Resolution Limited

Annual report and accounts 2010

Value driven restructuring in financial services

Operational highlights

Increased cash delivery and strong capital position maintained

- available shareholder cash increased to £1,067 million at 31 December 2010, from £510 million at 31 December 2009
- successful completion of the testing exercise regarding the re-attributed inherited estate
- proposed rebasing of final dividend to 12.57 pence per ordinary share, up 15% on the prior period
- intention to increase the 2011 dividend to 18.85 pence per ordinary share
- the Board will continue to keep under review the appropriateness of the Company moving to a growing dividend, from the rebased level, by the end of the UK Life Project
- strong capital position maintained; estimated IGCA surplus as at 31 December 2010 of £2.3 billion

Restructuring and strategic re-positioning on track

- the acquisitions to date have an attractive blended average acquisition price (net of external debt) of approximately 66.9% of net MCEV
- anticipated cost synergies increased to £112 million per annum before tax by end 2013
- financial targets re-confirmed and on schedule for delivery
- good progress with integrating the businesses
- management team strengthening continues

Profits focused on value

- IFRS operating profit before tax of £275 million (including £71 million for the four month post-acquisition period for the AXA UK Life Business)
- MCEV operating profit before tax increased to £412 million (including £87 million for the four month post-acquisition period for the AXA UK Life Business)
- value of new business up 9% to £145 million driven by the non UK businesses; Lombard increased its value of new business by 38% to £83 million
- UK remains challenging but expense reductions continue: new business strain reduced from 18.9% of APE to 16.6% of APE

Outlook

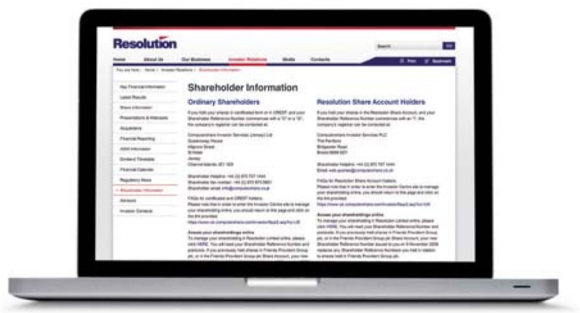
- confidence that the UK life project will achieve its targeted returns for shareholders, without the need for further acquisitions
- no contemplation of acquisitions which would dilute project returns, creating a high threshold
- focus on cash delivery for shareholders remains a priority

Resolution Limited online
www.resolution.gg

Register for online annual reports

To receive shareholder communications electronically in future, including your annual reports and notices of meetings, please go to: **www.resolution.gg**

If you currently do not receive communications electronically but would like to, please register your email address online at http://www.resolution.gg by going to the Investor Relations page and clicking on the "Shareholder Information" link on the left-hand side of the screen.



Overview

Business review

Governance

IFRS financial statements

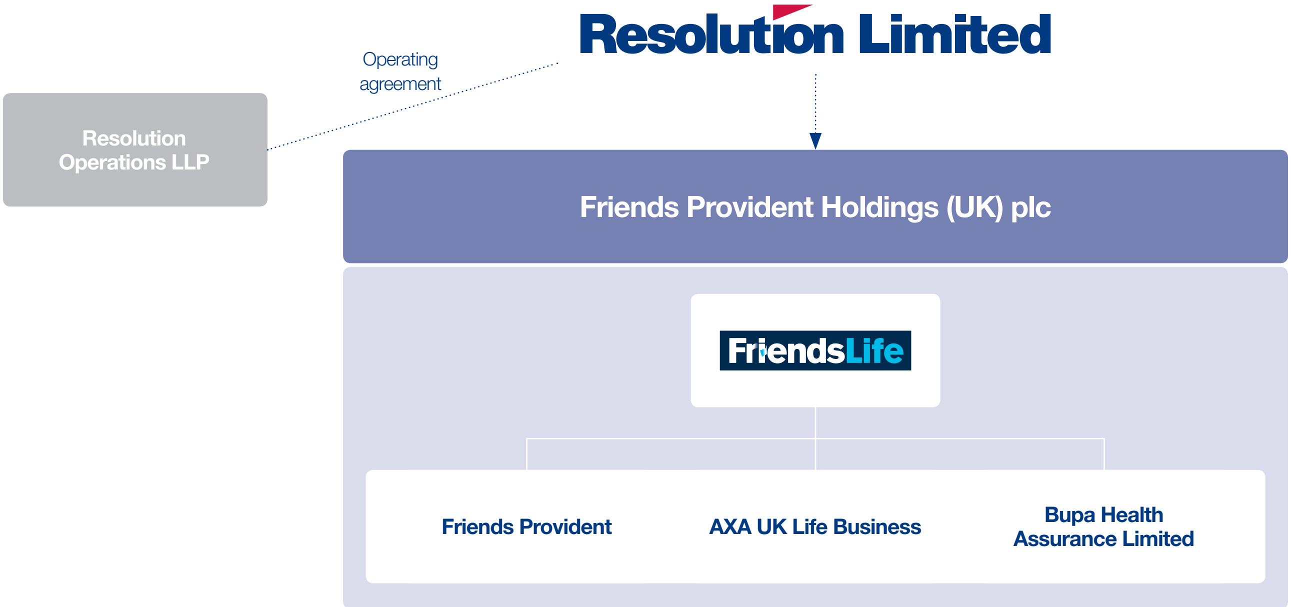
MCEV financial statements

Additional information

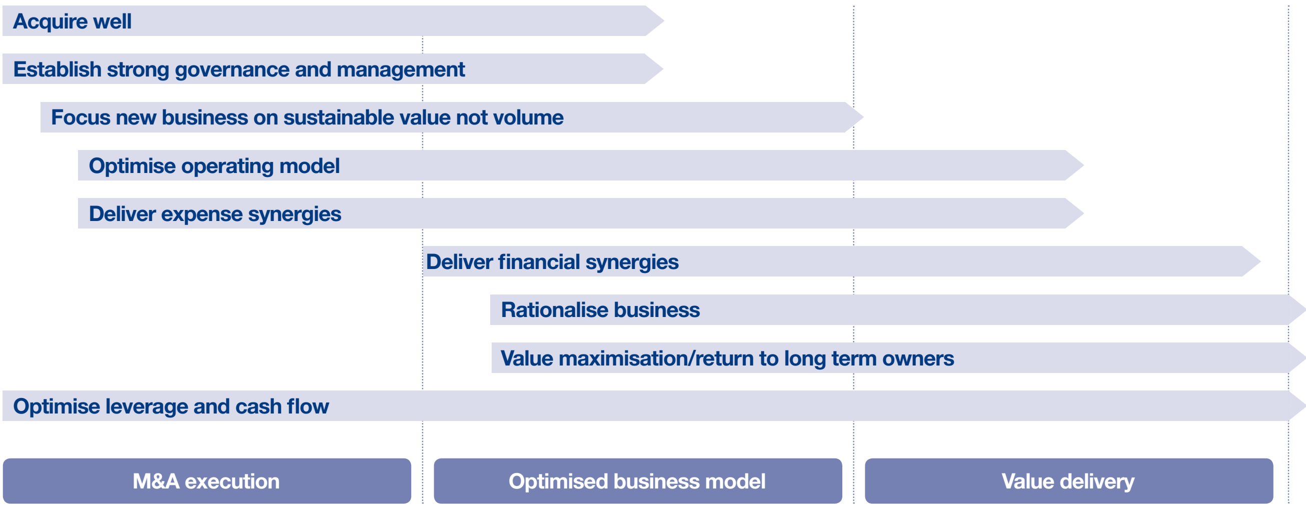
Who we are

Resolution Limited was incorporated in Guernsey to provide public markets with a series of restructuring opportunities in the financial services industry within UK and Western Europe. The Company's current restructuring project is the UK Life Project. During the year the Group completed the acquisition of the majority of the AXA UK Life Business.

Our structure today



What we do



Overview

"2010 was an important year for the Company. The acquisitions we have made and the clear strategic plans we are implementing underpin the Board's confidence that the project will deliver its targeted mid-teens returns."

Michael Biggs Chairman

Overview

In 2010 the Company continued its consolidation strategy and was pleased to announce on 24 June 2010 the acquisition of the majority of the UK life and pensions business of AXA UK plc ("AXA UK") which completed on 15 September 2010. The Company was also pleased to announce the acquisition of Bupa Health Assurance Limited ("BHA") on 15 October 2010 which completed on 31 January 2011. The combination of these businesses with Friends Provident, acquired in 2009, create one of the leading life assurance providers in the protection and corporate pensions markets in the UK. The UK business will be re-launched at the end of March 2011 under the brand Friends Life.

The enlarged life assurance group comprises a significant provider in the UK (Friends Life), the largest IFA distribution network in the UK (Sesame Bankhall), a specialist estate management business in Luxembourg (Lombard) and a provider of unit-liked life products internationally (Friends Provident International "International"). Lombard and International have strong positions in their respective markets and have generated good levels of performance in 2010. The priority for these businesses in the next few years is to maintain their momentum in winning profitable market share and focusing on cash generation and payment of dividends to the Group. Following completion of the AXA UK Life Business acquisition the Company has conducted a comprehensive strategic review of the UK business focusing on product offerings, costs, cash and capital management. The conclusions of this review were released to the market on 23 February 2011 and are discussed in further detail in Resolution Operations LLP ("ROL")'s operating report which follows this statement.

As the 2010 results confirm, the UK businesses have not performed to a satisfactory level during 2010. The Board is confident that the steps to be taken following the strategic review to narrow the products and distribution channels, focus on value rather than volume, and reduce costs and new business strain will put the UK new business activities onto a sustainable footing. The strategic review has also enabled the Company to conclude that it can meet its target mid-teens percentage gross internal rate of return[i] over the duration of the UK Life Project without the need for further acquisitions.

The Company was established in 2008 with a broad mandate to engage in restructuring projects within the financial services industry in the UK and Western Europe. The Company decided that its first project would be the UK Life Project and the three acquisitions to date have created a business with a net Market Consistent Embedded Value ("MCEV") of £6.5 billion at the end of 2010.

Corporate governance

The Company was pleased to announce the appointment of Jacques Aigrain, Gerardo Arostegui and Mel Carvill to the Board as independent non-executive directors with effect from 1 February 2010. The Company was also pleased to welcome Tim Wade to the Board with effect from 19 May 2010. All have experience and expertise across the financial services industry.

(i) The gross internal rate of return is calculated before payment of the Value Share and is the rate of interest such that the present value of all investor cash flows is zero. Investor cash flows are the net investor outflows and investor inflows. The investor outflows include the initial fund raising by the Company (including issue costs) and future shareholder investments (for example, by way of rights issues or issue of shares as consideration for an acquisition); the investor inflows include all dividends and returns of capital made by the Company, whether by cash or the distribution *in specie* of shares in acquired businesses to shareholders or otherwise.

12.57p
Final dividend

18.03p
Total 2010 dividend

18.85p
Intended 2011 total dividend

Dividend policy

As previously announced, following the acquisition of the AXA UK Life Business, the Board reviewed the Company's dividend policy and confirmed an annual dividend of 16.39 pence per ordinary share (reflecting the impact of the rights issue and share consolidation on the number of outstanding shares).

After due consideration, the directors have decided to propose an increase in the final dividend of 15% to 12.57 pence per share, which brings the total dividend for the year to 18.03 pence per share. Subject to approval by shareholders at the AGM, the dividend will be paid on 26 May 2011. In line with previous dividends, shareholders will be offered a scrip alternative in respect of the final dividend.

The Company intends to increase the 2011 dividend to 18.85 pence per ordinary share.

As the Group progresses towards the end of the UK Life Project, the Board intends to keep under review the appropriateness of the Company moving to a growing dividend.

ROL

Resolution has an operating agreement with ROL, which has a highly experienced management team. ROL provides a number of important services to Resolution. These include: (i) assisting the Company with the origination and completion of new acquisitions, (ii) assessing Resolution's funding requirements, (iii) advising on the reorganisation of completed acquisitions and monitoring their progress, and (iv) assisting with the disposal of assets. The directors of Resolution are, however, responsible ultimately to shareholders for consideration of these matters and for overseeing the delivery of all services provided by ROL. In view of the importance of these activities, ROL, through its Chief Executive, John Tiner, has been requested by the Board to provide an operating report. This is included immediately after my statement.

Other projects

The Company announced on 23 February 2011 that it is confident that it will achieve its targeted mid-teen returns on the UK Life Project without further acquisitions and that the Company and ROL recognise that shareholders do not currently wish to blend returns from the UK Life Project with those from other projects shareholders may wish to support.

As envisaged at the time of the Company's IPO in 2008, ROL was engaged to develop proposals for a number of projects for consolidation in Western Europe in one or more of the life assurance, asset management, general insurance, banking and diversified general financial sectors. The first of those projects was the consolidation of UK life insurance and asset management, the UK Life Project. The Company, in conjunction with ROL, is determined to complete the UK Life Project to deliver its targeted mid-teen returns.

The Company understands that ROL has new projects within the wider scope of the Company which may proceed in 2011. In light of this, ROL has discussed with the Company how ROL could undertake new projects outside of Resolution. The Board is considering the scope and extent of changes needed to the Operating Agreement for this, whilst at the same time ensuring the successful completion and value delivery of the UK Life Project.

Any proposed changes to the Operating Agreement would seek to achieve three objectives; firstly that ROL remains committed to overseeing the successful completion of the UK Life Project and will continue to (a) advise Resolution on all opportunities within the scope of the UK Life Project; (b) oversee the integration and implementation of the Friends Life strategic review; and (c) advise RSL on exit strategies for the UK Life Project to maximise returns for the Company's shareholders; secondly that returns from the UK Life Project will not be blended with those from other projects; and thirdly that new ROL sponsored projects in other vehicles would not compete with the UK Life Project.

The Board will continue to listen to the views of shareholders and will in due course, if appropriate, present a recommendation to shareholders on the scope and extent of any proposed changes to the Operating Agreement. Any changes to the Operating Agreement would require approval by ordinary resolution of the Company's shareholders.

Outlook

The Board is confident that Resolution will achieve its targeted mid-teens returns on the UK Life Project. Its focus is on the continued integration of the businesses and the delivery of the announced targets on cost synergies, new business strain, cash flow per annum and returns from its product strategies.

Michael Biggs
Chairman

Operating report by Resolution Operations LLP

"The delivery of cash in 2010 shows early value for shareholders. The non UK businesses are performing well and generating value. In the UK our restructuring and strategic repositioning continues. As we deliver operationally these businesses will generate valuable growth and cash rewards for shareholders."

John Tiner Chief Executive, Resolution Operations LLP

Introduction

2010 was an important year for the Company as it continued the successful execution of its consolidation strategy in the UK life assurance market.

During the year, the Company announced the acquisition of the AXA UK Life Business and BHA. Following completion of the AXA acquisition in September the Company started a strategic review of the enlarged business and announced the outcome of that review to the market on 23 February 2011.

The strategic aim of the Company is to create a business which has a clear and strong future cash flow profile; is successful in winning new customers while at the same time generating good returns; and delivers the target mid-teens returns on the UK Life Project. Based on the outcome of the strategic review summarised below, the Company has confirmed that it is confident that it can meet its mid-teens target return for the UK Life Project from the three acquisitions to date.

The UK business will focus on providing customers with individual protection, group risk, corporate pensions and annuities products delivered through distribution partners where the Group is able to establish strong and long-term business relationships. In combination with the successful overseas businesses, the Group is targeting an IRR on new business of at least 15% per annum by the end of 2013. The review has also underscored the Company's confidence in achieving its distributable cash target of £400 million per annum after interest costs from 2011 onwards.

The Company is now well into the integration phase of the project and the work carried out to date has enabled the Company to increase the level of expected annual cost synergies from £75 million announced at the time of the AXA UK life acquisition to £112 million.

Set out below are ROL's comments on the:

- market environment;
- UK Life Project;
- business performance in 2010; and
- business leadership.

Market environment

While 2009 was characterised by extremely weak market conditions during the first six months followed by a muted recovery during the second half of the year, 2010 has been a relatively more stable year. Fears of a double-dip recession abated but there remained risks to the downside, notably in relation to potential sovereign default, where it has been necessary to make available to heavily indebted countries in Western Europe funds from the European Financial Stability Facility and the International Monetary Fund. The Group has relatively immaterial exposure to these countries.

The macro environment continues to present significant challenges to policymakers: the re-emergence of inflation; geopolitical risks; rising oil prices; and, the consequences of the terrible events in Japan, all present risks to global growth prospects.

The UK life assurance market also faces a number of significant policy developments which will influence the shape of the market in the future: Solvency II; the Retail Distribution Review ("RDR"); auto-enrolment; and gender neutral pricing.

