
Gross claims paid and benefits	1,562.3	1,732.4

7. Net policyholder claims paid and benefits (continued)

	2008	2007
Less recovered from reinsurers		
Long term business:		
Death benefits	(13.2)	(8.9)
Annuity and other benefits	(125.2)	(69.1)
	(138.4)	(78.0)
General insurance:		
Current year claims	–	–
Prior years claims	(108.0)	(194.6)
	(108.0)	(194.6)
Amounts recovered from reinsurers	(246.4)	(272.6)
Net claims paid and benefits	1,315.9	1,459.8

8. Fees and commissions

	2008	2007
Commissions	28.3	21.4

9. Operating expenses

	2008	2007
Administration expenses	73.2	72.6
Acquisition expenses	36.1	37.2
Non-recurring expenses	46.3	37.6
Other	2.4	1.7
	158.0	149.1

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's share is charged to the company, at cost, by way of a management service charge from CFSMS.

	2008	2007
Operating expenses are classified by nature:		
Depreciation	0.5	0.6
Management recharges and other operating expenses	157.5	148.5
	158.0	149.1

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

9. Operating expenses (continued)

	2008	2007
	£'000	£'000
<i>Management recharges include the following payments to auditors and their associates:</i>		
Audit of these financial statements	162	179
Other services:		
Audit of financial statements of subsidiaries pursuant to legislation	38	37
Other services pursuant to legislation	75	73
Other services relating to taxation	14	–
Services relating to information technology	126	–
Services relating to litigation	3	–
Services relating to recruitment and remuneration	2	–
All other services	63	116
	483	405

10. Investment expenses and charges

	2008	2007
Investment property expenses	16.0	13.7
Investment management cost	14.8	14.6
Investment transaction costs	15.3	11.3
Interest on intragroup borrowing (see note 37)	11.5	11.1
Interest paid on customer deposits	1.3	1.5
Other interest payable	13.3	9.7
	72.2	61.9

Included in the above, £26.1m relates to investment expenses calculated on effective interest basis (2007: £22.3m)

11. Income tax expense

	2008	2007
Current year tax expense		
UK tax for the current year	162.1	75.9
Overseas tax for the current year	2.4	3.0
UK tax adjustments in respect of prior years	(3.6)	15.0
Total current tax expense	160.9	93.9
Deferred tax expense		
Origination and reversal of temporary differences	(193.7)	(77.8)
Change in tax rate	–	(9.6)
Adjustment in respect of prior years	0.5	(0.4)
Total deferred tax credit	(193.2)	(87.8)
Total income tax expense recognised in the income statement	(32.3)	6.1

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:

Profit before tax	39.8	42.7
Tax calculated at domestic corporation tax rate of 28.5% (2007: 30%)	11.4	12.8
Effect of:		
Accounting profit not subject to policyholder tax	14.8	(6.0)
Policyholder tax on long term insurance business	(52.1)	14.0
Investment income not subject to tax	(7.2)	(7.5)
Tax rate change on deferred tax	0.7	(9.6)
Other adjustments	0.1	2.4
Income tax expense	(32.3)	6.1

11. Income tax expense (continued)

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% (2007: 20%). The rate for other than long term business and subsidiary companies was 28.5% for current tax (2007: 30%) and 28% for deferred tax (2007: 28%). The tax expense attributable to policyholders' returns in the UK included in the tax charge is as follows:

	2008	2007
Current tax	93.8	77.5
Deferred tax	(145.9)	(63.5)
Total tax attributable to policyholders' returns charged to the income statement	(52.1)	14.0

12. Property, plant and equipment

Consolidated and Society

	Land and buildings 2008	Land and buildings 2007
Cost		
At the beginning of the financial year	42.1	45.8
Additions	–	–
Transfer to investment property	(8.4)	–
Revaluation	(5.3)	(3.7)
Disposal	(28.4)	–
At the end of the financial year	–	42.1
Depreciation		
At the beginning of the financial year	–	–
Depreciation charge for the year	(0.5)	(0.6)
Transfers on revaluation	0.5	0.6
At the end of the financial year	–	–
Carrying amount		
At the end of the financial year	–	42.1
At the beginning of the financial year	42.1	45.8

The Society's land and buildings are revalued annually by independent valuers. Valuations are made on the basis of open market value.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

12. Property, plant and equipment (continued)

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

	Land and buildings	
	2008	2007
Cost		
At the beginning of the financial year	46.3	46.3
Transfer to investment property	(9.8)	–
Disposals	(36.5)	–
At the end of the financial year	–	46.3
Depreciation		
At the beginning of the financial year	(2.6)	(2.0)
Depreciation charge for the year	(0.5)	(0.6)
Transfer to investment property	0.7	–
Disposals	2.4	–
At the end of the financial year	–	(2.6)
Carrying amount		
At the end of the financial year	–	43.7
At the beginning of the financial year	43.7	44.3

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.

