2016 Results

12 April 2017
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Agenda

- Group Results Overview
- GI Results
- Life Results
- Capital
- LVFS Operational Liquidity
- Expenses & Commission
- Best Loved
- Looking ahead
Group Results Overview: Operating Profit

<table>
<thead>
<tr>
<th>£m</th>
<th>Trading operations</th>
<th>Heritage business</th>
<th>LV= Group</th>
<th>LV= Group Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY</td>
<td>FY</td>
<td>FY</td>
<td>FY</td>
</tr>
<tr>
<td>General Insurance</td>
<td>113</td>
<td>72</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Life</td>
<td>45</td>
<td>41</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Heritage</td>
<td>0</td>
<td>0</td>
<td>(35)</td>
<td>88</td>
</tr>
<tr>
<td>Group</td>
<td>1</td>
<td>(6)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Operating Profit/(Loss) pre Ogden</td>
<td>159</td>
<td>107</td>
<td>(35)</td>
<td>88</td>
</tr>
<tr>
<td>Reserve increase due to Ogden</td>
<td>(139)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Operating (Loss)/Profit post Ogden</td>
<td>20</td>
<td>107</td>
<td>(35)</td>
<td>88</td>
</tr>
</tbody>
</table>

Group

- Operating profit from trading operations increased pre Ogden by £52m (+49%) to £159m reflecting strong trading performance in both general insurance and life.
- The reversal in operating profit for the group to a loss of £15m (2015: £195m profit) is mainly driven by the increased reserves due to the Ogden rate change and changes to the heritage reserving assumptions partially reversing the £88m operating profit in 2015.

General Insurance (GI)

- The main drivers for the improved underlying trading performance have been the continuing rate recovery in motor, although the impact of this has been partially eroded by ongoing claims inflation, and the turnaround in the broker division.
- The investment return increased to £43m (2015: £28m) reflecting the improved market conditions in the second half of the year.

Life

- New business volumes have grown across all product segments, with the increase in contribution from this new business helping to drive the increase in operating profit.
- The life operating profit result also benefited from favourable one-off model and valuation changes in the year, mainly driven by savings from reduced unit costs in the protection business as volumes increase.

Heritage & Group

- The heritage business operating loss of £35m (2015: £88m profit) is driven by model and valuation changes of £22, relating to the OB pensions payout basis and cash take-up rate and unit costs, in addition to claims experience variances of £11m.
- Group operating profit includes unallocated group overheads and also the return on the group’s free capital.
The increase in the tax charge during the year reflects the high gains made in policyholders’ fixed-interest investments during the year, partially offset by the tax credit associated with the loss in the GI business. This tax on investment gains in the with-profit business, which gets charged to policyholders’ asset shares, increased to £42m from £nil, with the favourable impact reported in STIF as per above.

Income Tax Expense

The loss in the year of £2m (2015: £51m gain) reflects a decrease in the discount rate increasing the value of the scheme’s liabilities, offset by an increase in the value of the scheme’s invested assets.

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Group Results Overview: Transfer to UDS

<table>
<thead>
<tr>
<th></th>
<th>£m</th>
<th>2016 FY</th>
<th>2015 FY</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating (Loss)/Profit post Ogden</td>
<td>(15)</td>
<td>195</td>
<td>(210)</td>
<td></td>
</tr>
<tr>
<td>Pensions business IFRS adjustment</td>
<td>3</td>
<td>(5)</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Short-term investment fluctuations and related items</td>
<td>14</td>
<td>(10)</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>Centrally managed costs (incl amortisation)</td>
<td>(30)</td>
<td>(32)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Gain arising on Teachers Acquisition</td>
<td>3</td>
<td>0</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Finance costs</td>
<td>(24)</td>
<td>(24)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>(Loss)/Profit before tax and mutual bonus</td>
<td>(49)</td>
<td>124</td>
<td>(173)</td>
<td></td>
</tr>
<tr>
<td>Mutual Bonus</td>
<td>(17)</td>
<td>(27)</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(35)</td>
<td>(6)</td>
<td>(29)</td>
<td></td>
</tr>
<tr>
<td>Pension scheme actuarial (loss)/gain net of tax</td>
<td>(2)</td>
<td>51</td>
<td>(53)</td>
<td></td>
</tr>
<tr>
<td>Transfer (from)/to the Unallocated Divisible Surplus</td>
<td>(103)</td>
<td>142</td>
<td>(245)</td>
<td></td>
</tr>
</tbody>
</table>