Mid-teens returns on UK Life project
on track

Target new business IRR of 15%+
on track by end of 2013

DCT of £400m
on track from 2011 onwards

Cost synergies increased to £112m per annum
integration on track

Solvency II is a major undertaking for the entire insurance industry. For the major players the preparations are complex and costly and the business implications remain uncertain. While Solvency II may well be a catalyst for better risk management across the industry, it does not seem at all clear that the very substantial investments made by the industry will produce better outcomes for UK policyholders or shareholders. There also remains uncertainty over the treatment of the so-called illiquidity premium in determining the discount rate applicable to annuity business. The private pension market is an essential means of saving for retirement in the UK and policymakers must consider carefully the implications of policy on the UK's ageing population. The Group preparations for Solvency II are on track.

From 2013 the structure and economics relating to the distribution of savings products will change substantially as the FSA's RDR is implemented. Overall, given the Group's product mix, we do not expect that the RDR will have a major impact on the Group. The Group has studied closely the economic viability of offering savings and investment products to the mass market following the changes to be brought about by the RDR and has reached the conclusion that the combination of the investment needed to build RDR compliant point of sale and operating platforms, the likely margins available and the projected volumes, will not generate adequate returns for shareholders. Therefore the Group do not plan to actively market investment products post-RDR.

Auto-enrolment, whereby all employees above the age of 22 earning more than £7,475 are automatically enrolled into a qualifying scheme (of which NEST is one) will impact the corporate pensions market from 2013 onwards, with a substantial transitional effect in 2013 and 2014 and a more steady impact thereafter.

The European Court of Justice has recently ruled that, as from 21 December 2012, it will be unlawful to use gender-related factors for determining premiums and benefits under insurance policies. Member states must change domestic law so that it complies with the ruling from 21 December 2012. This may have a significant impact for many insurers in Europe which use gender as a risk factor for pricing life insurance policies.

Overall, we believe that the UK life assurance market environment has improved during the last year or two from an investor perspective. A number of companies have responded to the demands from shareholders for greater transparency and have increased the focus of their business and of their reporting on cash flow, capital management and returns. However, issues of over-capacity, regulatory uncertainty and unclear profitability remain. Shareholders continue to demand greater transparency and a focus on value and cash over volume.

UK Life Project update

The UK Life Project comprises three overlapping phases:

1. Acquisition: where the Company's primary focus is on acquiring suitable businesses;
2. Integration: where the focus shifts to integrating and optimising the business models of acquired businesses; and
3. Value delivery for investors.

Acquisition

The aim of the acquisition phase is to acquire sufficient scale and capability at suitable prices to allow the realisation of value and the generation of target returns through synergies realised from effective integration of acquired businesses and the optimisation of business models.

To date the Company has completed three acquisitions:

- Friends Provident plc in November 2009 for £2.01 billion;
- AXA UK Life Business in September 2010 for £2.75 billion; and
- BHA in January 2011 for £168 million.

The embedded value of the acquired businesses amounts to £6.5 billion in aggregate, net of debt, on an MCEV basis as at 31 December 2010. The three acquisitions to date have a blended average acquisition price (net of external debt) of approximately 66.9% of net MCEV.

We continue to follow closely the activities of other life assurers in the UK market, since the Company has a responsibility to shareholders to bring them acquisition opportunities which would be clearly accretive to the Group's project returns. It follows naturally that any such transactions would need demonstrably to add to the mid-teens return on the project that we are already confident of achieving. However, the weight of our focus on the UK Life Project, which remains as committed and intense as it has been since launched in August 2009, has nonetheless shifted to the integration phase.

Integration

Separation and integration

The Group has been working intensively on the separation and integration of the AXA UK Life Business. The 100 day plan to secure the leadership and control of the acquired business has been completed. There are 75 transitional service agreements between Friends Provident and AXA, the majority of which will be closed in 2011 and the Part VII business transfers are progressing on track.

Integration planning and implementation is also progressing well. The detailed work carried out since completion has lead to the Company revising its expectation of cost synergies from £75 million per annum at the time the transaction was announced in June 2010 to £112 million, to be substantially achieved by the end of 2013. This compares to a cost baseline, including BHA, of £476 million. The one-off costs to realise these ongoing annual savings have increased from £76 million estimated when the acquisition was announced to £117 million.

The Group's launch of a new unified brand for its UK life businesses, Friends Life, by the end of March is on track. Later in the year a single service company will be established to support all of Friends Life's operations.

Strategic review

Following completion of the AXA UK Life Business acquisition in September 2010, the Company carried out a strategic review of the Friends Life UK operations focussing on product propositions, distribution channels and cash and capital management.

Products and distribution

The UK business strategy is centred on three key business lines: Individual Protection; Corporate Pensions and Risk; and Annuities.

Individual protection
Friends Life will build on its market-leading positions in Critical Illness Cover and Income Protection; introduce simplified term assurance targeted to the family and over 50's segments; and further develop profitable distribution segments and exclusive partnerships. This improved product mix and focused distribution, along with sales and marketing synergies, and consolidating the new businesses onto a single platform will improve returns significantly. Since the market announcement in February, the Group has concluded that the platform acquired with BHA would be the strategic platform for the future.

Corporate Pensions and Risk
The current financial returns from Friends Life's Corporate Pensions business are unacceptably low. The market is evolving, and its structure from 2013 onwards is uncertain due to the RDR and the introduction of auto-enrolment.

Friends Life has the advantages of a comprehensive range of defined contribution solutions, an integrated online workplace savings platform and a full range of group risk products, as well as the scale and relationships to be a major and profitable player, but it is not prepared to write loss making new business in anticipation of future reward. It will reshape the sales and marketing teams into more focused distribution and selectively migrate schemes to the more efficient Friends Provident NGP (New Generation Pensions) platform to improve returns on new business.

Group income protection is offered by the Friends Provident and BHA businesses. This market is dominated by a few market participants and price competition is high as competitors are keen to retain existing schemes. Friends Life will combine the Friends Provident and BHA businesses.

Annuities
Friends Life will have vesting pension claims in excess of £2 billion in 2011, growing steadily in subsequent years. Both Friends Provident and the AXA UK Life Business have historically retained only a small proportion of their available vesting pension funds as annuity new business. This is in part because of under-investment in the expertise required to underwrite and manage annuity business profitably. Following completion of the strategic review of product propositions, Friends Life continues to believe that the pension annuity market is attractive and intends to build its own capability in annuity underwriting, credit management and longevity risk management; while not ruling out acquiring capability via a bolt-on transaction should the opportunity arise.

Friends Life's immediate objective in the annuity market is to retain a larger proportion of vesting pension funds, and will aim to raise its retention rates from 30% of vesting amounts (excluding tax free cash) to at least 50% by 2013. As it has low exposure to longevity risk (as a result of past longevity risk hedging activity), and as the annuity market currently has attractive IRRs and Value of New Business ("VNB"), Friends Life has appetite to write more annuity business than available from its vesting pensions, and so in due course will examine options to enter the open market option ("OMO") market.

The financial targets for the product propositions from the end of 2013 are as follows:

	VNB £m	NBS(i) £m	IRR %
Protection	80	30	20
Corporate Pensions	25	75	10+
Annuities	50		15+

(i) New business strain.

In overall terms, the Company is targeting an operating return on embedded value of at least 10% per annum by 2013 on the FPH business as it is currently constituted.

Cash and capital management

At 31 December 2010, available shareholder cash was £1,067 million. The Company has defined a DCT of £400 million per annum, comprising cash and capital (excluding investment variances and one-off costs) that can be released from the Friends Life business without reducing the capital base of the Company, after meeting interest costs. The Company expects FPH to achieve this target from 2011 onwards. Over time, the amount will be fully driven by cash emergence from the back book, less the strain associated with writing new business and the associated movements in capital requirements, but in the near term will include releases of working capital and capital synergies.

The cash and capital position is impacted by the testing every five years of the reattributed inherited estate ("RIE") within the non-profit funds of Friends Life Company Limited ("FLC", formerly AXA Sun Life plc) to determine whether it is possible to transfer funds to the shareholders' fund and/or to distribute any of the inherited estate retained in the Old With Profits Fund ("the Old WPF"). As at 31 December 2010, the RIE was £2,437 million.

The latest five yearly test was undertaken as at 31 December 2010 and resulted in the FLC Board making:

(a) a transfer of £1,010 million of RIE from the non-profit funds to the shareholders' fund; and

(b) a distribution of £157 million of the inherited estate in the Old WPF, which will be split 90% to with-profits policies allocated to or reinsured to the Old WPF in the form of a Special Bonus and 10% to the FLC Shareholders Fund.

The cash transferred to the FLC Shareholders Fund will support the Group's ongoing capital requirements, the DCT, and form part of the wider capital plans of the business, which are currently being reviewed. The Company has advised the market of its intention to provide a wider update on capital in May 2011.

The Company continues to examine its capital structure and will seek to optimise required capital and reduce working capital. In designing the capital structure, the Company will ensure that due consideration is given to the options around exit and leverage.

Value delivery

The Company is committed to securing an exit for shareholders so that the value created by Resolution's UK Life Project can be crystallised. Exit options will be developed in due course and could take several forms:

- a cash sale, together or in parts, of the FPH businesses;
- a direct listing of FPH as a standalone entity;
- a separation of the UK open business from the UK back book leading to a separate sale or listing(s), or
- a merger with another life company.

Business performance

The reported performance for the year and comparisons to the prior year are complicated by the acquisitions to date occurring part way through each of the last two years and also by the dual reporting bases of IFRS and MCEV.

The business review following this report sets out a detailed commentary on the 2010 performance on both an IFRS and MCEV basis including, where relevant, like for like comparisons with 2009.

The IFRS operating profit before tax was £275 million, including £71 million for the AXA UK Life Business for the four month post acquisition period, compared to £6 million in 2009.

The MCEV operating profit before tax was £412 million, including £87 million for the AXA UK Life Business for the 4 month post-acquisition period, compared to £41 million in 2009.

Overall, the results for the year in contrast to 2009 reflect:

- increased annual management charges arising from higher investment markets;
- reduced expenses in the UK offset by weaker new business performance in protection and corporate pensions, where the markets remain challenging, and the effects of improved annuitant mortality assumptions;
- a strong all round performance by Lombard, which reports new business value up by 38% on 2009; and
- the non-recurrence of significant negative operating assumptions in International in 2009.

The net MCEV at the end of the period was £6,515 million reflecting the acquisition of the AXA UK Life Business but not including BHA.

The balance sheet of the Group also remained strong with an Insurance Group Capital Adequacy ("IGCA") surplus of £2,317 million at 31 December 2010.

Based on the 2010 results the current position and targets for 2013 onwards (except where noted) are summarised below:

	Current (baseline)	Target
New business strain (£m annualised)	372	172
UK individual protection IRR (%)	2.7	20
UK corporate pension IRR (%)	6.2	10+
UK annuities IRR (%)	16.5	15+
Blended group new business IRR (%)	11.2	15+
Cash dividends from non-UK businesses (£m)	2	50
DCT (£m)	746	400[i]
FPH ROEV (%)	8.3[ii]	10+

(i) Target for 2011 onwards.
(ii) Operating return after tax.

Business leadership

A leadership team comprising executives from both Friends Provident and the AXA UK Life Business has been in place since September 2010, led by Trevor Matthews. Trevor will continue in this role until Andy Briggs joins the group as CEO of Friends Life in July 2011, at which time Trevor will become Vice Chairman focusing on external relationships including with major distribution partners.

Other projects

ROL and other members of the Resolution Group continue their research and development activities in other financial services sectors and geographies which may benefit from the team's restructuring skills, be capable of delivering attractive returns, and be of interest to investors.

This research and development work suggests that there are opportunities in the asset management sector, either as a standalone consolidation project, or as part of the UK Life Project if there is the potential for synergy benefits with the Friends Life business. The Resolution Group has undertaken substantial development work into possible projects involving the consolidation of books of in-force life assurance policies in both the US and Continental Europe, and believes such projects have the potential to provide interesting investment opportunities in the near to medium term.

Conclusion

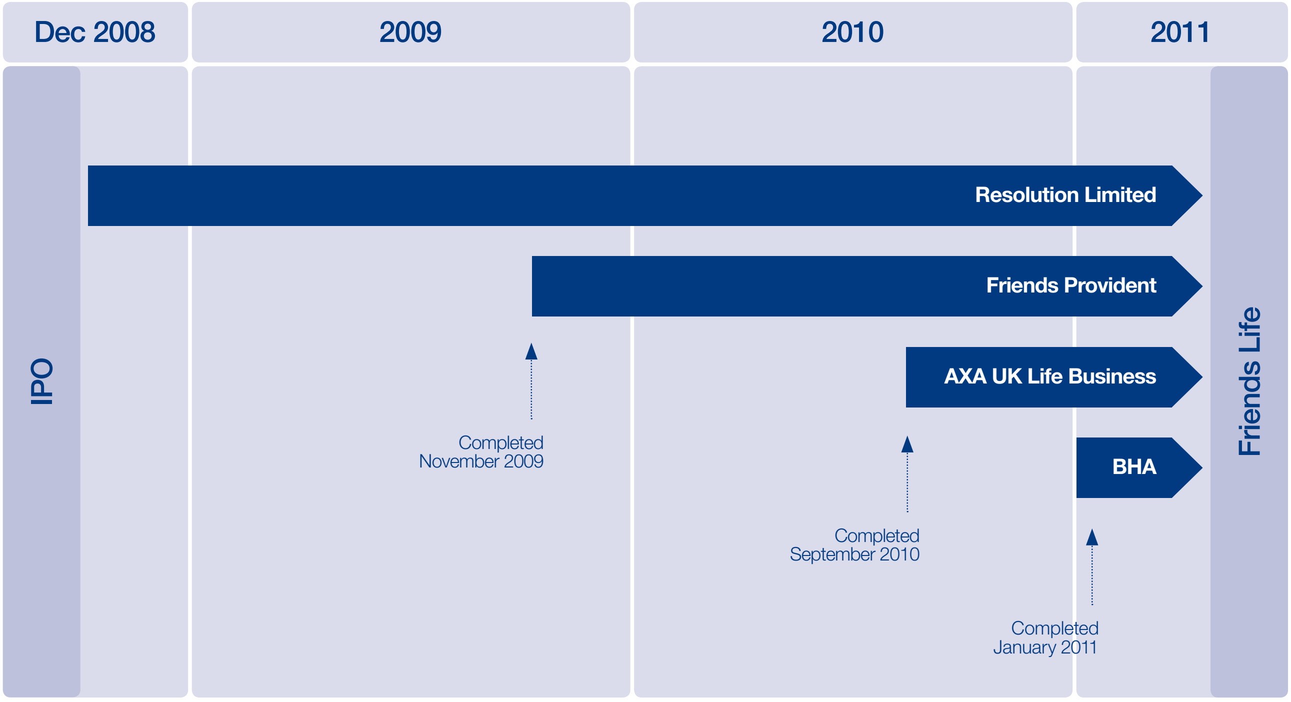
We and the Company remain grateful for shareholders' support. Our focus remains on helping the Company to successfully deliver its target mid-teens returns on the UK Life Project.

John Tiner
Chief Executive, Resolution Operations LLP

Business review

Introduction

Resolution's results over the last two years clearly reflect the fact that the UK Life Project has been in its acquisition phase; the profile of IFRS and MCEV profits for 2010 and 2009 is dominated by the timing of the acquisitions of Friends Provident and the AXA UK Life Business. These financial statements include the results of the acquired businesses from the dates of their acquisitions, as set out below:



The results for 2010 therefore include:

- Friends Provident for the full 12 months of 2010; and
- The AXA UK Life Business for the period from 3 September 2010.

Included in the assets that were acquired within the AXA UK Life Business are certain portfolios of insurance business (the Guaranteed over Fifties, "GOF", and Trustee Investment Plan, "TIP" portfolios) that are expected to be transferred back to AXA UK via Part VII transfers as part of the separation process agreed between FPH and AXA UK. This transfer is anticipated to take place in the final quarter of 2011. The terms of the transfer were agreed as part of the transaction and the portfolios are treated as "held for sale" in the Group's accounts.

In addition, the shares of Winterthur Life UK Limited ("WLUK") are to be acquired by the Group once the businesses to be retained by AXA UK have been removed from WLUK. This acquisition is also anticipated to take place in the final quarter of 2011, once the GOF and TIP insurance portfolios have been transferred back to AXA UK. WLUK will only be included in the Group's accounts once the acquisition has taken place in 2011 and is not therefore included within these financial results.

Recognising the difficulty in gaining clarity on the performance of the underlying businesses from the published consolidated results, the business review includes full 2010 actual and 2009 comparatives for Friends Provident and the AXA UK Life Business, as well as the actual results for the periods of ownership.