During the 2008 financial year, 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. The other than long term business has classified these on the balance sheet as non current assets held for sale as their carrying amount is expected to be recovered through sale rather than through continuing use.

13. Investment property

	2008	2007
Consolidated		
At the beginning of the financial year	1,977.6	2,218.5
Acquisitions	66.1	31.4
Disposals	(10.9)	(117.3)
Transfer from property, plant and equipment	8.4	–
Fair value adjustments	(562.1)	(157.0)
Foreign exchange movements	4.7	2.0
At the end of the financial year	1,483.8	1,977.6
Society		
At the beginning of the financial year	1,950.6	2,191.8
Acquisitions	66.1	31.4
Disposals	(10.9)	(112.1)
Transfer from property, plant and equipment	8.4	–
Fair value adjustments	(562.1)	(160.5)
At the end of the financial year	1,452.1	1,950.6

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:

	2008	2007
Rental income	121.8	121.1
Direct operating expenses from rented property	11.9	8.3
Direct operating expenses from property not rented	3.1	4.4
Total direct operating expenses on investment property	15.0	12.7

During the 2008 financial year, 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. The other than long term business has classified these on the balance sheet as non-current assets held for sale as their carrying amount is expected to be recovered through sale rather than through continuing use.

14. Intangible assets

Deferred acquisition costs

Consolidated	2008	2007
At the beginning of the financial year	17.9	23.6
Incremental acquisition costs incurred	2.9	3.4
Amortisation	(9.4)	(9.1)
At the end of the financial year	11.4	17.9

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 will be realised over a period of up to four and $\frac{3}{4}$ years (2007: six years), being the assumed average life of a unit trust contract. Of the total value £6.3m (2007: £12.7m) is expected to be recovered after more than one year.

15. Investments in group undertakings

	2008	2007
Shares in Group undertakings	306.5	37.3

Analysis of movement in equity share investments

At the beginning of the financial year	37.3	35.9
Additions	320.0	–
Reversal of impairment losses	–	3.1
Impairment	(50.8)	(1.7)
At the end of the financial year	306.5	37.3

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. Investments in group undertakings (continued)

	Trading Company	Country of incorporation or registration	Accounting reference date
CIS Mortgage Maker Limited	Yes	Great Britain	31 December 2008
CIS Policyholder Services Limited	Yes	Great Britain	12 January 2009
CIS Unit Managers Limited	Yes	Great Britain	12 January 2009
Hornby Road Investments Limited	Yes	Great Britain	31 December 2008
Neale House Holdings Limited	Yes	Great Britain	31 December 2008
Petros Developments (Leeds) Limited	Yes	Great Britain	31 December 2008
CIS Asset Managers Limited	Yes	Great Britain	12 January 2009
Goldman Sachs Multi-Strategy Portfolio COIS Limited	Yes	Cayman Islands	31 December 2008
Leyburn Developments Limited	No	Great Britain	31 December 2008
Primera (Fenchurch Street) Limited	No	Great Britain	31 December 2008
R.O.P.K. (1980) Limited	No	Great Britain	31 December 2008
CIS Home Loans Limited	No	Great Britain	31 December 2008
CIS Mortgage Finance Limited	No	Great Britain	31 December 2008
CIS Limited (formerly CIS Residential Mortgages Limited)	No	Great Britain	31 December 2008

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 18.

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 intragroup guarantees are accounted for in accordance with IFRS 4 Insurance Contracts.

Investment in associates

At 10 January 2009, the long term business fund held an interest of 20% or more of the nominal value of the issued share capital in one company which is held as an investment of CIS. The holding has 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 this holding purely for investment purposes and does not seek to exert a significant influence over the operating and financial policy of the company.

Company	Country of incorporation	Class of shares held	Fair value at 10 January 2009	Percentage of class held
Knightsbridge Integrated Limited	Guernsey	Redeemable preference	0.2	20.1%
Rising Star Growth II	England	Redeemable preference	0.8	21.8%

The assets, liabilities, revenue and profit/(loss) for the year, reported at the last accounting date, for the above, is provided in the entity's functional currency below:

Company	Accounting date	Assets	Liabilities	Revenue	Profit/(loss)
Knightsbridge Integrated Limited	30 September 2008	\$1.1m	\$1.1m	–	–
Rising Star Growth II	30 September 2008	£2.2m	–	–	–

CIS also has a number of holdings in non-voting preference shares which represent 20% or more of the class of shares:

Company	Share description	Holding
BP plc	9.0% £1 cumulative irredeemable 2nd preference shares	27.4%

16. Financial investments at fair value through profit or loss

Consolidated	2008	2007
Listed equities	4,528.9	6,227.4
Unlisted equities	298.0	102.7
Listed debt securities – fixed rate	6,780.7	6,170.4
Listed debt securities – floating rate	–	461.2
Unlisted debt securities – fixed rate	6.5	8.9
Unlisted debt securities – floating rate	2,267.7	1,842.0
Deposits with credit institutions – fixed rate	2,564.3	4,044.6
	16,446.1	18,857.2

Of the total value £13,913.1m (2007: £14,746.2m) are expected to be recovered after more than one year.