Headline

The loss before tax of £49m (2015: £124m profit) was primarily driven by the overall group operating loss of £15m, plus centrally managed costs (including Solvency II project costs) and debt interest.

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Short-term investment fluctuations (STIF) and related items

STIF of £14m (2015: £10m loss), is primarily made up of a loss of £28m representing the unmatched movements in the value of investment assets and liabilities predominantly caused by the fall in yields during the year. This adverse impact was more than offset by the recovery of tax paid on investment gains deducted from policy asset shares and the RNPFN fund totalling £42m.

Mutual Bonus

Mutual bonus of £17m (2015 £27m) is applied by enhancing the asset share of relevant policies by 0.5%. The mutual bonus has been reduced to reflect lower operating profit and reduced capital strength.

Income Tax Expense

The increase in the tax charge during the year reflects the high gains made in policyholders’ fixed-interest investments during the year, partially offset by the tax credit associated with the loss in the GI business. This tax on investment gains in the with-profit business, which gets charged to policyholders’ asset shares, increased to £42m from £nil, with the favourable impact reported in STIF as per above.

Pension scheme actuarial loss net of tax

The loss in the year of £2m (2015: £51m gain) reflects a decrease in the discount rate increasing the value of the scheme’s liabilities, offset by an increase in the value of the scheme’s invested assets.
Gross written premiums were up 7% compared to 2015. This was due to both growth in policies and motor premium rate increases.

Direct policies increased by 9% to 3.6m, with car and breakdown portfolios passing their two million and one million milestones respectively.

Broker division policies remained at 1.4m, and grew premiums by 5% from £635m in 2015 to £668m, as a result of the focus on higher margin business.

Non-motor policies increased to 38% of the book (2015: 36%) reflecting our strategy to reduce motor concentration.

In commercial broker we have continued to focus on regional brokers and achieved 9% premium growth.

Personal lines within the broker division has concentrated on areas of the market that complement our direct division and achieved premium growth of 3%.

We have not been able to make sustainable profits in the highly competitive broker home market, consequently we have withdrawn this product from April 2017.

<table>
<thead>
<tr>
<th></th>
<th>2016 FY</th>
<th>2015 FY</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor</td>
<td>1,103</td>
<td>1,013</td>
<td>90</td>
</tr>
<tr>
<td>Home</td>
<td>168</td>
<td>175</td>
<td>(7)</td>
</tr>
<tr>
<td>Commercial Lines incl SME</td>
<td>267</td>
<td>245</td>
<td>22</td>
</tr>
<tr>
<td>Other</td>
<td>43</td>
<td>39</td>
<td>4</td>
</tr>
<tr>
<td><strong>GWP (£m)</strong></td>
<td><strong>1,581</strong></td>
<td><strong>1,472</strong></td>
<td><strong>109</strong></td>
</tr>
<tr>
<td>Direct premium income</td>
<td>913</td>
<td>837</td>
<td>76</td>
</tr>
<tr>
<td>Broker premium income</td>
<td>668</td>
<td>635</td>
<td>33</td>
</tr>
<tr>
<td>Motor policies in-force</td>
<td>3.1m</td>
<td>3.0m</td>
<td>0.1</td>
</tr>
<tr>
<td>Non-Motor policies in-force</td>
<td>1.9m</td>
<td>1.7m</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Total policies in-force</strong></td>
<td><strong>5.0m</strong></td>
<td><strong>4.7m</strong></td>
<td><strong>0.3</strong></td>
</tr>
</tbody>
</table>
The reduction in the Ogden discount rate from 2.5% to minus 0.75% had an overall impact on 2016 operating profit of £139m and £100m capital impact under Solvency II.