The operating segment results section includes the IFRS based operating results of the acquired businesses for the full year 2010 with a comparison to the full year 2009, and, for the Friends Provident businesses, MCEV operating profit for the same periods. The AXA UK Life Business did not prepare MCEV information prior to its acquisition, consequently MCEV results for this business are only included from 3 September.

The results for the AXA UK Life Business and Friends Provident components are shown separately to provide clarity on the underlying results in the periods following acquisition. These businesses are managed as one segment and in future reporting periods the Group will not supply separate numbers for these components as the businesses are being integrated and will not be distinguishable as separate entities.

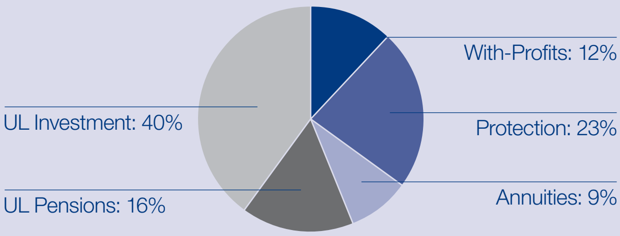
The acquisition of BHA completed on 31 January 2011 and consequently the results for BHA are not included in these financial statements.

Operating business overview

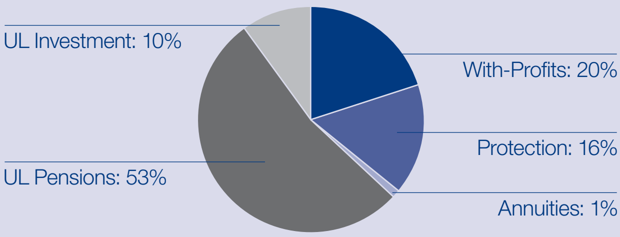
The life operating businesses are managed in three distinct segments. These are:

- The UK segment, comprising the UK life and pensions operations of Friends Provident; the AXA UK Life Business; and the UK distribution businesses, Sesame Bankhall Group Limited ("Sesame Bankhall") and (until its disposal in March 2010) Pantheon Financial Limited ("Pantheon"). BHA forms part of this segment from the date of acquisition, 31 January 2011. The life and pensions companies within the UK segment are long established entities with large "back books" of unit-linked life savings, with-profits savings and annuity business.

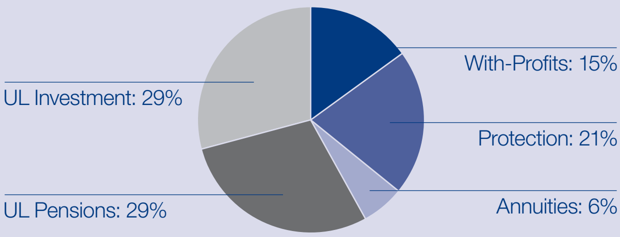
AXA UK Life Business VIF Analysis
£2,028 million



FP UK VIF Analysis
£1,243 million



Total UK VIF Analysis
£3,271 million



The charts show the relative profiles by product of the value of in-force profits ("VIF") of the AXA UK Life Business and Friends Provident UK life and pensions companies at 31 December 2010. The market facing activities involve offering defined contribution pension schemes and group protection to corporate customers, protection products (term life, critical illness and income protection) to consumers and annuities to maturing pensions customers. The alignment of the business units from the integration of the Friends Provident and the AXA UK Life Business sales and marketing operations is already largely complete, and plans are well advanced for incorporating the BHA business while protecting its market leading capabilities. At a recent presentation, the Group clarified its intention to continue to develop the UK business focusing on annuities, protection and corporate pensions. Within the UK, the Group does not expect to write significant volumes of individual unit-linked or with-profits savings business. The Group remains open to increments for existing customers and will continue to offer with-profits and unit-linked options as part of its pensions product.

- The International segment, comprising Friends Provident International Limited ("FPIL"); the overseas branch business of Friends Provident Life Assurance Limited ("FPLA"); a German distribution business, Financial Partners Business AG ("fpb"); and Friends Provident's 30% interest in AmLife Insurance Berhad ("AmLife"). The major component is FPIL which is an Isle of Man-based entity, manufacturer of unit-linked regular contribution savings and single premium bond products targeted at high net worth individuals via its distribution hubs in Hong Kong, Singapore and Dubai. fpb is responsible for the German distribution of products, largely unit-linked regular contribution pensions savings, manufactured in the overseas branch of FPLA. In December 2008, Friends Provident acquired a 30% interest in AmLife, a Malaysian life insurance company, majority owned by AmBank Berhad, a major Malaysian banking group. In 2010, AmLife was granted a Takaful licence to manufacture and sell Sharia compliant products. The Takaful subsidiary is expected to become active in 2011.
- Lombard, which is a leading pan-European life assurance business specialising in estate planning solutions for high and ultra high net worth individuals. The business, based in Luxembourg, offers innovative solutions, backed up by superior service, through private banks and high-end IFAs across Europe. The products offered are single premium, whole of life, unit-linked life assurance with the majority of the life exposure reinsured.

Key performance indicators

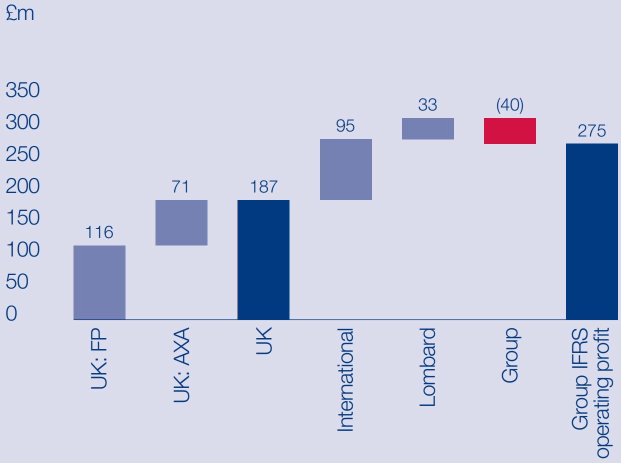
Key performance indicators, including Friends Provident business from 5 November 2009 and the AXA UK Life Business from 4 September 2010

	2010	2009 restated
IFRS based operating profit[(i)] (£m)	**275**	6
IFRS profit after tax[(ii)] (£m)	**820**	1,308
MCEV operating profit before tax (£m)	**412**	41
MCEV profit after tax (£m)	**460**	71
Group embedded value on an MCEV basis (£m)	**6,515**	3,488
FPH operating ROEV[(iii)] (%)	**8.3**	n/a
Group available shareholder cash (£m)	**1,067**	510
Estimated IGCA surplus capital (£bn)	**2.3**	1.0
Asset quality[(iv)] for shareholder related assets (%)	**95**	95

(i) IFRS based operating profit in 2009 has been restated to exclude the impact of investment volatility in the long-term funds. £14 million of positive investment return has been reclassified from operating profit to short-term investment fluctuations. This has no impact on profit after tax.
(ii) IFRS profit after tax in 2009 has been restated in accordance with improvements to IFRS 3 (Revised) issued by the IASB, resulting in an increase to the gain on acquisition of Friends Provident Group Limited of £119 million.
(iii) FPH operating ROEV is calculated as the MCEV operating return, after tax and financing, divided by the start of period net embedded value, and adjusted to allow for the timing of the rights issue, dividend payments, the acquisition of the AXA UK Life Business and the issue of debt during the year. A 2009 comparative has not been provided as FPH earnings in 2009 only cover the period from 5 November 2009 to 31 December 2009.
(iv) Corporate debt and asset-backed securities at investment grade or above.

KPI: **IFRS based operating profit**

2010: £275 million



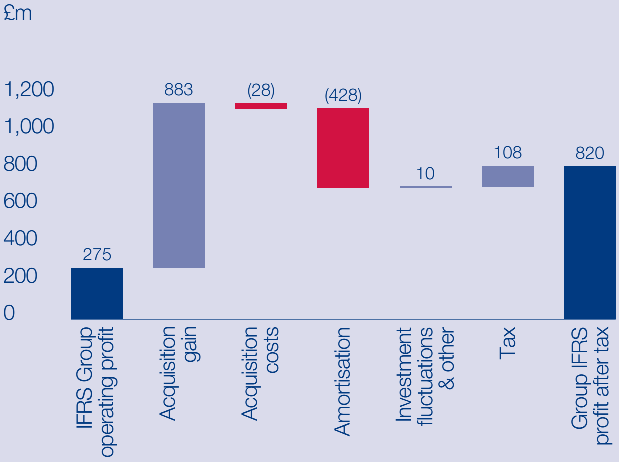
2009: £6 million[(i)]

(i) Restated.

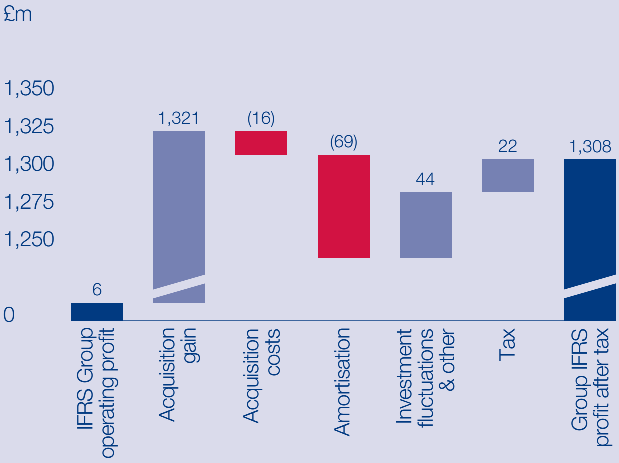
IFRS based operating profit before tax of £275 million in 2010 compared to £6 million in 2009. This reflects a full year of Friends Provident results and the post-acquisition four month results of the AXA UK Life Business. Operating profit for the life businesses of £315 million, offset by £40 million of corporate costs, demonstrates the good performance of the in-force book, with positive experience variances offsetting the impact of assumptions strengthening in respect of annuitant mortality. New business strain reflects good control over acquisition expenses, despite increased sales in International and Lombard businesses.

KPI: **IFRS profit after tax**

2010: £820 million



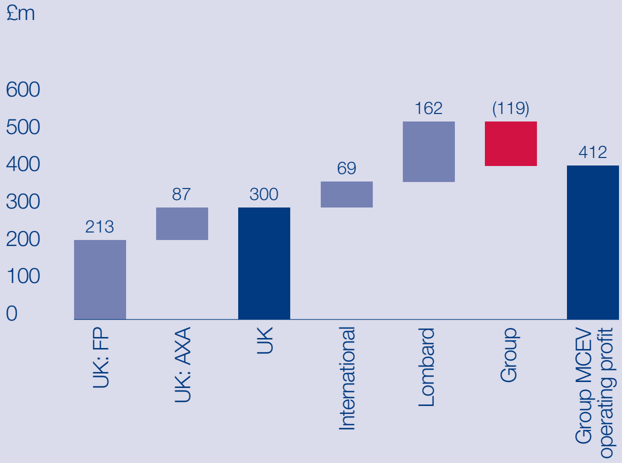
2009: £1,308 million



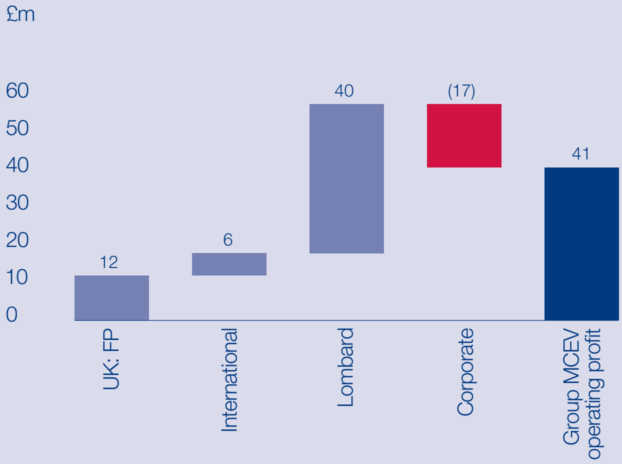
IFRS profit after tax of £820 million in 2010 compares to £1,308 million in 2009. This primarily reflects the differing gains on acquisition recognised for Friends Provident and the AXA UK Life Business together with the inclusion of a full year's amortisation of acquired value of in-force business and other intangible assets for Friends Provident in 2010.

KPI: **MCEV operating profit before tax**

2010: £412 million



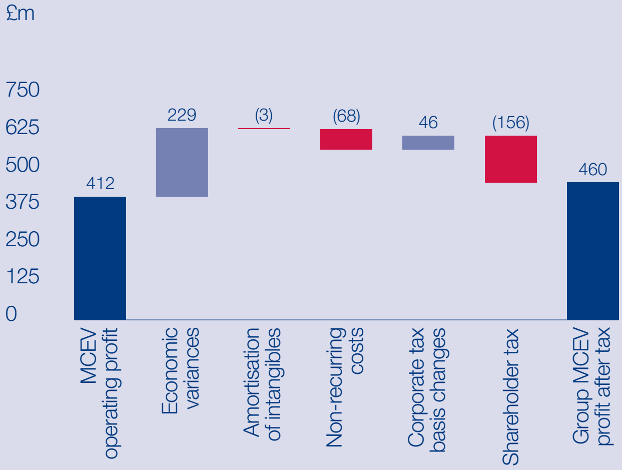
2009: £41 million



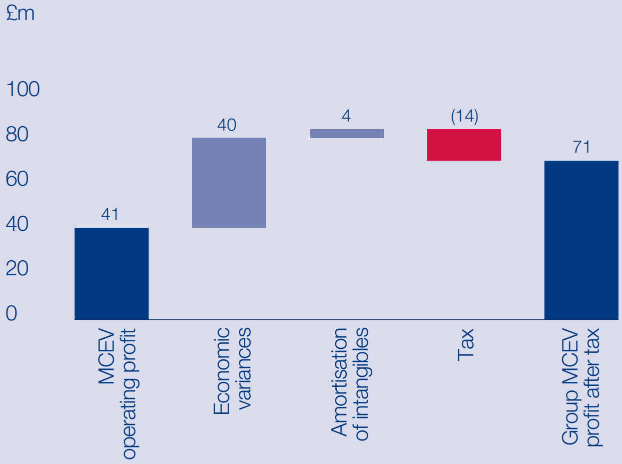
MCEV based operating profit before tax of £412 million in 2010 increased from £41 million in 2009, reflecting a full year of Friends Provident results and the post acquisition four month results of the AXA UK Life Business. Key drivers, in addition to the value of new business and the expected existing business contribution, include positive operating experience variances and economic variances offset by the adverse impact of operating assumption changes, cost of capital and development costs.

KPI: **MCEV profit after tax**

2010: £460 million



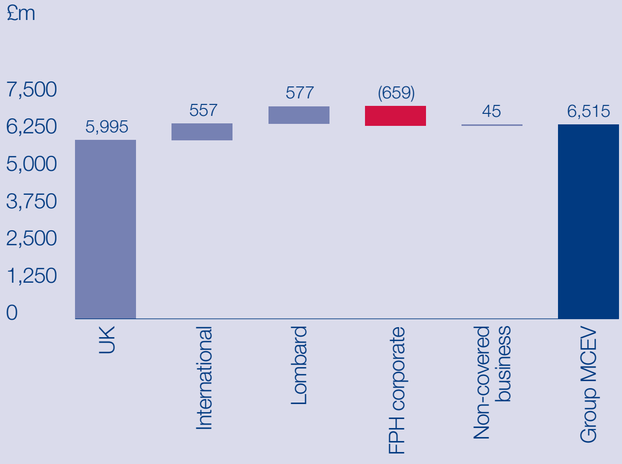
2009: £71 million



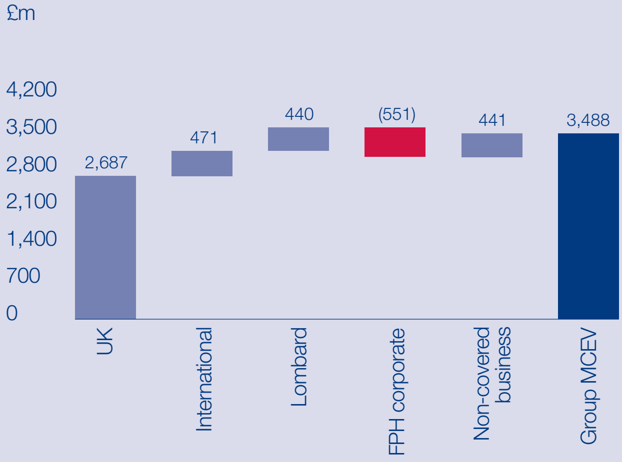
Economic variances, which reflect investment returns over and above the expected returns included in operating profit, have benefitted the results in 2010 more than the offsetting impact of changes to economic assumptions. Separation and integration costs, together with the costs relating to Solvency II and other finance transformation costs have been mitigated by the impact on the Friends Provident business of the change in tax rate (offset partly by the increase in VAT rate) set out in the Emergency Budget in June 2010.