Society	2008	2007
Listed equities	4,526.0	6,223.3
Unlisted equities	121.4	102.7
Listed debt securities – fixed rate	6,780.7	6,170.4
Listed debt securities – floating rate	–	461.2
Unlisted debt securities – fixed rate	6.5	8.9
Unlisted debt securities – floating rate	2,267.7	1,842.0
Deposits with credit institutions – fixed rate	2,443.6	4,044.6
	16,145.9	18,853.1

Of the total value £13,612.9m (2007: £14,742.1m) 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 £239.8m (2007: £1,193.9m) on loan under approved stock lending arrangements. Eligible collateral totalling £254.2m (2007: £1,253.5m), was held as security.

Government guaranteed securities with a market value of £1,512.4m (2007: £2,782.9m) 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 £1,828.0m (2007: £2,589.3m) purchased with the collateral. A liability of £1,814.4m (2007: £2,981.2m) 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 year.

17. Loans at amortised cost

Consolidated	2008	2007
Loans:		
Secured by mortgages	4.0	5.1
Secured by insurance policies	5.4	7.2
Other loans	0.3	0.4
	9.7	12.7
Society	2008	2007
Loans:		
Loans to group companies	4.0	5.4
Secured by mortgages	5.4	5.1
Secured by insurance policies	0.3	7.2
Other loans	–	0.4
	9.7	18.1

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

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

17. Loans at amortised cost (continued)

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 £8.7m (2007: £16.6m) is expected to be recovered after more than one year. Similarly for the Society £8.7m (2007: £11.2m) 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 year.

18. Derivative financial instruments

Consolidated	2008	2007
Derivative financial assets at fair value through profit or loss – held for trading:		
Financial futures contracts	1.7	47.5
– Interest rate swaptions	471.4	435.0
– Interest rate swaps	208.1	8.8
– FTSE options	114.3	54.4
– Total return swaps	231.9	–
	1,027.4	545.7
Derivative financial liabilities at fair value through profit or loss – held for trading:		
Financial futures contracts	33.6	–
Interest rate futures	327.0	5.9
Interest rate swaptions	1.8	–
Forwards	34.4	–
	396.8	5.9
Society	2008	2007
Derivative financial assets at fair value through profit or loss – held for trading:		
Financial futures contracts	1.7	47.5
Interest rate swaptions	471.4	435.0
Interest rate swaps	208.1	8.8
FTSE options	114.3	54.4
Total return swaps	231.9	–
Forwards	–	–
	1,027.4	545.7
Derivative financial liabilities at fair value through profit or loss – held for trading:		
Financial futures contracts	33.6	–
Interest rate futures	327.0	5.9
Interest rate swaptions	1.8	–
Forwards	1.5	–
	363.9	5.9

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 10 January 2009 had the effect of reducing CIS' exposure to UK equities by £446.1m (2007: £1,187.6m).

19. Insurance receivables and other assets

Consolidated	2008	2007
Receivables arising from insurance contracts:		
Insurance operations	28.7	20.9
Reinsurance operations	–	0.1
Other receivables:		
Accrued interest and rent	196.6	180.9
Prepayments and accrued income	0.4	6.3
Outstanding interest	7.8	7.3
Amounts receivable for investments sold	95.8	406.1
Amounts receivable from group undertaking	10.7	5.3
Other receivables	25.8	35.9
	365.8	662.8
Society	2008	2007
Receivables arising from insurance:		
Insurance operations	24.4	14.6
Reinsurance operations	–	0.1
Other receivables:		
Accrued interest and rent	196.5	180.9
Prepayments and accrued income	0.4	6.3
Outstanding interest	7.8	7.3
Amounts receivable for investments sold	62.8	406.0
Amounts receivable from group undertakings	11.5	7.2
Other receivables	19.6	28.3
	323.0	650.7

No amounts are expected to be recovered after more than one year (2007: nil).