Direct business grew in LV= branded car and home portfolios due to strong sales and market leading renewal retention.

Broker saw a strong turnaround in the profits pre-Ogden from a loss of £19m last year to a profit of £26m this year. This was achieved through disciplined underwriting, and a forensic review of all our business lines.

COR (pre Ogden) reduced to 94.1% following an improved underwriting result, partly due to increased motor premium rate earning through and the broker turnaround, despite a lower prior year reserve release of £64m (2015 £93m).

<table>
<thead>
<tr>
<th>Operating Profit</th>
<th>2016</th>
<th>2015</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underwriting result</td>
<td>70</td>
<td>44</td>
<td>26</td>
</tr>
<tr>
<td>Investment return</td>
<td>43</td>
<td>28</td>
<td>15</td>
</tr>
<tr>
<td>Operating Profit pre Ogden</td>
<td><strong>113</strong></td>
<td>72</td>
<td>41</td>
</tr>
<tr>
<td>Reserve increase due to Ogden</td>
<td>(139)</td>
<td>0</td>
<td>(139)</td>
</tr>
<tr>
<td>Operating (Loss)/Profit post Ogden</td>
<td>(26)</td>
<td>72</td>
<td>(98)</td>
</tr>
</tbody>
</table>

### Direct/Broker Operating Profit

- Direct operating profit - pre Ogden: 93m (2015: 91m) 2m increase
- Broker operating profit/(loss) - pre Ogden: 26m (2015: (19)m) 45m increase
- Operating profit ceded to reinsurers - pre Ogden: (6)m (2015: 0m) (6)m increase

### ROCE (pre tax) pre Ogden

- 14.2% (2015: 9.5%)

### Loss & Expense Ratios

- Loss ratio pre Ogden: 69.7% (2015: 66.3%)
- Expense ratio pre Ogden: 24.4% (2015: 29.8%)
- Combined ratio pre Ogden: 94.1% (2015: 96.1%)

- Loss ratio post Ogden: 81.7% (2015: 66.3%)
- Expense ratio post Ogden: 24.1% (2015: 29.8%)
- Combined ratio post Ogden: 105.8% (2015: 96.1%)
Continuing investment in our systems and processes, with greater adoption by IFAs of both our new business front end, Retirement View, and of our Retirement Account proposition has led to:

- Continued growth in 2016, delivering a 7% increase in new business premium income.

- Increased new business sales across almost every product line (fixed term annuities up 24%, our flexible guarantee bond up 12% and equity release up 62%).

Our Retirement Advice business grew by 25%, both through direct marketing, supporting our heritage customers and in 2016 opening up new corporate solutions distribution.

Towards the end of 2016 we took the decision to stop selling new enhanced annuity business, because of the low interest rate environment, high capital requirements of Solvency II and the risk of poor customer outcomes.

Growth was underpinned by double digit sales growth in Critical Illness and Term Life. This includes further growth in LV= Business Protection, our proposition for small and medium business owners less withdrawal from whole of life.

Transforming our protection business through the launch of Fastway, our new quote and apply system. This is a key driver of our increased sales volumes and cost control.
Retirement new business contribution before investment in new propositions remains strong at £25m, driven by our flexible guarantee product as consumers increasingly utilise our specialist savings expertise. Reduction in equity release and pensions contributions is driven by lower margins reflecting:

- Product restructuring and change in product mix following the writing of externally funded business in equity release.
- Strengthened pricing basis assumptions in pensions.

As a result of the current extended low yield environment our participation in the whole-of-life protection markets was substantially curtailed in 2016 for capital management reasons. This led to protection new business contribution being below 2015 levels due to the lost acquisition allowances. In addition protection margins contracted in a competitive market.