KPI: **Group embedded value on an MCEV basis**

2010: £6,515 million



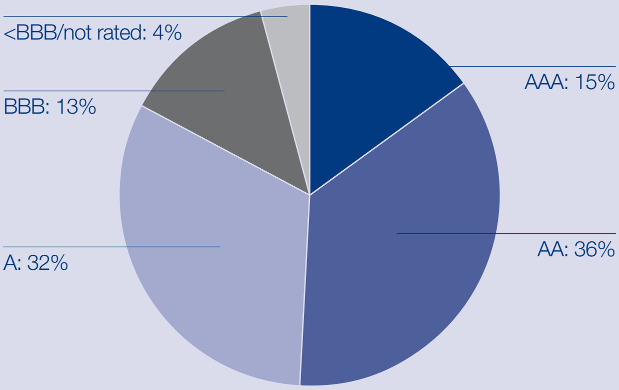
2009: £3,488 million



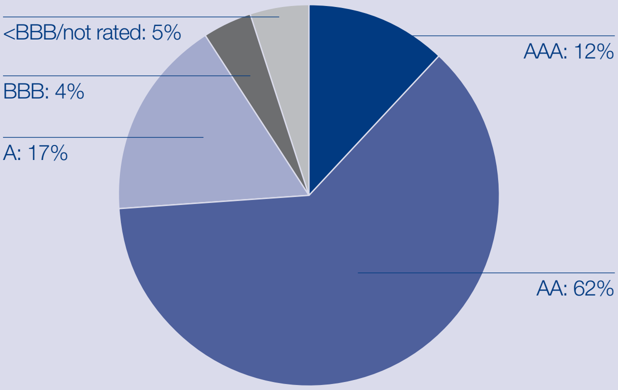
Group embedded value on an MCEV basis of £6,515 million up from £3,488 million in 2009 reflects the inclusion of the AXA UK Life Business (£3,498 million MCEV at 3 September 2010). The acquisition was funded by the proceeds of a rights issue by the Company, net of costs, of £1,979 million, short-term borrowings of £400 million and the issue of deferred consideration notes of £500 million to members of the AXA UK group. External dividends of £136 million were paid in cash in the year (the scrip dividend does not impact on MCEV).

KPI: **Asset quality**
(corporate debt and asset backed securities)

2010: £7.2 billion

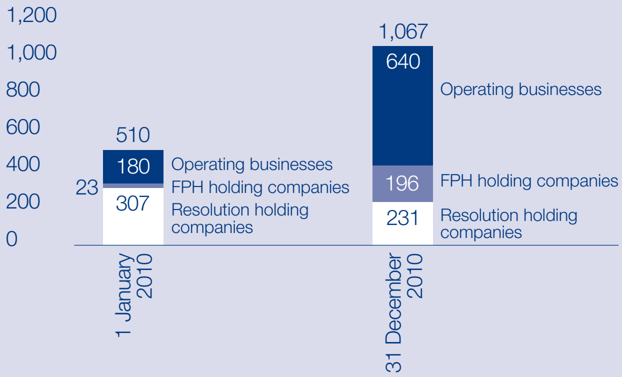


2009: £3.0 billion



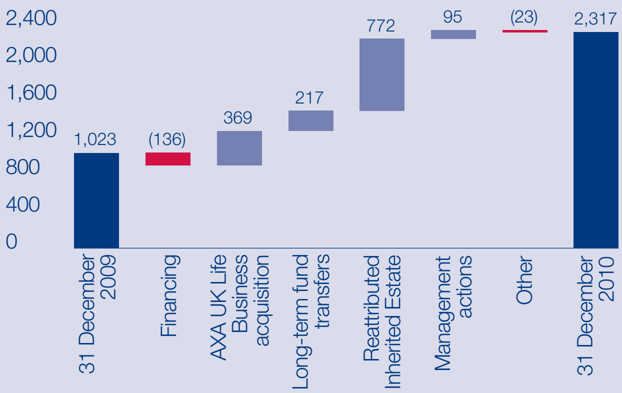
The quality of the Group's corporate debt and asset-backed securities portfolio remains high with an overall improvement in rating quality for a portfolio almost twice the size in volume terms compared to 2009.

KPI: **Available shareholder cash**



Group available shareholder cash of £1,067 million as at 31 December 2010 has increased significantly from £510 million at 31 December 2009, reflecting £810 million dividends paid or declared in respect of 2010 by the life businesses, including £300 million funded by the transfer to the FLC shareholders' funds from the RIE. This was offset by amounts retained for integration activities, payment of external dividends and other corporate costs.

KPI: **IGCA**



Estimated IGCA surplus capital at FPH level of £2.3 billion as at 31 December 2010, up from £1.0 billion at the end of 2009 reflects the positive impact from the acquisition of the AXA UK Life Business, the transfer from the RIE from the FLC non-profit funds to the FLC shareholders' fund, transfers from other long-term funds and the positive impact of management actions offset by financing costs.

IFRS profit

The Group's IFRS results are set out below, including a reconciliation from operating profit to IFRS profit before tax. The Group utilises the operating profit measure as management considers that this better represents the underlying performance of the business and the way in which it is managed. These results include the results of the acquired Friends Provident business and the AXA UK Life Business from the dates of their acquisitions, which are 4 November 2009 and 3 September 2010 respectively.

£m	RSL(i) 2010	RSL(ii) 2009 restated(iii)
UK		
– Friends Provident(iv)	**116**	11
– AXA UK Life Business	**71**	–
International	**95**	9
Lombard	**33**	4
Corporate		
– FPH	**(25)**	(5)
– Resolution(iv)	**(15)**	(13)
IFRS based operating profit before tax	**275**	6
Short-term fluctuations in investment return	**24**	12
Returns on F&C Commercial Property Trust	**23**	23
Acquisition accounting adjustments:		
– Amortisation of acquired in-force business	**(364)**	(59)
– Amortisation of other acquired intangible assets	**(64)**	(10)
Non-recurring items:		
– Gain on acquisition of businesses	**883**	1,321
– Costs associated with the business acquisitions	**(28)**	(16)
– Other non-recurring items	**(68)**	4
STICS interest adjustment to reflect IFRS accounting for STICS as equity	**31**	5
IFRS profit before shareholder tax	**712**	1,286
Shareholder tax	**108**	22
IFRS profit after tax	**820**	1,308

(i) 2010 results comprise 12 months results for the Resolution Group holding companies, 12 months for Friends Provident and four months for the AXA UK Life Business.
(ii) 2009 results comprise 12 months results for the Resolution Group holding companies and two months for Friends Provident.
(iii) Restated to:
a) reclassify £14 million of positive investment fluctuations on non-profit fund investments as short-term investment fluctuations; and
b) increase the gain on acquisition of Friends Provident by £119 million reflecting revaluation of STICS to fair value.
(iv) The Friends Provident operating result includes £19 million of interest expense in respect of the £700 million loan from Resolution holding companies. The corresponding interest receipt is included in the Resolution corporate result.

Operating profit

£m	UK: FP	UK: Ex-AXA	Int'l	Lombard	Corporate	RSL 2010
New business strain	(65)	(24)	(28)	(28)	–	(145)
In-force surplus	195	85	120	66	–	466
Long-term investment return	24	11	3	(4)	(14)	20
Reserving changes and one-offs	(15)	–	2	–	–	(13)
Development costs	(20)	(1)	(6)	(1)	–	(28)
FPH other income and charges	(3)	–	4	–	(11)	(10)
RSL other income and charges	–	–	–	–	(15)	(15)
IFRS based operating profit before tax	116	71	95	33	(40)	275

Operating profit is based on a longer-term investment return with the impact of short-term investment fluctuations shown separately as a non-operating item. In common with a number of life companies, the Group has amended its definition of operating profit to exclude the impact of investment volatility in the non-profit funds. This reduces operating profit by £14 million offset by a corresponding increase in short-term investment fluctuations for the two months to 31 December 2009.

IFRS based operating profit for 2010 was £275 million comprising operating profit for the life business of £315 million and £40 million of corporate costs. A detailed review of each segment is set out in the operating segment results section.

Overall, new business strain was £145 million, reflecting the inclusion of a full year's result for the Friends Provident businesses and the results for the four month post-acquisition period for the AXA UK Life Business. In the UK, Friends Provident new business strain improved due to a 10% fall in acquisition expenses against a smaller reduction in new business volumes. The AXA UK Life Business results for the post-acquisition period benefited from no longer writing commission paying pensions business although this was offset by continuing strain in the protection book.

Acquisition expense levels in the International business were held to a 7.6% increase whilst annual new business volumes rose by 24%, thereby mitigating the increase in strain that would otherwise have been experienced. In Lombard, new business strain remained flat year on year, despite a 10% increase in volumes.

Similarly, the in-force result for the period includes 12 months of Friends Provident results and four months in respect of the AXA UK Life Business. The main driver of in-force surplus improvement has been the stock market advances which have helped to generate higher annual management charges on increased funds under management across all business segments. The shareholders' share of the special bonus arising from the inherited estate five year testing has also benefited the in-force surplus by £16 million.

Longer-term investment returns on shareholders' funds in the life businesses have been adversely impacted by the payment of £462 million of dividends to the holding companies and the continuing relatively low level of current interest rates. This is offset, in part, by interest earned by the Friends Provident holding companies on the dividend receipts.

Principal reserving changes mainly affecting the Friends Provident result were largely driven by the strengthening for future improvements in annuitant mortality offset by the benefit of the re-negotiation of expense recoveries from the Friends Provident Life and Pensions Limited ("FPLP") with-profits fund in accordance with the Friends Provident demutualisation scheme.

Development costs of £28 million, which are reported consistently across IFRS and MCEV, include UK corporate investment platform development, Tesco distribution relationship, enhanced web security and ongoing development of the German operation and other International and Lombard business initiatives.

Corporate costs of £40 million comprise £14 million negative expected investment return and £11 million corporate costs in Friends Provident holding companies as well as £15 million corporate costs in Resolution holding companies. The expected return in the Friends Provident holding companies includes interest on the £700 million lower tier 2 debt issued to Resolution holding companies to fund the acquisition of the AXA UK Life Business (for which the income is included in the Resolution corporate result) and fees in respect of the revolving credit facility offset by the expected return on corporate assets. Friends Provident corporate costs include the impact of management incentive schemes.

The Resolution operating loss is a combination of £2 million investment return earned on the largely cash based assets of the holding companies, £19 million of interest received from Friends Provident on the £700 million lower tier 2 debt referred to above, offset by £18 million interest on the external debt, £13 million of fees payable to ROL, £1 million of directors' emoluments as well as £4 million of other professional fees and corporate costs.

Non-operating items

Short-term fluctuations in investment return of £24 million include the variance between expected and actual investment return on assets backing shareholders' and non-profit funds, with the benefit primarily driven by a slightly improved credit default allowance on the corporate bond portfolio to reflect current market conditions. As noted above, the 2009 short-term fluctuations in investment return have been restated to include £14 million of fluctuations relating to the non-profit funds.

In April 2010, the Friends Provident UK business reduced its holdings in F&C Commercial Property Trust ("F&C CPT") from 50.3% to 34.16% in order to manage the property exposure of the life funds. As a result, the Group is no longer required to consolidate the assets, liabilities and results of this investment trust and the results for the year therefore only include F&C CPT through to April. The £23 million return on F&C CPT in 2010 reflects the market return attributable to third parties for the period up to April; this will not recur in future.

Acquisition accounting adjustments, totalling £428 million, represent the amortisation of the intangible assets recognised on the acquisition of Friends Provident and the AXA UK Life Business in 2009 and 2010 respectively. These charges include £364 million of amortisation of acquired in-force business, and £64 million of amortisation of other intangible assets. The 2010 charge includes a full 12 month charge relating to the intangible assets recognised on the acquisition of Friends Provident with a four month charge relating to the intangible assets recognised on the AXA UK Life Business. The charges in 2009 relate to two months' amortisation accounted for in the period from the acquisition of Friends Provident to 31 December 2009.

Non-recurring items are a significant element of the Group IFRS profit before tax. The main item in 2010 relates to the gain on the acquisition of the AXA UK Life Business amounting to £883 million. Total transaction costs for the acquisition amounted to £104 million, compared to the £110 million estimated at announcement. Of this amount, £76 million has been charged to equity (in accordance with IAS32) and the balance of £28 million, including stamp duty, has been charged to profit. In 2009 the gain on, and cost of, acquiring the Friends Provident business was similarly recorded.

Other non-recurring items of £68 million include separation and integration costs of £34 million, capital optimisation costs of £3 million, finance transformation costs (including the costs of preparing for Solvency II) of £24 million and a charge of £7 million reflecting the one-off impact of the increase in the VAT rate to 20%.

Interest payable on the Friends Provident Step-up Tier one Insurance Capital Securities ("STICS") of £31 million is included as a deduction to corporate long-term investment return in the foregoing operating profit analysis, and is added back here to reflect the requirements of IFRS (where the STICS are accounted for as equity with interest being recorded as a reserve movement).

The total IFRS tax charge is £136 million and comprises a policyholder tax charge of £244 million and a shareholder tax credit of £108 million. Of the total tax charge, £7 million is current and £129 million is deferred. The policyholder tax charge is predominantly tax borne by the policyholder funds in the operating life companies but accounted for by the Group under the UK's I minus E tax regime. The quantum of the policyholder tax is a function of the investment return on the policyholder funds and is not included in the summary of IFRS shareholder profit shown above. The shareholder tax credit principally comprises tax relief for expenses.

Summary IFRS balance sheet

£m	RSL 2010	RSL 2009 restated
Acquired value of in-force business	**4,685**	2,879
Other intangible assets	**455**	372
Financial assets	**99,445**	48,315
Cash and cash equivalents	**9,288**	5,386
Other assets	**8,492**	4,139
Total assets	**122,365**	61,091
Insurance and investment contracts	**107,492**	52,602
Loans and borrowings		
– Deferred consideration notes	**500**	–
– Acquisition finance facility	**400**	–
– Other	**312**	590
Other liabilities	**7,112**	3,629
Total liabilities	**115,816**	56,821
IFRS net assets	**6,549**	4,270
Equity attributable to equity holders of the parent	**6,227**	3,655
Attributable to non-controlling interests	**322**	615
Total equity	**6,549**	4,270
Shares in issue(i)	**1,443,985,079**	600,700,335

(i) Post-share consolidation and rights issue, and for 2010, adjusted to exclude 8,579,292 Resolution Limited shares held by subsidiaries.

At 31 December 2010, IFRS total equity was £6,549 million (31 December 2009: £4,270 million), with equity attributable to equity holders of the parent of £6,227 million (31 December 2009: £3,655 million) giving IFRS net assets per share attributable to shareholders of £4.31 based on shares in issue at the balance sheet date, excluding Resolution Limited shares held by subsidiaries. IFRS net assets per share at 31 December 2009 were £1.52 based on shares in issue at that date and £6.08 after adjusting for the impact of the Company's share consolidation and rights issue, explained below.

Resolution undertook a share consolidation on 20 July 2010 to ensure that, following the rights issue, the number of its shares in issue and the likely share price would be appropriate for a company of its size in the UK market. The share consolidation was undertaken on the basis that shareholders received one consolidated ordinary share for every 30 existing ordinary shares held at the share consolidation record date. The share consolidation was followed by a rights issue of 17 shares issued for every share (on a post-consolidation basis) held.

£20 million of shares in Resolution Limited were held by the life companies, primarily in unit-linked funds and OEICS. In accordance with IFRS requirements, these shares have been excluded from the equity attributable to equity holders of the parent. On divestment of these holdings, the equity will increase by £20 million.

Financial assets are predominantly invested in listed shares, other variable yield securities and corporate bonds and asset- backed securities where 95% are at investment grade or above. There have been no corporate bond defaults in the period.

Other assets and other liabilities shown above include £281 million of net assets in respect of the GOF and TIP portfolios which are treated as "held for sale" in the Group's accounts.

As part of the financing for the acquisition of the AXA UK Life Business, £500 million of deferred consideration notes ("DCNs") were issued to the AXA UK group. An additional £400 million short-term funding arrangement was put in place; this has an extendable maturity date of 30 June 2012 and is expected to be refinanced in due course.

At 31 December 2010, the ratio of debt to IFRS equity, gross of debt, was 16.3% (31 December 2009: 13.9%), with the movement primarily reflecting the financing put in place to fund the acquisition of the AXA UK Life Business.