Consolidated

Insurance receivables arising from insurance operations are stated net of a provision of £4.2m (2007: £4.0m) 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 £2.7m (2007: £2.2m). 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 £4.4m (2007: £3.5m). 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 £39.6m (2007: £31.8m) which are overdue but not considered to be impaired, age analysed as follows:

Amounts overdue:	2008	2007
Less than 3 months	37.5	30.5
3 to 6 months	0.1	0.3
6 to 12 months	0.2	0.2
More than 12 months	1.8	0.8

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

	2008	2007
Consolidated		
Property, plant and equipment	43.1	–
Investment property	6.9	–
	50.0	–
Society		
Property, plant and equipment	43.1	–
Investment property	6.9	–
	50.0	–

21. Cash and cash equivalents

	2008	2007
Consolidated		
Cash at bank and in hand	50.8	62.4
Society		
Cash at bank and in hand	1.7	7.6
	1.7	7.6

Cash and cash equivalents are measured at amortised cost.

22. Share capital

	2008	2007
Authorised		
105,000 ordinary shares of £1 each	105,000	105,000
Allotted and called up		
105,000 ordinary shares of £1 each, £0.50 paid	52,500	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

	2008 General reserve	2008 Retained earnings	2008 Total	2007 General reserve	2007 Retained earnings	2007 Total
Consolidated and Society						
At the beginning of the financial year	317.0	40.9	357.9	317.0	19.1	336.1
Profit for the financial year	–	72.1	72.1	–	36.6	36.6
Total recognised income and expense for the financial year	–	72.1	72.1	–	36.6	36.6
Dividend paid	–	–	–	–	(21.1)	(21.1)
Tax on dividend	–	–	–	–	6.3	6.3
At the end of the financial year	317.0	113.0	430.0	317.0	40.9	357.9

Reserves include £10.2m (2007: £15.1m), 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.

23. Reserves (continued)

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 2007 financial year.

24. Insurance and participating contracts liabilities and reinsurance assets

Consolidated and Society

(a) Analysis of insurance and participating contract liabilities

Gross	2008	2007
Long term insurance contracts:		
Insurance contracts	2,388.9	2,326.8
Insurance participating contracts	13,156.5	14,798.1
Investment participating contracts	494.0	553.5
	16,039.4	17,678.4
General insurance contracts:		
Claims reported	223.1	272.8
Claims incurred but not reported	54.3	171.8
Claims settlement expenses	–	–
Unearned premiums	–	–
Provision for unexpired risks	–	–
	277.4	444.6
Total gross insurance liabilities	16,316.8	18,123.0
Recoverable from reinsurers		
Long term insurance contracts:		
Insurance contracts	(1,779.4)	(1,879.5)
Insurance participating contracts	(1,301.4)	(1,223.1)
Investment participating contracts	–	–
	(3,080.8)	(3,102.6)
General insurance contracts:		
Claims reported	(223.1)	(272.8)
Claims incurred but not reported	(54.3)	(171.8)
Unearned premiums	–	–
	(277.4)	(444.6)
Total reinsurers' share of insurance liabilities	(3,358.2)	(3,547.2)
Net		
Long term insurance contracts:		
Insurance contracts	609.5	447.3
Insurance participating contracts	11,855.1	13,575.0
Investment participating contracts	494.0	553.5
	12,958.6	14,575.8
General insurance contracts:		
Claims reported	–	–
Claims incurred but not reported	–	–
Claims settlement expenses	–	–
Unearned premiums	–	–
Provision for unexpired risks	–	–
	–	–
Total net insurance liabilities	12,958.6	14,575.8

24. Insurance and participating contracts liabilities and reinsurance assets (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 judgement 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 and in assessing the liability for periodic payment settlement cases.

ii) Key assumptions

Principal assumptions underlying the claims provisions include:

- explicit allowance for future inflation at rates varying from 0% pa to 10% pa 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 JSB guidelines;
 - a small proportion of large claims being settled by periodic payments;
 - the average cost of bodily injury claims for the last three accident years on the motor account reflecting the increased proportion of similar claims relating to whiplash and the known incidence of large claims; and
 - the speeding up of recognition of large 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 years 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 assets (continued)

(c) Change in general insurance liabilities and reinsurance assets

i) General insurance – claims and loss adjustment expenses

	2008 Gross	2008 Reinsurance	2008 Net	2007 Gross	2007 Reinsurance	2007 Net
Notified outstanding claims	272.8	(272.8)	–	442.7	(442.7)	–
Claims incurred but not reported	171.8	(171.8)	–	305.2	(305.2)	–
Claims settlement expenses	–	–	–	–	–	–
At the beginning of the financial year	444.6	(444.6)	–	747.9	(747.9)	–
Claims paid during the year	(108.0)	108.0	–	(194.6)	194.6	–
Increase in liabilities:						
Arising from current year claims	–	–	–	–	–	–
Arising from prior year claims	(59.2)	59.2	–	(108.7)	108.7	–
Total movement	(167.2)	167.2	–	(303.3)	303.3	–
Notified outstanding claims	223.1	(223.1)	–	272.8	(272.8)	–
Incurred but not reported	54.3	(54.3)	–	171.8	(171.8)	–
Claims settlement expenses	–	–	–	–	–	–
At the end of the financial year	277.4	(277.4)	–	444.6	(444.6)	–

ii) General insurance – provisions for unearned premiums

	2008 Gross	2008 Reinsurance	2008 Net	2007 Gross	2007 Reinsurance	2007 Net
At the beginning of the financial year	–	–	–	0.7	(0.7)	–
Increase in the financial year	–	–	–	–	–	–
Release in the financial year	–	–	–	(0.7)	0.7	–
Movement in the financial year	–	–	–	(0.7)	0.7	–
At the end of the financial year	–	–	–	–	–	–

iii) General insurance – provisions for unexpired risk

There was no requirement for an unexpired risk provision in 2008 or 2007.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