We have invested £9m to support our goal of providing good quality propositions efficiently. This has included transforming our protection business through the launch of Fastway as well as investing in our retirement systems.

Operating profit is £14m above new business contribution driven by model and basis changes. The cost of annuity reinsurance (£14m), transacted for capital management reasons, is more than offset by substantial expense reserve releases as continued volume growth has resulted in increased scale and operating efficiency.

Our investment in Wealth Wizards has enabled us to further strengthen our LV= Retirement Wizard digital proposition, making affordable retirement advice available to the mass market.
The change in surplus largely reflects favourable movements in:

- Transition recalculation £281
- Capital optimisation activities £140

Offset by:

- Negative market movements, including reduced interest rates increasing capital requirements £182
- Ogden discount rate change £100
- New business strain, primarily from enhanced annuities which was closed as a product line during 2016 £57
- Other items £98

Change in Surplus capital £16

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### Capital

#### Solvency II Standard Formula basis

<table>
<thead>
<tr>
<th></th>
<th>£m</th>
<th>2016</th>
<th>2015</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible own funds</td>
<td></td>
<td>1,296</td>
<td>1,220</td>
<td>76</td>
</tr>
<tr>
<td>Solvency Capital Requirement (SCR)</td>
<td></td>
<td>929</td>
<td>837</td>
<td>92</td>
</tr>
<tr>
<td>Surplus</td>
<td></td>
<td>367</td>
<td>383</td>
<td>(16)</td>
</tr>
<tr>
<td>Capital coverage ratio</td>
<td></td>
<td>140%</td>
<td>146%</td>
<td>-6%</td>
</tr>
</tbody>
</table>

Eligible own funds includes Transition of £837 and 816, a change of £21.

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### Risk appetite

- We have no appetite to breach the regulatory Minimum Capital Requirement (MCR) and are only prepared to breach the Solvency Capital Requirement (SCR) in the event of severe risk stresses or scenarios.
- For year end 2016 the surplus capital target above SCR was £470m.

- The largest contributions to the SCR are general insurance, credit and life insurance risks.
- SCR of £929m analysed after deducting £193m of tax relief and Management Actions.

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### Change in Surplus

The change in surplus largely reflects favourable movements in:

- Transition recalculation £281
- Capital optimisation activities £140

Offset by:

- Negative market movements, including reduced interest rates increasing capital requirements £182
- Ogden discount rate change £100
- New business strain, primarily from enhanced annuities which was closed as a product line during 2016 £57
- Other items £98

Change in Surplus capital £16
Adopting the Internal Model for regulatory capital purposes will only occur following PRA review and approval of the application.

A further aspect of managing our future capital position is the group’s recent application to the PRA to move onto an Internal Model.

Implementation of a quota share agreement to reinsure 20% of our general insurance business.

<table>
<thead>
<tr>
<th>Changes in economic assumptions</th>
<th>Impact on Solvency II capital surplus</th>
<th>Impact on Solvency II capital coverage ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity values fall by 10%</td>
<td>(35)</td>
<td>(4)</td>
</tr>
<tr>
<td>Credit spreads increase by 50bps (vs swaps)</td>
<td>84</td>
<td>10</td>
</tr>
<tr>
<td>Gilt spreads increase by 25bps (vs swaps)</td>
<td>(51)</td>
<td>(5)</td>
</tr>
<tr>
<td>Fixed Interest yields fall by 25bps</td>
<td>(39)</td>
<td>(5)</td>
</tr>
<tr>
<td>Fixed Interest yields increase by 25bps</td>
<td>37</td>
<td>5</td>
</tr>
</tbody>
</table>

**Capital Management actions**

During 2016 we have **taken a number of actions to improve our capital position** and to reduce the sensitivity of our capital position to market movements including:

- Implementation of the Matching Adjustment for certain annuity liabilities.
- Interest rate hedging across the group to reduce the exposure of the Group Solvency II surplus capital to interest rate movements.
- Increased longevity reinsurance on our enhanced annuity business.
- Transfer of Teachers non-profit annuities into the matching adjustment portfolio.
- Holding expenses flat while growing the business, reducing unit costs and releasing expense reserves.
- Implementation of a quota share agreement to reinsure 20% of our general insurance business.