MCEV results

MCEV profit

Market consistent embedded value ("MCEV") is an alternative accounting basis to International Financial Reporting Standards ("IFRS") for life assurance companies. MCEV reporting is designed to recognise profit as it is earned over the lifetime of each policy and reflects the future cash flows that are expected to arise from sales in the year, together with the effect of updating the previous year's assumptions on existing business for the actual experience. The total profit recognised under both MCEV and IFRS will be the same over the life of each policy, it is the timing of the recognition of that profit which differs.

Resolution presents the results and financial position for its life and pensions business ("covered business") on the MCEV basis and for its other businesses on the IFRS basis. The MCEV basis is in compliance with the European Insurance CFO Forum MCEV Principles[i] ("MCEV Principles"), issued in June 2008, and re-issued in amended form in October 2009. The amendments in October 2009 primarily related to the allowance of an illiquidity premium on contracts with predictable cash flows.

	RSL 2010[ii] £m	RSL 2009[iii] £m
Life and pensions		
UK		
– Friends Provident	**213**	12
– AXA UK Life Business	**87**	–
International	**69**	6
Lombard	**162**	40
Corporate	**(93)**	(7)
Life and pensions covered business operating profit before tax	**438**	51
Other income and charges	**(11)**	3
Life and pensions operating profit before tax	**427**	54
Corporate income and charges	**(15)**	(13)
Operating profit before tax	**412**	41
Economic variances	**229**	40
Amortisation of non-covered business intangible assets	**(3)**	(1)
Non-recurring items and non-operating variances	**(22)**	5
Profit from continuing operations before tax	**616**	85
Tax	**(156)**	(14)
Profit from continuing operations after tax	**460**	71

(i) Copyright© Stichting CFO Forum Foundation 2008.
(ii) 2010 results comprise 12 months' results for the Resolution Group holding companies, 12 months for the Friends Provident companies and four months for the AXA UK Life Business.
(iii) 2009 results comprise 12 months' results for the Resolution Group holding companies, and two months for the Friends Provident companies.

Operating profit

	UK: FP £m	UK: Ex-AXA £m	Int'l £m	Lombard £m	Corporate £m	RSL 2010 £m
Value of new business	26	(7)	43	83	–	145
Expected existing business contribution	143	67	29	38	(30)	247
Operating experience variances	43	(6)	12	(17)	–	32
Other operating variances	62	34	(7)	39	(63)	65
Operating assumption changes	(41)	–	(2)	20	–	(23)
Development costs	(20)	(1)	(6)	(1)	–	(28)
Covered business operating profit	213	87	69	162	(93)	438
FPH other income and charges	6	–	(1)	–	(16)	(11)
RSL other income and charges	–	–	–	–	(15)	(15)
MCEV operating profit	219	87	68	162	(124)	412

Overall MCEV operating profit increased from £41 million in 2009 to £412 million in 2010, primarily reflecting the impact of the timing of acquisitions of the life businesses. The 2010 operating profit comprised operating profit for the Friends Life group of £427 million and £15 million of corporate costs in the Resolution holding companies.

In the Friends Provident UK business, the value of new business ("VNB") on a like for like basis was flat despite a 4% fall in APE income, reflecting the focus on value over volume. The AXA UK Life Business generated a negative £7 million contribution in the period of ownership, reflecting reduced business volumes in corporate pensions and individual protection as a result of uncertainties in the market surrounding the AXA UK Life Business activities ahead of the announcement of the conclusions of the Group's UK strategic review.

International held VNB in line with previous levels with the increase in new business sales of 24% offset by the impact of strengthening and improvement of internal models and a degree of margin compression. Lombard improved the value of in-force result and benefited from expected existing business contribution rising in line with the growing in-force book and enhanced operating assumptions for maintenance expenses.

Expected existing business contribution reflected a lower reference interest rate and lower expected returns on corporate bonds backing annuity funds whilst equity and property rates were increased. Returns on shareholder net worth for the Friends Provident UK business have also fallen due to being invested in cash, gilts and corporate bonds; however, a reduction in the cost of non-hedgeable risk benefited the expected return by £15 million and the AXA UK Life Business reported a pleasing £67 million for the four months of ownership.

Total operating variances were £97 million for the year, comprising £32 million experience and £65 million from management actions, with positive operating performance in all business segments other than for the corporate segment, where a cost of capital of £63 million was recognised which includes the impact of a change in the Group's capital management policy. This reflects the decision of the FPH board to increase its group capital policy to hold a minimum of 160% of Group Capital Resource Requirements (excluding WPICC), the cost of which impacts the FPH corporate segment. Further details on this are given in the cash and capital section. Positive operating experience was driven by mortality and morbidity claims on individual protection business being below long-term expectations across the total UK book and the benefit of a £14 million release of a prior year tax provision as reported at the interim in 2010.

The positive operating performance was partly offset by negative assumption changes of £23 million reflecting the strengthening of annuitant longevity provisions in the UK, the results of a thorough appraisal of the modelling of investment management charges in International and adverse persistency experience in Spain in the fourth quarter of the year for Lombard. Overall, operating variances and assumption changes therefore amounted to £74 million, even after longevity and capital strengthening.

Development costs are consistent with the IFRS results.

The Friends Provident corporate segment includes the interest on debt instruments at the reference rate and expected return over reference rate, together with the impact of the frictional costs in respect of the group capital policy. Other income and charges of £(11) million represent the Friends Provident corporate costs as reported in the IFRS section. The expected return on the debt held by the Friends Provident companies is £(30) million in MCEV compared to £(14) million in IFRS, primarily reflecting the treatment of the STICS as debt in MCEV, but as equity in IFRS.

Resolution holding companies operating loss of £(15) million is the same as the IFRS result.

Non-operating items

There have been strong profits from economic variances in 2010. These variances reflect investment returns over and above the expected returns included in operating profit, offset by changes to economic assumptions underlying the value of in-force and statutory liabilities.

In 2010, positive equity returns and exchange rate movements have significantly increased the value of future unit-linked annual management charges, with these unit-linked products constituting 58% of VIF at 31 December 2010. These returns, over and above those expected, are reflected in the economic variances.

Within the UK, average returns on linked funds were significantly in excess of those expected within the operating profit and contributed £147 million to the economic variances. This was particularly the case in the final quarter of the year where average returns on the AXA UK Life Business linked funds were 10% higher than the return included in operating profit.

Within International and Lombard, positive investment returns in global markets were coupled with favourable exchange rate movements that increased the value of annual management charges by £59 million.

The remaining items in economic variances reflect the positive returns on shareholders' net assets as a result of falling yields on fixed interest assets, offset by economic assumption changes to reflect the economic position at the end of 2010 and movements in the market value of debt.

Non-recurring expenses and non-operating items of £(22) million comprise the £(68) million of non-recurring expenses described in IFRS and £46 million of other non-operating items. These relate primarily to the impact on the Friends Provident UK business of the Emergency Budget in June 2010 and include the effects on the value of in-force business of changing the corporation tax rate from 28% to 24% offset by the change in the rate of Value Added Tax from 17.5% to 20.0%. The impacts on the AXA UK Life Business of the budget changes were reflected in the acquisition balance sheet published on 23 February 2011.

MCEV balance sheet

£m	2010 Net worth	2010 VIF	2010 Total	2009 Total
UK	**2,724**	**3,271**	**5,995**	2,687
International	**84**	**473**	**557**	471
Lombard	**80**	**497**	**577**	440
FPH corporate	**659**	**(39)**	**620**	17
FPH other[(i)]	**61**	**–**	**61**	71
Gross FPH MCEV	**3,608**	**4,202**	**7,810**	3,686
RSL net assets, excl. internal debt[(ii)]	**199**	**–**	**199**	307
Gross Group MCEV	**3,807**	**4,202**	**8,009**	3,993
FPH corporate – STICS	**(393)**	**–**	**(393)**	(318)
FPH corporate – Lower tier 2 debt	**(201)**	**–**	**(201)**	(187)
RSL deferred consideration notes	**(500)**	**–**	**(500)**	–
RSL acquisition finance facility	**(400)**	**–**	**(400)**	–
Net Group MCEV	**2,313**	**4,202**	**6,515**	3,488
Shares in issue[(iii)]			**1,443,985,079**	600,700,335

(i) Includes IFA distribution and management services businesses.
(ii) Resolution net assets and FPH debt exclude £702 million of internal debt.
(iii) Post-share consolidation and rights issue, and for 2010, adjusted to exclude 8,579,292 Resolution Limited shares held by subsidiaries.

At 31 December 2010, net Group MCEV was £6,515 million (31 December 2009: £3,488 million) giving MCEV per share of £4.51 based on shares in issue at the balance sheet date, adjusted to exclude shares held by subsidiaries. MCEV per share at 31 December 2009 was £5.81 based on shares in issue at that date adjusted to include the impact of the share consolidation and rights issue.

At the end of the period the ratio of debt to gross Group MCEV was 18.7% (31 December 2009: 12.6%), primarily reflecting the acquisition of the AXA UK Life Business part funded by the issuance of DCNs and the £400 million acquisition financing facility.

Resolution holding companies net worth, including internal and external debt, reduced by £306 million over the period reflecting the result for the period, the impact of external debt financing and the reduction in net assets in respect of shares held by subsidiaries, consistent with IFRS.

AXA UK Life Business acquisition

Acquisition of the AXA UK Life Business on an IFRS basis

Resolution completed the acquisition of the AXA UK Life Business with an effective acquisition date for accounting purposes of 3 September 2010. Included in the assets that were acquired are the GOF and TIP portfolios of insurance business that are required to be transferred back to AXA UK via Part VII transfer as part of the separation. This transfer is anticipated to take place later in 2011. The terms of the transfer were agreed as part of the transaction and the GOF and TIP portfolios are treated as "held for sale" in the Group's financial statements.

The acquisition of WLUK will not complete until after the transfer of the GOF and TIP portfolios back to AXA UK, and is anticipated to take place in the last quarter of 2011. Again the terms of the transfer were agreed as part of the transaction. WLUK will only be included in the Group's accounts once the acquisition has taken place in 2011 and is not therefore included within the current acquisition balance sheet.

The total consideration payable was £2,750 million, comprising:

- £2,224 million paid in cash;
- £26 million net (plus interest) of deferred consideration to be paid in cash on completion of the agreed post-completion steps outlined above; and
- £500 million, consisting of DCNs issued to the AXA UK group and repayable in equal instalments over eight years from completion of the acquisition.

The acquisition was financed by:

- a fully underwritten rights issue of £2,055 million (gross), which successfully completed on 5 August 2010 with the new ordinary shares issued by Resolution commencing trading on the London Stock Exchange on the following day;
- a short-term acquisition finance facility of £400 million; and
- £500 million DCNs, as outlined above.

The deferred consideration is the estimated difference between the receipt of £281 million (plus interest, before tax) which will be paid by AXA UK to the FLC non-profit fund in respect of the GOF and TIP portfolios, offset by the payment of £307 million (plus interest) to be paid by the FPLP shareholders' fund in respect of WLUK.

Summary of transaction financing

Sources of funds	£m
Rights issue proceeds	2,055
Costs attributable to rights issue	(76)
DCNs	500
Acquisition finance facility	400
Total	**2,879**

Utilisation of funds	£m
Transaction consideration	2,750
Less deferred consideration	(26)
Plus transaction costs expensed	28
Amounts retained to support integration	127
Total	**2,879**

IFRS acquisition balance sheet as at 3 September 2010 and gain on acquisition

Assets	£m
Intangible assets	2,342
Property, plant and equipment	2
Investment property	2,292
Financial assets	43,191
Reinsurance assets	640
Current tax assets	37
Insurance and other receivables	939
Cash and cash equivalents	3,193
Held for sale assets(i)	1,122
Total assets	**53,758**

Liabilities	£m
Insurance contracts	22,050
Unallocated surplus	823
Financial liabilities:	
– Investment contracts	25,031
– Loans and borrowings	23
– Amounts due to reinsurers	25
Net asset value attributable to unit-holders	377
Provisions	155
Deferred tax liabilities	494
Insurance payables, other payables and deferred income	332
Held for sale liabilities(i)	841
Total liabilities	**50,151**

Net identifiable assets acquired	**3,607**

(i) Held for sale assets and liabilities relate to the proposed transfer of the GOF and TIP portfolios under Part VII FSMA 2000 as set out in the sale and purchase agreement with AXA UK.

	£m
Fair value of net assets acquired	3,607
Cash paid	2,224
Deferred consideration notes	500
Fair value of consideration	2,724
Gain on the acquisition of AXA UK Life Business (excluding transaction costs)	**883**

In accordance with IFRS, Resolution is required to ascribe fair values to the acquired value of in-force business ("AVIF") and other intangible assets as well as placing a fair value on the assets acquired and liabilities assumed.

The AVIF has been calculated on the basis of assumptions which are consistent with those which have been used in the preparation of the MCEV Results. The AVIF and other intangibles of £2,192 million and £150 million, respectively, are presented gross of tax.

Distribution relationships have been valued using an income based methodology with the valuation reflecting the net present value of the underlying cash flows for forecast new business from existing distribution relationships over appropriate periods. Customer relationships have been valued based on the net cash flows for fees and commissions expected to be earned.

Acquisition of the AXA UK Life Business on a MCEV basis

The review of the MCEV assets and liabilities at the acquisition date confirmed that there were no unexpected changes from the items identified as part of Resolution's pre-acquisition due diligence with no material difference between the estimated embedded value of Friends ASLH Limited ("FASLH") and the actual embedded value of FASLH at 31 December 2009.

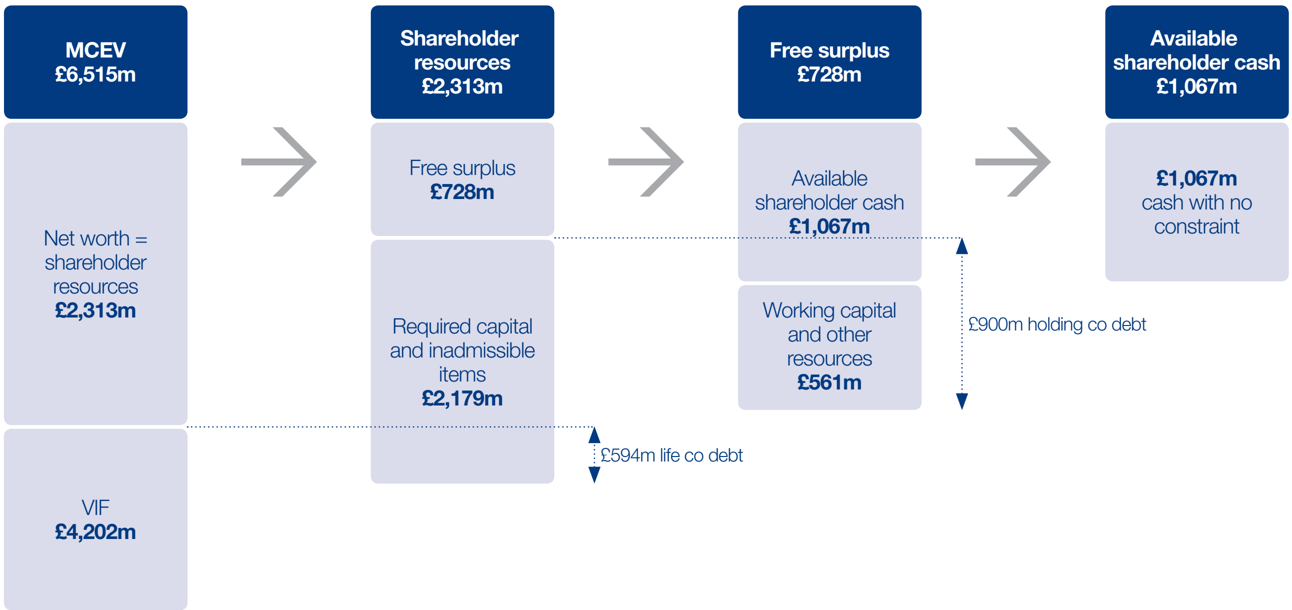
On a MCEV basis, the amount attributable to ordinary shareholders at the acquisition date was £3,498 million and consideration paid, net of external debt of £900 million, was £1,824 million, representing 70.2% of acquired net MCEV. A summarised balance sheet as at the date of acquisition is set out below.

AXA UK Life Business	£m	£m
Adjusted net assets		1,594
Value of in-force business		
– Certainty equivalent value	2,045	
– Time value of options and guarantees	(9)	
– Frictional costs of required capital	(46)	
– Cost of residual non hedgeable risks	(86)	
		1,904
AXA UK Life Business MCEV (excluding WLUK)		**3,498**

Reconciliation of equity attributable to ordinary shareholders on an IFRS basis to MCEV as at 3 September 2010

	£m
Equity attributable to ordinary shareholders on an IFRS basis (excluding WLUK)	**3,607**
Less items only included on an IFRS basis:	
– IFRS reserving and other IFRS adjustments	30
– GOF/ TIP held for sale valuation uplift in IFRS but not in net worth	(281)
– Acquired VIF (net of tax)	(1,640)
– Other intangible assets (net of tax)	(122)
Net worth on a MCEV basis	**1,594**
Value of in-force business	1,904
Equity attributable to ordinary shareholders on a MCEV basis (excluding WLUK)	**3,498**

Cash and capital



1. Group cash delivery

The Group has continued to focus on cash management during the period and cash available to shareholders at the end of the year has increased from £510 million at 31 December 2009 to £1,067 million at 31 December 2010, after payment of £136 million of cash dividends to shareholders in the year.