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

iv) Analysis of claims development

Gross of reinsurance

									Total
	2001	2002	2003	2004	Accident year		2007	2008	
					2005	2006			
<i>Estimate for cumulative claims</i>									
At end of accident year:	507.1	591.8	572.0	550.5	480.1	258.4	–	–	2,959.9
One year later	484.4	559.7	542.8	527.1	468.3	209.0	–	–	2,791.3
Two years later	475.8	560.3	526.5	495.3	439.9	204.0	–	–	2,701.8
Three years later	486.2	550.6	507.6	467.2	414.0	–	–	–	2,425.6
Four years later	488.8	547.4	499.5	450.3	–	–	–	–	1,986.0
Five years later	488.3	548.1	498.9	–	–	–	–	–	1,535.3
Six years later	484.9	540.3	–	–	–	–	–	–	1,025.2
Seven years later	481.5	–	–	–	–	–	–	–	481.5
Estimate of cumulative claims	481.5	540.3	498.9	450.3	414.0	204.0	–	–	2,589.0
Cumulative payments to date	(461.6)	(511.6)	(458.9)	(408.5)	(340.1)	(168.7)	–	–	(2,349.4)
Provision	19.9	28.7	40.0	41.8	73.9	35.3	–	–	239.6
Provision for prior years									37.8
Gross outstanding claims liabilities									277.4
<i>Analysed as follows:</i>									
Gross claims reported									223.1
Gross claims incurred but not reported									54.3
Gross outstanding claims liabilities									277.4

Net of reinsurance

									Total
	2001	2002	2003	2004	Accident year		2007	2008	
					2005	2006			
<i>Estimate for cumulative claims</i>									
At end of accident year:	504.0	585.6	569.6	547.2	477.6	–	–	–	2,684.0
One year later	480.6	553.0	540.7	525.1	151.8	–	–	–	2,251.2
Two years later	471.6	553.8	524.5	317.1	151.8	–	–	–	2,018.8
Three years later	480.9	541.0	369.1	317.1	151.8	–	–	–	1,859.9
Four years later	480.1	446.4	369.1	317.1	–	–	–	–	1,612.7
Five years later	408.9	446.4	369.1	–	–	–	–	–	1,224.4
Six years later	408.9	446.4	–	–	–	–	–	–	855.3
Seven years later	408.9	–	–	–	–	–	–	–	408.9
Estimate of cumulative claims	408.9	446.4	369.1	317.1	151.8	–	–	–	1,693.3
Cumulative payments to date	(408.9)	(446.4)	(369.1)	(317.1)	(151.8)	–	–	–	(1,693.3)
Provision	–	–	–	–	–	–	–	–	–
Provision for prior years									–
Net outstanding claims liabilities									–
<i>Analysed as follows:</i>									
Net claims reported									–
Net claims incurred but not reported									–

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

(d) Capital position statement 2008

	Long term (excl. stakeholder)	With-Profits stakeholder fund	Shareholder funds	Total long term business
Available capital resources				
Shareholder's funds outside fund	–	–	200.0	200.0
Shareholder's funds held in fund	–	–	–	–
Total shareholder's funds	–	–	200.0	200.0
Adjustments onto regulatory basis:				
UDS	598.8	–	–	598.8
Adjustments to assets	(25.4)	–	–	(25.4)
Total available capital resources	573.4	–	200.0	773.4
With-profits liabilities on realistic basis:				
Options and guarantees	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 assurance	609.5	–	–	609.5
Insurance and participating contract liabilities per capital position statement	12,683.5	159.6	–	12,843.1

Capital position statement 2007

	Long term (excl. stakeholder)	With-Profits stakeholder fund	Shareholder funds	Total long term business
Available capital resources				
Shareholder's funds outside fund	–	–	200.0	200.0
Shareholder's funds held in fund	–	–	–	–
Total shareholder's funds	–	–	200.0	200.0
Adjustments onto regulatory basis:				
UDS	1,028.1	–	–	1,028.1
Adjustments to assets	(18.8)	–	–	(18.8)
Total available capital resources	1,009.3	–	200.0	1,209.3
With-profits liabilities on realistic basis:				
Options and guarantees	1,121.6	–	–	1,121.6
Other policyholder obligations	12,819.6	187.3	–	13,006.9
Total participating contract liabilities	13,941.2	187.3	–	14,128.5
Non-participating life assurance	357.2	–	–	357.2
Insurance and participating contract liabilities per capital position statement	14,298.4	187.3	–	14,485.7