**Going Forward**

- Carry out further actions to bring the group’s capital surplus within risk appetite.
- Reduce balance sheet volatility to investment market changes.

**Internal Model**

A further aspect of managing our future capital position is the group’s recent application to the PRA to move onto an Internal Model. Adopting the Internal Model for regulatory capital purposes will only occur following PRA review and approval of the application.
LVFS Operational Liquidity

<table>
<thead>
<tr>
<th>£m</th>
<th>2016 FY</th>
<th>2015 FY</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>General insurance surplus cash remitted</td>
<td>7</td>
<td>37</td>
<td>(30)</td>
</tr>
<tr>
<td>Life subsidiaries surplus cash remitted</td>
<td>18</td>
<td>0</td>
<td>18</td>
</tr>
<tr>
<td>Life</td>
<td>(21)</td>
<td>(10)</td>
<td>(11)</td>
</tr>
<tr>
<td>Group items</td>
<td>(30)</td>
<td>(24)</td>
<td>(6)</td>
</tr>
<tr>
<td>Debt interest paid</td>
<td>(23)</td>
<td>(23)</td>
<td>0</td>
</tr>
<tr>
<td>Tax</td>
<td>(4)</td>
<td>(4)</td>
<td>0</td>
</tr>
<tr>
<td>Outflow before non-recurring items and mutual bonus</td>
<td>(53)</td>
<td>(24)</td>
<td>(29)</td>
</tr>
<tr>
<td>Non-recurring items</td>
<td>(131)</td>
<td>34</td>
<td>(165)</td>
</tr>
<tr>
<td>Net (outflow)/inflow before mutual bonus</td>
<td>(184)</td>
<td>10</td>
<td>(194)</td>
</tr>
<tr>
<td>Mutual bonus</td>
<td>(17)</td>
<td>(27)</td>
<td>10</td>
</tr>
<tr>
<td>Net outflow</td>
<td>(201)</td>
<td>(17)</td>
<td>(184)</td>
</tr>
<tr>
<td>Operational liquidity held at 31 December</td>
<td>306</td>
<td>507</td>
<td>(201)</td>
</tr>
</tbody>
</table>

Group items

- Group items comprise centrally managed costs (e.g. Solvency II costs) and also the net impact of the heritage with-profits business.

Non-recurring items

- The pay-out for the general insurance long-term incentive scheme of £43m,
- Pension scheme contributions of £34m,
- Consideration paid as part of the Teachers business acquisition of £26m,
- Adverse impact of one-off model and valuation changes in the heritage business of £60m,
- This is offset by positive investment gains in the life and heritage business of £37m.

Headlines

- The amount of LVFS operational liquidity held at 31 December 2016 was £306m (2015: £507m), this is £44m below the group’s liquidity risk appetite of £350m. The group is pursuing a number of options which are intended to get the group back within its risk appetite.

General Insurance Surplus Cash remitted

- The general insurance business returned funds of £7m to the Society, less than 2015 as the general insurance subsidiaries have retained more funds internally in order to strengthen their capital positions under Solvency II.

- The change in the Ogden discount rate had an adverse impact on the general insurance subsidiary of £100m, which required a £40m capital injection in February 2017.

Life

- The life outflow has been impacted by increased new business sales of pensions and protection products which have increased the level of new business cash consumption.

- This was offset by cash generated from sales of flexible guarantee bonds. Surplus cash of £18m has also been received within the estate from the equity release subsidiary.
The increase in gross expenses pre-commission is predominantly as a result of expenses incurred by the newly acquired Teachers business in heritage and increased costs related to Solvency II in central items.