The Group's cash management framework is based on the movement in MCEV, reflecting the basis of MCEV as the discounted value of anticipated future cash flows on a market consistent basis. The chart below shows how the core components of MCEV within this framework, and their respective values as at 31 December 2010, reconcile to available shareholder cash.

The total MCEV is split between the net worth, or shareholder resources, and the value of in-force business ("VIF"). At 31 December 2010, total MCEV before debt was £8,009 million, of which £4,202 million was the VIF, that is, the value of the future cash flows arising from the policies currently in-force, and £3,807 million which was shareholder resources. Total debt amounted to £1,494 million resulting in net shareholder resources of £2,313 million and net MCEV of £6,515 million. Debt, at market consistent values, therefore equated to 18.7% of the gross MCEV at the balance sheet date.

Shareholder resources comprise the free surplus and the required capital of the business. Free surplus for the life businesses is defined as shareholder net assets (in line with MCEV definitions) after required capital. Required capital is based on the Group's capital management policy of maintaining 160% of Group capital resource requirements ("CRR") excluding WPICC, and at life company level, the higher of 150% of Pillar 1 CRR excluding WPICC and 125% of Pillar 2 CRR including Individual Capital Guidance. For other operating businesses and Friends Life Group holding companies, free surplus is defined as IFRS net assets less required capital and inadmissible assets on an IGCA basis which are treated as if they are required capital.

At 31 December 2010, total required capital and inadmissible assets of the Group were £2,179 million on a gross basis and £1,585 million net of the £594 million of debt that is supporting the operations of the Friends Life group and is guaranteed by the life businesses. The debt comprises STICS of £393 million and lower tier 2 subordinated debt of £201 million.

The free surplus of £728 million at the balance sheet date comprises available shareholder cash of £1,067 million and working capital of £561 million less £900 million of debt (£500 million DCNs and £400 million acquisition finance facility) taken on by the Group to support the acquisition of the AXA UK Life Business. The total free surplus, net of debt, comprises free surplus of the life businesses of £977 million and free surplus of the operating businesses and holding companies of £(249) million. Available shareholder cash is stated after the deduction of regulatory and other restrictions on the availability of cash resources. Required capital and inadmissible assets comprise £1,291 million in respect of the life operating businesses and £294 million in respect of other operating businesses and holding companies. Available shareholders cash represents cash available to cover corporate costs, to service debt and, subject to shareholder approval, to pay dividends, fund future acquisitions, or return to shareholders.

The key components and drivers of available shareholder cash for 2010 are detailed in the following sections.

a) Value of in-force business and shareholder resources

The movement in the VIF and shareholder resources is summarised in the table below, adopting an MCEV style presentation on a net of tax basis. The movements in shareholder resources are further subdivided into required capital, including inadmissible assets, and free surplus.

Analysis of movement in shareholder resources

		Shareholder resources		
	Value in-force £m	Required capital £m	Free surplus £m	Total MCEV £m
Opening MCEV at 1 January 2010	1,873	649	966	3,488
Impact of capital raise and acquisition of AXA UK Life Business	1,904	1,467	(618)	2,753
Capital movements within profit	–	(460)	460	–
MCEV profit after tax	433	3	24	460
Foreign exchange variances	(11)	(2)	2	(11)
Dividend and share based payments	3	–	(136)	(133)
Other movements in net equity	–	(72)	30	(42)
Closing MCEV at 31 December 2010	**4,202**	**1,585**	**728**	**6,515**

The impact of the capital raise and subsequent acquisition of the AXA UK Life Business is set out in more detail below.

		Shareholder resources		
	Value in-force £m	Required capital £m	Free surplus £m	Total MCEV £m
Rights issue net of capital raise costs	–	–	1,979	1,979
Assets acquired: AXA UK Life Business	1,904	1,467	127	3,498
Consideration paid	–	–	(2,724)	(2,724)
Total impact	**1,904**	**1,467**	**(618)**	**2,753**

To fund the acquisition of the AXA UK Life Business, Resolution raised £1,979 million (net of capital raising costs) through a rights issue and took on debt of £900 million. The net rights issue proceeds result in an increase in free surplus, but the debt gives rise to an increase in gross free surplus (the asset acquired) that is offset by the debt liability assumed. Free surplus is therefore unaffected by the debt raise.

The consideration paid of £2,724 million therefore gives rise to a net reduction in free surplus of £745 million, compared to the funds raised.

In exchange for the consideration, the Group received businesses with a value of £3,498 million, giving a gain on acquisition of £774 million on an MCEV basis. The acquired business included free surplus of £127 million, required and retained capital of £1,467 million and VIF of £1,904 million.

This transaction therefore results in an overall increase in shareholder resources of £849 million, representing an increase in required and retained capital, which included the net assets of the RIE, of £1,467 million and a decrease in free surplus of £618 million.

The movements arising from the MCEV profits are set out in more detail in the following section. They include capital movements of £460 million. These are the result of a £178 million increase in required capital, following the change in the Friends Life group capital management policy and £638 million in respect of the RIE, transferred from retained capital to free surplus. This is explained in more detail in the section that follows. Other movements in IFRS net equity arise from the actuarial losses on defined benefit pension schemes and the accounting for the scrip issue element of the dividend.

The shareholder dividend of £136 million comprises the cash element of the dividends paid in the period; that is, £61 million final dividend for 2009 and £75 million interim dividend for 2010. The scrip dividends (£5 million 2009 final dividend and £4 million 2010 interim dividend) do not impact on free surplus.

b) Impact of MCEV profits on shareholder resources and free surplus

The table below sets out the impact of the year's operating performance and non-recurring and non-operating items on shareholder resources split between free surplus and required capital. The analysis is shown on a net of tax basis. The impact of VIF is also included to enable a reconciliation to the full MCEV impact.

		Shareholder resources		
	Value in-force £m	Required capital £m	Free surplus £m	Total MCEV £m
Expected return from in-force business	(162)	(43)	404	199
Operating experience variances	30	(38)	4	(4)
Other operating variances	13	(1)	24	36
Operating assumption changes	20	5	(42)	(17)
FPH operating shareholder resources generation	**(99)**	**(77)**	**390**	**214**
Investment in new business	331	31	(245)	117
FPH operating profit/net shareholder resource generation	232	(46)	145	331
RSL income and charges	–	–	(15)	(15)
Group operating profit	**232**	**(46)**	**130**	**316**
Non-recurring and non-operating variances	201	(411)	354	144
Profit after tax	**433**	**(457)**	**484**	**460**

The primary components of underlying free surplus generation are expected return from in-force business (£404 million free surplus, £(43) million required capital) and investment in new business (£(245) million free surplus, £31 million required capital). The increase in free surplus arising from the expected return on in-force business is net of £(22) million expected return on the STICS and external lower tier 2 debt. Further detail on the return from in-force business and investment in new business is given in subsequent sections.

Operating experience variances (£4 million free surplus, £(38) million required capital) primarily relate to mortality and morbidity profits from protection products, expense overruns in the AXA UK Life Business offset by minor adverse persistency and mortality variances.

Other operating variances (£24 million free surplus, £(1) million required capital) represent the benefit of modelling improvements and shareholders' share of the special bonus declared from the Old WPF of FLC, offset by development costs and corporate income and other charges.

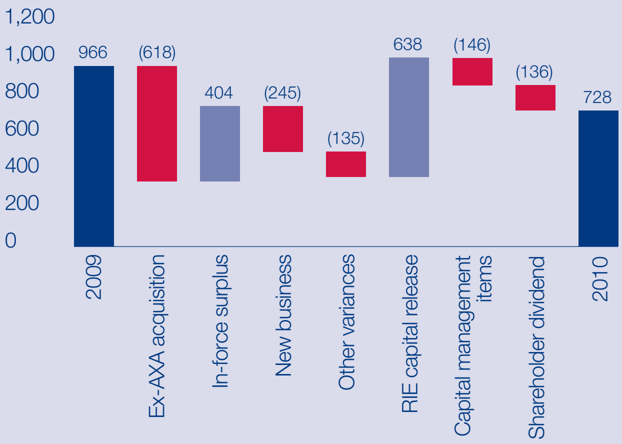
Operating assumption changes (£(42) million free surplus, £5 million required capital) reflect the impact on the Friends Provident UK business of strengthening annuitant mortality reserves for forecast longevity improvements (free surplus impact) offset by the benefit of reduced expenses in Lombard which primarily benefits required capital and VIF.

Non-operating items reflect those items reported in the MCEV summary and their effects on surplus (£354 million increase) and required capital (£411 million decrease). This includes the impact of positive economic variances outlined earlier in the review. The impact on free surplus reflects the costs of separation and integration, finance transformation, capital optimisation and acquisition related costs. These were offset by the corporation tax changes which impact on VIF.

c) Free surplus – £728 million

The generation of free surplus, net of movements in required capital, underpins the declaration of dividends. The chart below details the movements in free surplus already outlined on an MCEV basis, followed by an analysis of free surplus between those resources available to shareholders as cash, and resources retained by the operating businesses as working capital.

Movement in free surplus
£m



Total free surplus of the Group amounts to £728 million at the end of 2010, down from £966 million at the end of 2009. This predominantly reflects the acquisition of the AXA UK Life Business in September 2010, the net increase in free surplus from the emergence of profit on the in-force book and investment in new business, the transfer of surplus from the RIE offset by the impact of the change in capital management policy and the dividend to shareholders.

The principal drivers of the operating free surplus generated in the retained business are the expected return from in-force business of £404 million less investment in new business of £245 million. At product level these drivers are monitored on a "cash strain" and "cash surplus" basis which reflects a slightly more prudent basis than free surplus, utilising IFRS reserving and tax assumptions rather than MCEV best estimates. The impact of this is set out below.

In-force business expected return and investment in new business

	Free surplus £m	Movement in required capital £m	Tax and other items(i) £m	Cash strain/ surplus £m
New business cash strain	**(245)**	31	(24)	**(238)**
In-force cash surplus	**404**	(42)	42	**404**
	159			**166**

(i) Tax and other items include the cumulative adjustments for tax and long-term investment return which use different assumptions across the MCEV and IFRS bases. Experience variances are also excluded and reported separately in the movement in shareholder resources.

The new business cash strain and in-force cash surplus is split between the business segments as follows. A detailed analysis by product, showing the year on year change is included for each business in the segmental analysis section of this review.

	New business cash strain £m	In-force cash surplus £m	Total £m
UK			
– Friends Provident	(82)	177	**95**
– AXA UK Life Business	(67)	91	**24**
International	(83)	106	**23**
Lombard	(6)	30	**24**
Total	**(238)**	**404**	**166**

Based on full year results for the life operating businesses, excluding the AXA UK Life Business, and including an annualised estimate for the AXA UK Life Business based on the four month period shown above, the in-force surplus and new business strain for the combined Friends Life group businesses are new business strain of £370 million and in-force surplus of £580 million respectively. Annualised new business strain is targeted to be reduced by approximately £200 million from this level by 2013 through actions put in place following the UK strategic review.

Overview
Business review
Governance
IFRS financial statements
MCEV financial statements
Additional information

Reconciliation of cash strain and surplus to IFRS

A reconciliation of cash strain and surplus to IFRS is shown below. The principal adjustments are the inclusion of deferred acquisition costs ("DAC") and deferred front end fees ("DFF") in IFRS strain and surplus and other adjustments in respect of sterling reserves and actuarial funding.

New business strain	Free surplus impact £m	Movement in required capital and other items £m	Cash strain £m	DAC/DFF adjustments £m	Other IFRS adjustments £m	IFRS strain £m
UK						
– FP UK	**(78)**	(4)	**(82)**	20	(3)	**(65)**
– AXA UK Life Business	**(70)**	3	**(67)**	39	4	**(24)**
International	**(84)**	1	**(83)**	210	(155)	**(28)**
Lombard	**(13)**	7	**(6)**	(22)	–	**(28)**
	(245)	**7**	**(238)**	**247**	**(154)**	**(145)**

In-force surplus	Free surplus impact £m	Movement in required capital and other items £m	Cash surplus £m	DAC/DFF adjustments £m	Other IFRS adjustments £m	IFRS surplus £m
UK						
– FP UK	**208**	(31)	**177**	8	10	**195**
– AXA UK Life Business	**73**	18	**91**	–	(6)	**85**
International	**99**	7	**106**	7	7	**120**
Lombard	**24**	6	**30**	36	–	**66**
	404	**–**	**404**	**51**	**11**	**466**

Working capital

The £728 million of closing free surplus comprises £1,067 million available shareholder cash and £561 million of working capital, illiquid and restricted assets, less £900 million of debt taken on to finance the acquisition of the AXA UK Life Business. A review of available shareholder cash is included in the next section.

Working capital is held to cover known future requirements or reflects illiquid assets and requirements to ensure sufficient flexibility to manage the Group's capital policy.

As at 31 December 2010, the key components are:

	£m
Amounts retained to support separation integration and service company costs	175
Amounts retained to facilitate BHA acquisition	77
Long-term fund surplus currently unavailable to shareholders and restricted assets	129
Life company amounts retained for flexibility	125
Other operating businesses working capital	55
Total working capital	**561**

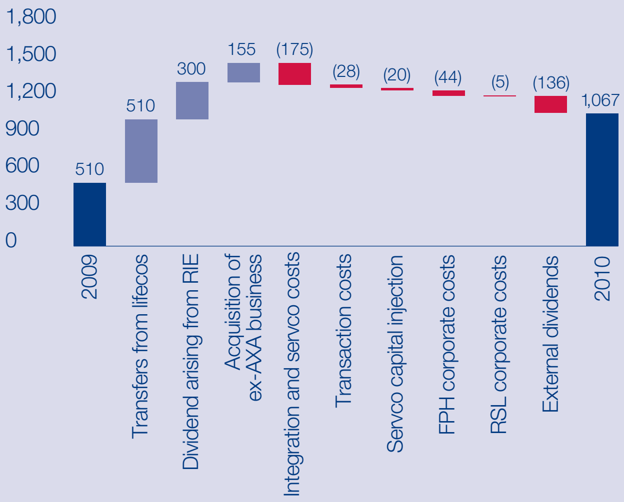
d) Available shareholder cash – £1,067 million

Available shareholder cash comprises £602 million of shareholder cash at holding company level, less £175 million required to fund integration costs and other operating costs, plus £640 million proposed dividends from life operating businesses, as summarised below.

	£m
Friends Provident holding companies cash	371
Cash retained to fund integration costs and service company losses (working capital)	(175)
Friends Provident holding companies available shareholder cash	196
Proposed dividends from life businesses:	
– FPLP	185
– FLC dividend funded by transfer in respect of RIE	300
– FLC dividend funded by special bonus and trading result in the period	90
Agreed loan repayment from FASLH to FPH	65
Friends Provident available shareholder cash	**836**
Resolution holding companies cash	231
Group available shareholder cash	**1,067**

The dividends were declared by the life companies after 31 December 2010 and consequently are included in available shareholder cash. The agreed loan repayment represents a scheduled loan repayment to FPH from the life businesses.

Movement in available shareholder cash
£m



During the year the Group received £350 million of dividends (net of internal loan repayments) from the life businesses. Of this amount, £180 million was included in opening available shareholder cash, having been declared at the time of reporting and a further £170 million was declared and paid in the year.

In addition to the £170 million of dividends declared and paid above, the life companies have declared further dividends and made loan repayments totalling £340 million at the year end, bringing the total increase in shareholder cash from life company sources to £510 million.

A further £300 million was declared as a dividend from FLC following the transfer in respect of the RIE. This is covered in more detail in the section that follows.

Together with the £810 million received from the life businesses outlined above, the Group received a net £155 million as a result of the funding of the acquisition of the AXA UK Life Business comprising receipt of rights issue proceeds, net of equity raising costs, of £1,979 million and acquisition financing of £400 million which funded the payment of the cash consideration of £2,224 million. Transaction costs of £28 million were also incurred.

This amount will be retained, together with a further £20 million of existing resources, to fund the separation and integration costs and short-term operational costs of the service companies. During 2010, £20 million was made available to the service companies to support their operations.