	2008	2007
Reconciliation to insurance and participating contracts liability		
Insurance and participating contract liabilities as per capital position statement	12,843.1	14,485.7
Add back reinsurance	3,080.8	3,102.6
Outstanding claims reserves	115.5	90.1
General insurance gross contract liabilities	277.4	444.6
Insurance and participating contract liabilities	16,316.8	18,123.0

24. Insurance and participating contracts liabilities and reinsurance assets (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 10 January 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 25 to 33. 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 2008. At 10 January 2009, provisions amounting to £750.5m (2007: £670.5m) 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 2008. At 10 January 2009, provisions amounting to £137.4m (2007: £41.0m) 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 2008. At 10 January 2009, provisions amounting to £964.6m (2007: £530.5m) 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 10 January 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 assets (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 cashflows 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 non-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 3.84% (2007: 4.51%) 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.

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

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

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 4.2%pa (2007: 4.0%pa).

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 2008 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% (2007: 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 64. 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 (£m)
20% fall in equity values and 12.5% fall in property values	239
17.5% change in long term gilt yields	29
32.5% improvement in persistency rates	118
Increase of 99 basis points in bond yields for credit risk test	123
Total RCM before management actions	509

- In calculating the RCM, it has been assumed that the following management action would be taken under the stressed conditions:
 - All allowances in respect of past miscellaneous surplus are removed from asset shares; and
 - The Equity Backing Ratio backing traditional with-profits policies is reduced to 40%.

With these management actions, the RCM has been calculated to be £147m (2007: £86m). The excess working capital of the fund after the RCM is therefore £426m (2007: £923m), or £626m (2007: £1,123m) if the additional capital available outside the long term business fund is included. The RCM is covered 3.9 (2007: 11.7 times) times by working capital (excluding the £200m allocated from the general reserve).

Other stress tests	Reduction in working capital (£m)
5% fall in assurance mortality rates	8
5% fall in annuitant mortality rates	51
10% increase in renewal expenses	74
1% increase in renewal expense inflation	140

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

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

	Non-participating insurance contracts	Participating insurance contracts	Reinsurance	Net total
2008				
At the beginning of the financial year	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 year	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)
At the end of the financial year	2,389.1	13,534.8	(3,080.8)	12,843.1

	Non-participating insurance contracts	Participating insurance contracts	Reinsurance	Net total
2007				
At the beginning of the financial year	1,944.4	16,079.3	(1,062.4)	16,961.3
New liabilities	186.8	218.1	–	404.9
Changes in liabilities during the year	(64.4)	(1,434.4)	–	(1,498.8)
Effect of changes in non-economic assumptions	(26.1)	134.9	–	108.8
Effect of changes in asset shares	–	441.7	–	441.7
Effect of changes in economic conditions	127.8	(197.8)	–	(70.0)
Other	68.3	109.7	(2,040.2)	(1,862.2)
At the end of the financial year	2,236.8	15,351.5	(3,102.6)	14,485.7

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

	2008	2007
At the beginning of the financial year	1,009.3	1,130.4
Opening adjustments	(23.2)	22.7
Changes to insurance assumptions	17.0	(165.0)
Economic variances	(504.6)	(139.7)
Insurance variances	11.1	(21.7)
Other factors	63.8	182.6
At the end of the financial year	573.4	1,009.3

Opening adjustments

Opening adjustments consist of:

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

Changes to insurance assumptions

Changes to insurance assumptions include:

- changes to expense, mortality and persistency assumptions to reflect the latest experience investigations; and
- a move to the use of an underpin for future annuitant mortality improvements (2007 only).

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

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

Economic variances

Economic variances arise from the following:

- investment returns exceeding the assumed risk-free rate helping to reduce the cost of meeting policy guarantees;
- a decrease in risk-free rates which has increased the cost of policy guarantees; and
- assumed equity volatility which has increased the cost of policy guarantees.

Insurance variances

Insurance variances include:

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

Other factors

Other factors include:

- changes to reinsurance arrangements (2007 only);
- the effect of asset sales to maintain the Equity Backing Ratio within the range specified in the Principles and Practices of Financial Management (PPFM); and
- a reduction in annual bonus rates for accumulating with-profits business.