GI expense ratio was higher in 2015 due to the loss portfolio transfer reinsurance arrangement entered into. Excluding this the expense ratio for 2015 would have been 24.6% in line with the 2014 and 2016 results.

Life costs over PVNBP are coming down year on year as volumes increase and this has led to greater expense efficiency.

Management continues to focus on cost control, by holding expenses broadly flat while growing the business.
Our focus on being the UK’s ‘best loved’ insurer is another key objective validated by being voted the UK’s most recommended insurer again, according to YouGov, for the third year running.

We are now listed as a recommended provider for car and home insurance according to Which? Having already received this status for travel in November and breakdown in August, these completed a full suite of accolades for our major product lines.


Staff engagement - Our people are a major differentiator for LV= and are crucial to delivering our best loved vision so it is important they are engaged with the work we do. We have an engagement score of 83% in line with that of the Willis Towers Watson high performing Organisations index norm (83%).
Looking ahead

**Group Strategy**

LV= is at its best when it is **agile** and **entrepreneurial** and we increasingly expect LV= to become the **challenger brand** in this industry. In a changing financial world, our approach remains consistent; earning the trust of our customers and members by **providing good value backed up with great values**.

To help deliver on this ambition we have recently launched a clear and simple **blueprint** for the future of LV=.

- Build a business that is sustainably **Lean & Strong** so we can achieve our goals over the long term whilst continuing to grow member value.
- Deliver **Green Heart Experiences** for our customers, colleagues and members, designing and delivering solutions that prevent as well as fix - and inspire total trust.
- Harness the latest technologies, evolve how we operate, and bring in the new talent needed to ensure that we lead the industry today and into the future. We have termed this **LV=3.0**.

**Capital**

Following the transition to the **Solvency II** regulatory regime we will continue to focus on **reducing the balance sheet exposure to volatility** in risk free interest rates and other market changes and carry out further management actions to strengthen the capital position and bring the group’s capital surplus and operational liquidity within risk appetite. A further aspect of managing our future capital position is the group’s recent application to the PRA to move onto an **Internal Model**.
Looking ahead

**General Insurance**

- Over the next five years we expect to see significant disruption in the general insurance market. We expect to fully play our part in this and our focus is in two areas:
  - Combining the **best of technology** with the excellent **human customer service** for which LV= is well known.
  - Addressing the market impacts of **new technology** as car manufacturers move from partial automation to full automation.

- Our general insurance business is strongly positioned in all our markets with **excellent customer service**, exciting digital offerings in development, and a strong brand franchise. We are **investing in technology** to improve the customer experience and eliminate waste.

- We are expecting to see the **improvements in underwriting profits continue** in 2017, subject to the usual caveats about bad weather, large losses and the negative impact of Ogden discount rate change. We have re-priced our motor business to take account of the higher expected claims costs going forward.

**Life**

- Across our retirement and protection businesses **financial advisers will remain our primary distribution channel** and we are making **smart investments in digital solutions** to make it easier for them to do business with us while at the same time reducing our costs.

**Retirement Solutions**

- With the support of Wealth Wizards, our ground-breaking **low cost robo-advice solution** (LV= Retirement Wizard) and our new **Pension Compass service** are gaining real appeal and firmly evidence our distinctive ability to **deliver modern advice solutions** for today’s market.

- The **trend towards blended solutions** that we identified in 2015 has continued and we have seen increased sales of annuities 9%, flexible guarantee bonds 12% and equity release products 62%.

- We continue to focus on developing our **market leading propositions** and, with continued high levels of customer satisfaction, remain confident that we can continue to challenge the industry to ensure customers get the best possible outcome for their at-retirement income.

**Protection**

- We have made significant investment in **transforming our protection business** through the launch of **Fastway**, our new quote and apply system, providing a **faster and more intuitive** application journey and enabling more clients to be covered quicker.