Friends Life group corporate costs of £44 million include £31 million payment of the coupon on the STICS, £16 million interest paid on external lower tier 2 debt, £19 million interest paid to Resolution holding companies, £8 million fees in respect of the revolving credit facility offset by £46 million of interest received from the life businesses on loans to the life businesses.

Resolution corporate cash outflows of £5 million represent payment of financing costs and corporate expenses offset by the receipt of £19 million loan interest from Friends Life group (as referred to above). The £136 million dividend paid to shareholders is the cash element of the 2009 final dividend and 2010 interim dividend paid in the year.

Distributable cash target ("DCT")

The Company has set a DCT of £400 million per annum at Friends Life group for 2011 and onwards, after interest costs and without reducing the MCEV of Friends Life group.

In 2010 the increase in available shareholder cash at Friends Life group level, which is the measure against which this is set, was as summarised below:

	£m
Friends Life group ASC at 1 January 2010	203
Friends Life group ASC at 31 December 2010	836
Movement in Friends Life group ASC in 2010	633
Adjusted to exclude:	
Dividends paid to RSL	65
Net transaction funding	(127)
Cash retained for integration	175
Underlying Friends Life group ASC generation	**746**

This arose from:

	£m
Excess of in-force surplus over new business strain (including AXA UK Life Business for four months only)	159
Capital strengthening	(146)
Net benefit of other operating items, economic experience and a reduction in working capital	266
Cash from RIE	300
Assets transferred from RIE	167
	746

The excess of in-force surplus over new business strain only included the AXA UK Life Business for four months. Had it been included for 12 months, the estimated underlying net cash surplus would have been approximately £50 million higher.

As announced in February 2011, there is a strategic initiative in place to reduce cash new business strain by £200 million by the end of 2013 and the Group has targeted the overseas businesses to deliver £50 million of dividends by the end of 2014. The Group therefore expects the £400 million DCT to be met predominantly from operational cash flows and related releases of required capital, but until such time as this is achieved the delivery of the target will be dependent on the release of working capital and capital synergies to some extent.

2. Distribution of the FLC re-attributed inherited estate

As at 31 December 2010, the FLC RIE was £2,437 million, increased from an estimated £2,200 million at 31 December 2009.

The High Court approved scheme ("the Scheme") rules require that a test be undertaken every five years to determine whether it is possible to transfer any of the RIE from the FLC non-profit funds to the FLC shareholders' fund or to distribute any of the inherited estate retained in the Old With-Profits Fund ("the Old WPF") in the form of Special Bonuses (and associated transfer to the shareholders' fund). The latest five yearly test was undertaken as at 31 December 2010.

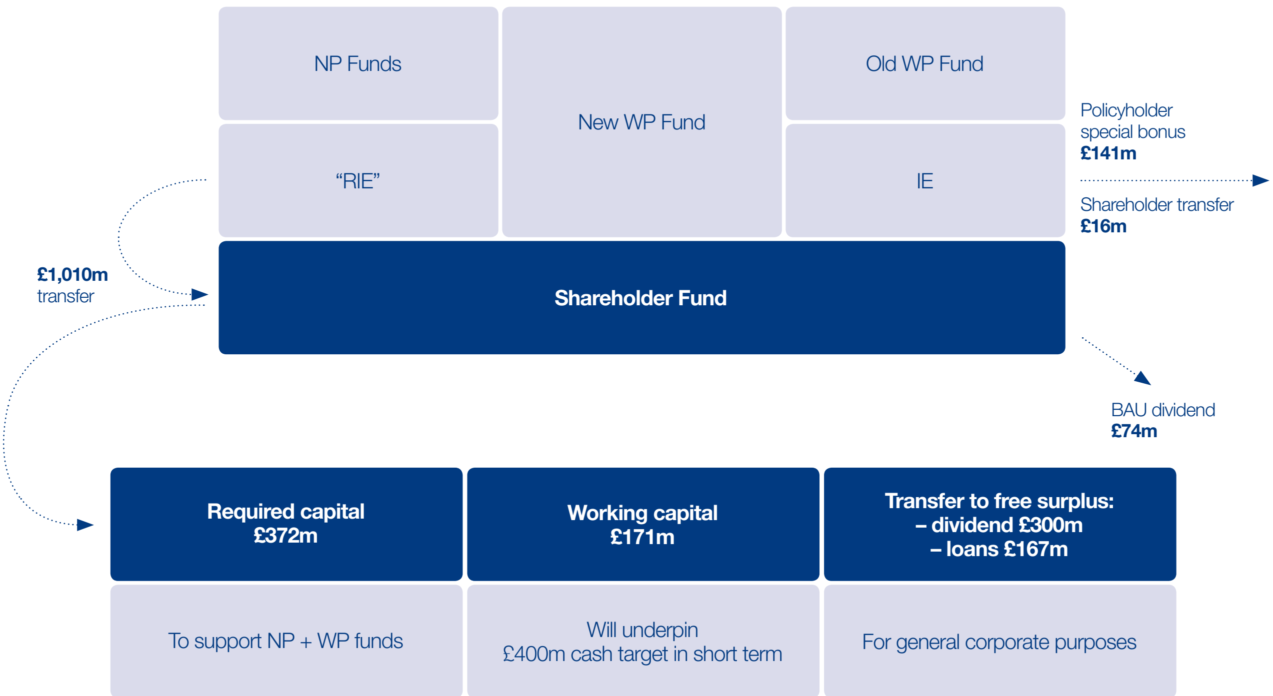
Following the results of the five year testing, the FLC board determined that as at 31 December 2010 it should make:

(a) a transfer of £1,010 million of RIE from the non-profit funds to the shareholders' fund; and

(b) a distribution of £157 million of the inherited estate in the Old WPF, which will be split 90% to with-profits policies allocated to or reinsured to the Old WPF in the form of a Special Bonus and 10% to the FLC Shareholders' Fund.

The transfer of RIE to the FLC Shareholders' Fund is an after tax amount, and consists of £843 million of cash and £167 million of receivables which would otherwise have had to be repaid by holding companies. Following completion of the 2010 year end valuation, FLC has paid a dividend of £390 million to its parent company, FPLP, consisting of £300 million of the cash transferred from the RIE, the £16 million shareholders' share of the Special Bonus declared in the Old WPF, and £74 million derived from business as usual activities.

Friends Life Company Limited – formerly AXA Sun Life plc



3. Group capital management

The Friends Life group manages its capital on both regulatory and economic capital bases, focusing primarily on capital efficiency and the ease with which cash and capital resources can be transferred between entities. In managing capital, the Friends Life group considers the following:

- establishing targets for the main UK life companies at the greater of 150% of Pillar 1 CRR (excluding WPICC) and 125% of Pillar 2 CRR – the capital required to mitigate the risk of insolvency to a 99.5% confidence level over a one year period;
- at the FPH level, to hold sufficient capital to meet 160% of the Group CRR (excluding WPICC);
- maintaining financial strength within companies sufficient to support new business growth targets, including rating agency requirements;
- the need to have strong liquidity to cover expected and unexpected events, which includes access to an undrawn facility with a consortium of banks;
- managing, in particular, the with-profits business of the Group in accordance with agreed risk appetites and all statutory requirements; and
- transfers from long-term business funds and dividends from entities that support the cash generation requirements of the Group, balanced with the need to maintain appropriate capital within the businesses for the reasons outlined above.

As part of the integration of the AXA UK Life Business, a number of initiatives are being considered including fund mergers and the optimisation of the corporate structure, to ensure capital efficiency and maximise the fungibility of capital resources.

Solvency II

The implementation of the EU Solvency II Directive continued to be a key focus of attention for the Group during 2010. The Group has been closely following the emerging regulations and monitoring their potential impact on the Group balance sheet. Friends Life group is closely involved with the industry in lobbying on key areas where some uncertainty remains. During 2010, Friends Life group participated in the QIS5 exercise, which was an EU-wide test of the calibration of the standard formula and other technical items. Friends Life group continues to be closely engaged in the development of the tax proposals arising as a result of Solvency II.

During the course of 2010, Friends Life group has successfully integrated the Solvency II programme for Friends Provident and the AXA UK Life Business and the overall programme is progressing well against its plans.

Friends Life group intends to apply for internal model approval pursuant to the Solvency II Directive and has been notified by the FSA that it may start the internal model pre-application process. The purpose of the internal model pre-application process is to give firms and the FSA an opportunity to consider whether a firm's proposed internal model is suitable to be submitted for approval under the formal internal model assessment requirements. The pre-application process ends when a firm either submits a formal internal model application to the FSA for approval or notifies the FSA that it no longer intends to use an internal model.

Insurance Groups Capital Adequacy

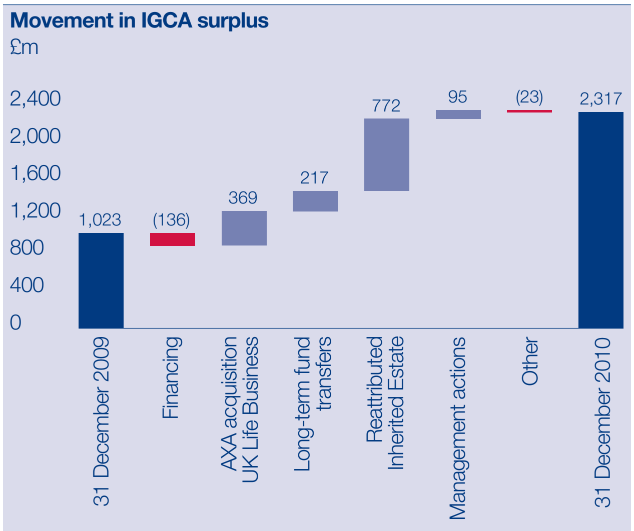
In addition to individual company requirements, FPH group, as the ultimate European Economic Area ("EEA") parent insurance undertaking, is required to meet the IGCA requirements of the Insurance Groups Directive. The Group's capital policy is to maintain sufficient group capital resources to cover 160% of group CRR (excluding WPICC). This policy was increased from 150% following the acquisition of the AXA UK Life Business. It is anticipated that the FPH capital management policy target will reduce back to 150% in due course as the integration of the AXA UK Life Business and BHA into the group proceeds.

The balance sheet remained strong at the Friends Life group level, with an IGCA surplus of £2.3 billion at 31 December 2010, with Group Capital Resources being 228% of Group CRR (excluding WPICC). Group Capital Resources were estimated to be £1.2 billion in excess of the amount required to satisfy Friends Life group's revised group capital policy of holding 160% of Group CRR (excluding WPICC).

The increase in IGCA surplus over the year largely reflects the £369 million impact of the AXA UK Life Business, the impact of the transfer of RIE to the FLC shareholders' fund of £772 million (£1,010 million transfer less shareholder funds required to cover FLC non-profit fund capital resources requirements of £238 million) and other long-term fund transfers totalling £217 million (net of any shareholder funds now being utilised to cover capital resource requirements).

Financing costs include the £65 million dividend paid to Resolution and interest costs at Friends Life group. These include the coupon payments of the external debt in addition to the interest due on the £700 million lower tier 2 debt issued to Resolution in September 2010.

Management initiatives in the year to optimise the IGCA surplus position delivered a benefit of £95 million. This largely related to the more appropriate valuation treatment of non-regulated entities within the Group's distribution businesses.



The IGCA surplus is a prudent measure and excludes surplus capital not immediately available to shareholders, such as surplus capital held in long-term funds to the extent that this is not needed to cover the capital resource requirements of the long-term fund concerned. Following actions taken in 2010 to transfer surplus long-term fund assets to shareholders, only £39 million of non-profit funds outstanding surplus remains in the UK business which is not counting towards the IGCA surplus; this has not been transferred due to FPLP demutualisation scheme restrictions. The IGCA surplus also excludes £836 million of with-profits funds surpluses. As the calculation is prepared to include the subsidiaries of the highest EEA parent company, the net assets of the Resolution holding companies are excluded.

Management of the with-profits fund

Friends Provident Life and Pensions Limited

Asset allocation within the With-Profits Fund is actively managed. During 2010 steady improvement in the investment return of the With-Profits Fund has facilitated the removal of Market Value Reductions ("MVRs").

At 31 December 2010 the proportion of equities and property backing asset shares (equity backing ratio or "EBR") was 49% (2009: 26%).

Following credit de-risking of the With-Profits Fund, the EBR was increased throughout the year. A strategic level of 45% was approved by FPLP's board in November 2010 reflecting the fund's ability to support more investment risk.

These actions reflect work to more clearly define the risk appetite of the With-Profits Fund and are in line with FPLP's commitment to fair treatment of all its customers and the published Principles and Practices of Financial Management underlying the Fund.

Friends Life Company Limited

Asset allocation within the With-Profits Funds is actively managed. During 2010 steady improvement in the investment return of the With-Profits Funds has facilitated the reduction in MVRs on single premium bonds, although some remain due to the low levels of equity markets compared to when these bonds were taken out.

At 31 December 2010 the EBR was close to 68% (2009: 68%).

There were no changes to the investment policy in 2010. The fund maintained a stable asset allocation with a target EBR of 65% for assets other than those backing the realistic cost of guarantees, options and non-profit business. Guarantees and options remained backed by a combination of bonds and hedging derivatives (equity put options, interest rate swaps and swaptions). Cash is allocated to back current liabilities.

Non-profit business in the With-Profits Funds is backed by a mix of gilts and corporate bonds (some with credit default swap protection to hedge the default risk).

Friends Life Assurance Society Limited ("FLAS")

Asset allocation within the With-Profits Fund is actively managed. During 2010 steady improvement in the investment return of the With-Profits Fund has facilitated the reduction in MVRs on single premium bonds, although some remain due to the low levels of equity markets compared to when these bonds were taken out.

At 31 December 2010 the EBR was close to 54% (2009: 52%).

The investment policy of FLAS was reviewed in 2010, and this has resulted in the following target strategic allocation:

- the allocation for assets backing asset shares has been set to target a stable EBR of 50%, previously 48%;
- the allocation for assets backing guarantees and options has been defined to consist of gilts and hedging derivatives (equity put options, sold equity futures, interest rate swaps, swaptions and 'spreadlock' trades);
- the allocation for assets backing the realistic with-profits estate has been defined to consist of gilts only;
- the most significant effect of the change for assets backing guarantees, options and the realistic estate has been the sale of corporate bonds previously allocated to these pools to reduce the credit risk exposure of the fund; and
- the allocation for non-profit business in the fund has been defined according to two pools. The first pool consists of a large block of immediate pension annuity liabilities for which 95% of the longevity risk was reinsured in June 2010. These liabilities are backed by a portfolio of low risk assets including gilts, UK government guaranteed assets, and other 'liquidity trade' assets (such as corporate bonds with matching credit default swap protection) which seek an enhanced yield relative to gilts with very low default risk exposure. The second pool consists of the other non-profit liabilities which are backed by a mix of bonds, with some sales of corporate bonds taking place in this pool during 2010 with the purpose of reducing the credit risk exposure of the fund.

4. Asset quality and exposure

The Group's financial assets as at 31 December 2010, excluding cash, are summarised as follows:

	Unit-linked £bn	With-profit £bn	Non-profit £bn	Shareholder £bn	31 Dec 2010 Total £bn	31 Dec 2009 Total £bn
Shares, unit trusts and OEICs	52.1	8.1	0.2	–	60.4	30.4
Gilts	7.6	6.9	1.4	0.2	16.1	6.3
Corporate bonds and asset-backed securities	5.4	8.9	6.6	0.6	21.5	11.0
Derivatives	–	0.4	–	–	0.4	0.1
Deposits	0.4	–	–	–	0.4	0.4
Loans	–	–	0.1	0.6	0.7	0.1
Total 31 December 2010	**65.5**	**24.3**	**8.3**	**1.4**	**99.5**	
Total 31 December 2009	33.4	10.8	3.5	0.6		48.3

The vast majority of the Group's exposure to sovereign debt holdings is to UK gilts. The Group's non-profit and shareholder funds have immaterial exposure totalling £7 million to the higher risk government debts of Spain, Portugal, Italy, Ireland and Greece.

The Group has a direct exposure through its non-profit and shareholder funds to various corporate securities issued by companies domiciled in Spain, Portugal, Italy, Ireland and Greece of £405 million. 60% by value of these corporate securities are issued by non-financial companies, which are in many cases less exposed to their domicile economy than to other countries. Where the Group holds securities issued by financial companies, the company's financial strength and the ability of the domicile government to provide financial support in the event of stress has been considered.