25. Unallocated divisible surplus (UDS)

	2008	2007
Consolidated		
At the beginning of the financial year	1,045.6	1,155.4
Transfer from the income statement	(433.4)	(107.0)
Transfers (to)/from the statement of recognised income and expense (SORIE):		
Revaluation of owner occupied property	(4.8)	(3.1)
Revaluation of owner occupied property transferred to assets held for sale	14.8	–
Tax on items through SORIE	–	0.3
At the end of the financial year	622.2	1,045.6
Society		
At the beginning of the financial year	1,028.1	1,142.9
Transfer from the income statement	(439.3)	(112.0)
Transfers (to)/from the statement of recognised income and expense:		
Revaluation of owner occupied property	(4.8)	(3.1)
Revaluation of owner occupied property transferred to assets held for sale	14.8	–
Tax on items through SORIE	–	0.3
At the end of the financial year	598.8	1,028.1

The proportion of the change in the unallocated divisible surplus included on the face of the income statement within the column headed 'significant items' reflects the net of tax impact of the long term business share of non-recurring expenses associated with a programme of restructuring announced in 2007.

26. Investment contracts 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 contracts 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:

	2008	2007
At the beginning of the financial year	220.1	192.6
Contributions	38.7	37.0
Account balance paid on surrender and related benefits	(13.7)	(11.6)
Movement in fair value	(54.2)	2.1
At the end of the financial year	190.9	220.1
<i>Movement in fair value comprises:</i>		
Investment return credited and related benefits	(54.9)	1.5
Management charges	(2.1)	(2.0)
Other income – management rebate	2.8	2.6
	(54.2)	2.1

27. Loans and borrowings

Consolidated and Society

	2008	2007
Loans from Group undertakings	277.0	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% pa (2007: 4% pa). Following the end of the financial year 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 year.

28. Amounts owed to credit institutions

Consolidated and Society

	2008	2007
Gilt repo liability	1,814.4	2,983.2
	1,814.4	2,983.2

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). 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 shown in these accounts in respect of the 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 Co-operative Group Limited's pension scheme are as follows:

	2008	2007
The principal assumptions used to determine the liabilities of the Group's pension schemes were:		
Discount rate	5.70%	5.65%
Rate of increase in salaries	4.75%	5.15%
Future pension increases where capped at 5.0% pa	3.25%	3.65%
Future pension increases where capped at 2.50% pa	2.50%	2.50%

Assumptions used to determine net pension cost for the PACE scheme are:

Expected long term return on scheme assets	5.65%	5.10%
Rate of increase in salaries	6.40%	6.30%
	5.15%	4.50%

Assumptions used to determine net pension cost for the former United Co-operatives schemes are:

Discount rate	5.65%	5.40%
Expected long term return on scheme assets	6.50%	7.30%
Rate of increase in salaries	5.15%	4.80%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme and the former United Co-operatives schemes at 10 January 2009 are:

Life expectancy at age 65	Male	Female
Member currently aged 65 (current life expectancy)	20.3	23.2
Member currently aged 45 (life expectancy at age 65)	21.3	24.1

	2008	2007
The amounts recognised in the balance sheet of the Co-operative Group are as follows:		
Present value of funded obligations	(4,799.9)	(5,073.6)
Present value of unfunded liabilities	(3.5)	(3.7)
Fair value of plan assets	5,204.6	5,511.7
	401.2	434.4

The pension scheme assets include property occupied by the Group at fair value of £1.1m (2007: £1.1m)

	2008	2007
The weighted-average asset allocations at the year-end were as follows:		
Equities	42%	43%
Liability-driven investments	54%	21%
Property	4%	5%
Cash	0%	1%

To develop the expected long term rate of return on assets assumption, the 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 year ended 10 January 2009.

30. Other provisions

	2008	2007
Consolidated and Society		
Onerous contract provisions	5.3	4.1
Other provisions	1.3	1.2
	6.6	5.3

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

	Onerous contract provisions	2007 Other provisions	Total
At the beginning of the financial year	11.1	4.4	15.5
Provision utilised	–	(1.0)	(1.0)
Provision released	(7.0)	(2.2)	(9.2)
At the end of the financial year	4.1	1.2	5.3

Onerous contract provisions relate to long term business investment contracts and provide for potential cost overrun where management charges are capped, and is expected to unwind over the duration of the investment contract liabilities. Other provisions were established in 2006 to cover potential exposures arising from projects which were underway but not complete, this provision is expected to unwind during 2009.

31. Insurance and other payables

	2008	2007
Consolidated		
Arising out of direct insurance operations	3.7	2.4
Accruals and deferred income	49.2	46.0
Other taxation and social security	–	0.1
Amounts due for investments purchased	68.5	384.2
Amounts owed to other group undertakings	66.8	49.9
Other payables	103.6	68.0
	291.8	550.6

Society		
Arising out of direct insurance operations	3.7	2.4
Accruals and deferred income	33.2	25.3
Amounts due for investments purchased	68.5	384.2
Amounts owed to other group undertakings	60.4	30.5
Other payables	65.4	64.5
	231.2	506.9

Of the total value, £15.8m (2007: £14.8m) is expected to be recovered after more than one year.

Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

32. Other reinsurance liabilities

	2008	2007
Consolidated and Society		
Arising from reinsurance operations	2,268.9	1,837.1

Liabilities arising from reinsurance operations include a financial liability of £2,267.7m (2007: £1,834.7m) 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's 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, £50.6m (2007: £49.3m) is to be settled within one year giving rise to a cash outflow of £52.8m (2007: £50.6m) (inclusive of interest). The amount to be settled after more than one year is £2,218.3m (2007: £1,787.8m).

33. Income Tax

Consolidated	2008	2007
Current tax (asset)/liability		
At the beginning of the financial year	38.8	(80.0)
Tax charged to the income statement	160.9	93.9
Tax credited directly to reserves	–	(6.3)
Tax charged directly to the statement of recognised income and expense		
Revaluation of owner occupied property transferred as assets held for sale:	0.4	–
Tax (paid)/recovered during the financial year	(99.8)	31.2
At the end of the financial year	100.3	38.8

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2007 28%).

Deferred tax liability		
At the beginning of the financial year	281.0	369.1
Tax credited to the income statement	(193.2)	(87.8)
Tax credited directly to the statement of recognised income and expense:		
Revaluation of owner occupied property	(0.4)	(0.3)
At the end of the financial year	87.4	281.0

Analysis of deferred tax liability

Unrealised appreciation on investments	98.8	290.4
Acquisition costs deferred	(19.1)	(19.2)
Claims equalisation reserve	4.0	6.1
Other timing differences	3.7	3.7
At the end of the financial year	87.4	281.0

33. Income tax (continued)

Society	2008	2007
Current tax (asset)/liability		
At the beginning of the financial year	35.7	(81.7)
Tax charged to the income statement	161.9	92.7
Tax credited to reserves	–	(6.3)
Tax charged directly to the statement of recognised income and expense		
Revaluation of owner occupied property transferred assets held for sale:	0.4	–
Tax (paid)/recovered during the financial year	(99.0)	31.0
At the end of the financial year	99.0	35.7
Deferred tax liability		
At the beginning of the financial year	272.1	362.0
Tax credited to the income statement	(194.8)	(89.6)
Tax credited directly to the statement of recognised income and expense:		
Revaluation of other occupied property	(0.4)	(0.3)
At the end of the financial year	76.9	272.1
	2008	2007
Analysis of deferred tax liability		
Unrealised appreciation on investments	88.3	281.5
Acquisition costs deferred	(19.1)	(19.2)
Claims equalisation reserve	4.0	6.1
Other timing differences	3.7	3.7
At the end of the financial year	76.9	272.1

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 £4.6m (2007: £5.1m).

34. Contingent assets and liabilities

No contingent assets or liabilities have been identified at 10 January 2009 (2007: none).

35. Commitments

	2008	2007
Capital commitments arising from investment in partnership agreements	185.9	141.0

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.

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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 Group. Details of transactions and balances during the financial year are provided below.

Balances with related parties	2008	2007
<i>At the beginning of the financial year:</i>		
Due from ultimate parent undertaking	1.2	2.0
Due to immediate parent undertaking	(277.0)	(367.0)
Due from fellow subsidiaries	383.6	731.1
Movement in capital value	(184.2)	(258.9)
Fair value movements	(0.5)	0.6
<i>At the end of the financial year:</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

Net interest payable on these balances during the financial year amounted to £10.5m (2007: £10.4m).

Included within the consolidated balance sheet under the heading 'financial investments at fair value through profit or loss' the Society holds debt securities for which the counterparty is a related party.

The Society has entered into a loan agreement with its immediate parent, interest of £11.5m has been charged to the income statement during the year (2007: £11.1m).

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 year included amounts recoverable under the agreement of £256.1m (2007: £423.5m).

During the year the Society paid dividends of £nil (2007: £21.1m) to its immediate and ultimate parent.

The Society and its subsidiaries have bank accounts with The Co-operative Bank p.l.c, a fellow subsidiary. At the end of 2008, aggregate balances stood at £54.8m (2007: £33.6m). Interest earned on deposits throughout the year totalled £3.6m (2007: £2.3m).

CIS pays the Bank a fee for managing certain stocklending and repo activity on its behalf. The fee paid during 2008 amounted to £0.7m (2007: £0.2m).

	2008	2007
	£	£
<i>Transactions with key management personnel:</i>		
Value of insurance transactions at the beginning of the financial year	69,077	86,629
Movement during the financial year	(3,709)	(17,552)
Value of insurance transactions at the end of the financial year	65,368	69,077

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 £163.0m (2007: £176.3m) were charged to CIS from CFSMS.



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