Corporate bonds and asset-backed securities (excluding £0.9 billion of unlisted bonds held in unit-linked funds) are analysed by fund and credit rating as follows:

	Unit-linked £bn	With-profit £bn	Non-profit £bn	Shareholder £bn	31 Dec 2010 Total £bn	31 Dec 2010 %	31 Dec 2009 Total £bn	31 Dec 2009 %
AAA	0.3	2.3	1.0	0.1	3.7	18	1.9	18
AA	0.2	1.4	2.4	0.2	4.2	20	2.7	26
A	0.6	2.5	2.1	0.2	5.4	26	2.3	22
BBB	0.5	2.0	0.8	0.1	3.4	17	0.7	7
Sub-BBB or rating not available	2.9	0.7	0.3	–	3.9	19	2.8	27
Total 31 December 2010	**4.5**	**8.9**	**6.6**	**0.6**	**20.6**	**100**		
Total 31 December 2009	2.9	4.4	2.7	0.4			10.4	100

Over 95% of the corporate bond and asset-backed securities held in the non-profit and shareholder funds are investment grade. The Group controls its exposures to corporate issuers by rating, type of instrument and type of issuer. The sub-investment grade bonds held in investment portfolios are monitored closely in order to maximise exit values. Where asset-backed securities and other complex securities are held, the Group monitors closely its exposures to ensure that the relevant structure, liquidity and tail credit risks are well understood and controlled.

No defaults have been experienced in the year.

5. Liquidity

The liquidity of the Group remains strong.

FPH has an undrawn £500 million funding facility with a consortium of banks, which increased from £300 million in place at 31 December 2009 following the completion of the AXA UK Life Business acquisition. This facility is due to run until June 2013 but can be extended at the option of FPH for a further two years.

6. Financial strength ratings

A number of the Group's life businesses are attributed financial strength ratings.

	Fitch	Moody's	Standard & Poor's
FPLP	A+ (strong)	A3 (strong)	A- (strong)
FLC	A+ (strong)	A2 (strong)	A- (strong)
FLAS	A+ (strong)	A2 (strong)	NR

The Group targets financial strength ratings in the single A range and expects them to remain there for the foreseeable future.

7. Dividend policy

Following the acquisition of Friends Provident, Resolution announced that it expected to pay a dividend of 4.08 pence per share each year with one-third payable as an interim dividend and two-thirds as a final dividend commencing with a final dividend in respect of 2009.

A final dividend in respect of 2009 of 2.72 pence per share was paid on 28 May 2010. In total, £61 million of the 2009 dividend was paid in cash with the remaining £5 million (8%) taken as shares.

At the time of the acquisition of the AXA UK Life Business the directors reaffirmed the intention that the Company should continue to pay an annual dividend equivalent to 4.08 pence per share in issue as at 30 June 2010. Following the rights issue and share consolidation, the dividend policy was therefore to pay an annual dividend of 16.39 pence per new ordinary share with one-third, 5.46 pence, paid on 8 October 2010 in respect of the interim dividend for 2010. As with the 2009 final dividend, shareholders were offered a scrip alternative in respect of the interim dividend and 5.2% exercised this right in respect of total shareholdings.

After due consideration, the directors have decided to recommend a final dividend of 12.57 pence per share, an increase of 15%, which brings the total dividend for the year to 18.03 pence per share. Subject to approval by shareholders at the AGM, the dividend will be paid on 26 May 2011. In line with previous dividends, shareholders will be offered a scrip alternative in respect of the final dividend.

As the Group progresses towards the end of the UK Life Project, the Board intends to keep under review the appropriateness of the Company moving to a growing dividend.

Operating segment results

The results for Friends Provident, including International and Lombard, and the AXA UK Life Business are only reflected in the statutory Group results from their respective acquisition dates of 4 November 2009 and 3 September 2010.

The operating results below present the IFRS and MCEV operating results for UK, International and Lombard, with the UK segment further split between the Friends Provident UK business and the AXA UK Life Business. As the integration of the acquired business continues, the results for the Friends Provident UK business and the AXA UK Life Business will no longer be reported separately.

IFRS based operating results have been presented for each business unit for the whole of 2010 and the full year 2009, and are presented on a post-acquisition basis to assist in comparability between years. This presentation treats each business as if it had been acquired as at 1 January 2009 and therefore removes DAC amortisation which was incurred prior to acquisition providing a clear view of underlying performance. DAC arising post-acquisition is amortised through in-force surplus.

In seeking to enhance comparability and clarity of performance across business segments and bases of reporting, the Group has amended its definition of operating profit. As operating profit is intended to show a clear view of performance based upon a longer-term view of investment returns, which in turn reflect the long-term nature of the majority of the Group's product lines, investment variances over and above the calculated longer-term rate of return have been excluded from operating profit. This change impacts investment variances arising from fixed interest assets backing policyholder liabilities which are now included within short-term investment fluctuations.

The redefinition of operating profit has resulted in the reclassification of £176 million of fixed interest investment variances from operating profit to short-term investment fluctuations for the year ended 31 December 2009. In addition to this reclassification, the presentation of operating profit has been revised for the following points:

- development costs, previously disclosed within new business strain, are now presented separately to allow better comparison with development costs under MCEV; and
- in-force surplus has been restated to include some one-off items, which were previously reported within principal reserving changes and one-off items. These items have been allocated to in-force surplus as they are variances on experience, similar to those presented in MCEV, rather than changes in assumption or modelling. Other one-off items comparable to other assumption and modelling changes in MCEV continue to be reported within principal reserving and one-off items.

The MCEV results are likewise presented for the Friends Provident UK, International and Lombard businesses with the AXA UK Life Business only presented for the post-acquisition period of four months as the businesses did not formally report on this basis prior to acquisition. Estimates of the MCEV on a Resolution basis at 31 December 2009 were prepared in support of the acquisition. Subsequent to the acquisition, systems and processes capable of producing MCEV results and analyses have been implemented.

a) UK operating segment

	FP UK 12 months 2010	Ex-AXA 4 months 2010	FP UK 12 months 2009
APE (£m)	**391**	**81**	407
VNB (£m)	**26**	**(7)**	26
IFRS operating profit (£m)	**116**	**71**	132(i)
MCEV operating profit (£m)	**219**	**87**	127
PVNBP margin (%)	**1.2**	**(1.1)**	1.1
IRR on cash and capital invested in new business (%)	**9.0**	**3.9**	9.3

(i) Restated.

Key highlights of the 2010 results:

- new business volumes in the Friends Provident UK businesses were reduced in comparison to 2009 reflecting the competitive market conditions. The profitability of new business remained on a par with the previous year as active cost management reduced expenses from £223 million in 2009 to £199 million in 2010, offsetting the impact of lower volumes. AXA UK Life Business VNB was adversely impacted by reduced sales of group pensions, following the acquisition and also reflects incorporation of appropriate allowances for the cost of capital and the cost of non-hedgeable risk in accordance with MCEV Principles;
- persistency experience improved in the UK as the economy emerged from recession and the company focused on retaining profitable business in line with the strategy of the enlarged business;
- there was generally positive experience on mortality and morbidity relative to assumptions, but this was offset by strengthening of mortality assumptions in the Friends Provident annuity book in anticipation of the likely industry wide shift to new models for mortality improvement assumptions in the coming years and in line with the AXA UK Life Business; and
- after adjusting for the impact of one-off benefits in 2010 due to methodology improvements and taking account of the persistency provision established in 2009 and partially utilised in 2010, the underlying performance on an MCEV basis for the Friends Provident UK businesses have seen positive experience variance on mortality and expenses outweighed by the strengthening of mortality improvement assumptions as mentioned above together with lower expected contribution from existing business reflecting lower rates on corporate bonds and reduced shareholder net assets due to dividend payments.

Friends Provident UK

The Friends Provident UK business has continued to focus on the core markets of group pensions, individual protection and the provision of annuity policies to retiring pensions customers. Against a backdrop of challenging conditions in the UK life insurance industry, the business has maintained pricing discipline and remains focused on cash generation.

Friends Provident UK IFRS operating profit

	2010 12 months £m	2009 12 months £m
New business strain	**(65)**	(77)
In-force surplus	**195**	171
Investment return and other items	**24**	36
Principal reserving changes and one-off items	**(15)**	17
Development costs	**(20)**	(15)
Other	**(3)**	–
IFRS based operating profit before tax	**116**	132

Friends Provident UK IFRS based operating profit before tax of £116 million benefits from the action taken to reduce expenses, reflected in reduced new business strain and increased income from higher annual management charges on fund values which have risen as a result of improved market conditions.

The results also reflect the impact of basis changes which were a significant positive in 2009.

Friends Provident UK new business strain and in-force surplus

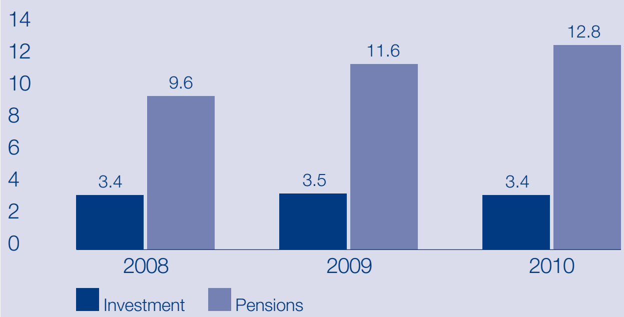
Details of new business strain and in-force surplus for the main Friends Provident UK product areas are as follows with the 2009 comparatives restated in line with the operating profit changes noted above:

	2010 12 months		2009 12 months	
	New business strain £m	In-force surplus £m	New business strain £m	In-force surplus £m
Protection	**(45)**	**38**	(49)	41
Pensions	**(33)**	**72**	(41)	44
Annuities	**15**	**18**	15	(3)
Investments	**(2)**	**23**	(2)	20
With-profits	**–**	**44**	–	69
Total	**(65)**	**195**	(77)	171
APE	**391**		407	

Against broadly consistent sales volumes, the principal driver of the movement in new business strain from year to year is the reduction of acquisition expenses with 2010 strain of £65 million, down £12 million on 2009. The majority of this benefit can be seen in the protection and pension product lines with protection strain down £4 million to £45 million and pension strain down £8 million to £33 million.

Annuity business continues to be cash generative at the point of sale with a day one surplus of £15 million, comparable to that seen in 2009.

Funds under management
£bn



As the chart shows, pensions funds under management have grown year on year. As the majority of the pensions business (and investments) is unit-linked, income from annual management charges is the key driver of profitability as opposed to premium income.

In-force surplus generated by the existing book has, in total, grown to £195 million over the year, and is up £24 million on 2009. The principal drivers of this improvement are the pension and annuity lines offset partially by a reduction in the surplus arising from the with-profits funds due to the non-recurrence of investment return methodology enhancements which benefited prior years.

While the underlying annuity in-force surplus is consistent with that arising in 2009, overall it has increased by £21 million as a result of a number of current and prior year one-off items. In 2010 the business refined the methodology for calculating expected investment return to improve consistency with MCEV reporting resulting in an £8 million increase in the in-force surplus compared to 2009. The surplus in 2010 also reflects a one-off increase in liabilities of £6 million offset by a £6 million benefit to the with-profits funds and a £2 million release of reserves due to prior strengthening of annuitant mortality basis. In 2009 there was a guaranteed annuity option rebate catch-up cost totalling £5 million which has not recurred in 2010.

Surplus emerging from the with-profits fund products was £44 million which reflects the negative impact of £9 million due to a refinement of the methodology for calculating expected return. The one-off items include the reallocation of liabilities from the annuity proposition referred to above and positive items totalling £10 million which benefited 2009.

Investment return and other items

	2010 £m	2009 £m
Longer term return on life and pension shareholder funds	**19**	26
Distribution businesses	**5**	4
Non-recurring items	**–**	6
Total	**24**	36

UK longer term investment returns have decreased from £26 million to £19 million with the payment of £462 million in dividends to the holding companies reducing the returns expected on the shareholders' surplus assets.

Distribution businesses principally relate to Sesame Bankhall, which generated operating profits of £5 million in 2010 (2009: £3 million). Sesame acquired Bankhall, an IFA directly regulated service business, and PMS, a mortgage adviser services provider, in October 2009 and successfully completed the integration of these businesses in the first half of 2010. The result reflects the combined fees generated by these businesses and is after charging £1 million of one-off integration costs related to the consolidation of offices. The 2009 comparative includes a contribution of £1 million from Pantheon which was disposed of in March 2010.

Principal reserving changes and one-off items

	2010 £m	2009 £m
Annuitant longevity strengthening	**(39)**	
Modelling and methodology changes	**14**	
Scheme expense release	**10**	
Total	**(15)**	17

In light of emerging industry and in-house views, in particular new mortality projection models, and as part of the harmonisation of assumptions across the Group, the assumptions regarding future rates of annuitant mortality improvement have been strengthened for the Friends Provident UK business. The minimum annual rates of improvement have been increased in both IFRS and MCEV with a £39 million adverse effect on the Friends Provident UK IFRS result.

A one-off benefit to the results of £14 million reflects improvements to the modelling of income protection expenses and of the charging structure applied to ex-employees in group pension schemes together with other small improvements.

Other one-off items include a £10 million provision release relating to the renegotiation of FPLP with-profits scheme expenses. Under the demutualisation scheme the amount of expenses that can be recovered from the with-profits fund is capped. A renegotiation of this cap, resulting in a 2% increase, has resulted in a £10 million release from the provision.

Friends Provident UK operating expenses

	2010 £m	2009 £m
Acquisition	**96**	107
Maintenance	**81**	97
Development	**20**	15
Other	**2**	4
Total	**199**	223

Friends Provident UK operating expenses, which exclude commission payments and non-recurring costs, have been further reduced in 2010 to £199 million for the Friends Provident business alone and continue the progress made on reducing the operating cost base in the last two years.

In 2010, development costs of £20 million include the development of the Corporate Investment Platform, a core element of the corporate pensions positioning in support of the strategic objectives, and the distribution arrangement for protection products with Tesco bank.

AXA UK Life Business

The pro forma results shown below for the full year 2010 and 2009 have been prepared on a post-acquisition basis and assume constant economic and demographic assumptions over the period from 1 January 2009. The results, therefore, do not include the impact of changes to the longer-term investment rate in the prior year or the impact of amortisation of deferred acquisition costs pre-September 2010. The pro forma results have been presented excluding both the WLUK business, yet to be acquired, as well as the GOF and TIP portfolios which are held for sale.

AXA UK Life Business IFRS based operating profit

The results for the AXA UK Life Business are only reflected in the Group's statutory results from the acquisition date, 3 September 2010. The following analysis compares the IFRS based operating results of the AXA UK Life Business on a stand-alone pro forma basis for the years ended 31 December 2010 and 2009.

Details of pro forma AXA UK Life Business operating profit are set out below.

	2010 4 months £m	2010 12 months £m	2009 12 months £m
New business strain	(24)	(80)	(85)
In-force surplus	85	244	207
Investment return and other items	11	36	39
Principal reserving changes and one-off items	–	–	–
Development costs	(1)	(3)	(3)
IFRS based operating profit before tax	**71**	**197**	158

AXA UK Life Business new business strain and in-force surplus

Details of new business strain and in-force surplus for the main UK product areas are as follows:

	2010 12 months		2009 12 months	
	New business strain £m	In-force surplus £m	New business strain £m	In-force surplus £m
Protection	(72)	116	(74)	114
Pensions	(19)	37	(24)	30
Annuities	11	21	13	16
Investments	–	22	–	21
With-profits	–	48	–	26
Total	**(80)**	**244**	(85)	207

New business strain fell in the year from £85 million in 2009 to £80 million in 2010 with reduced volumes across the majority of products lines.

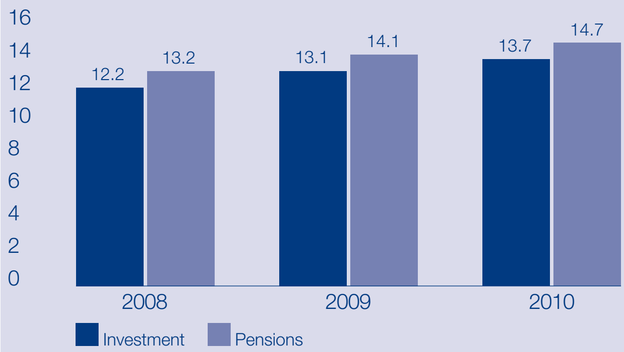
The full benefits of the FSA's Policy Statement PS06/14 in terms of utilisation of negative reserves have yet to be realised in the AXA UK Life Business acquired. This will impact 2011 and beyond.

Pensions strain has fallen by £5 million and is largely driven by the AXA UK Life Business ceasing to write commission paying pension products resulting in an associated fall in variable acquisition expenses.

In-force surplus increased year on year to £244 million principally as a result of the stronger stock market and a one-off transfer of £16 million in respect of the shareholders' share of the special bonus declared by FLC following the results of the 31 December 2010 inherited estate testing.

Investments and pensions surplus increased due to improved stock market conditions offsetting the run-off of the in-force business.

Funds under management
£bn



Investment return and other items

Longer term return on life and pension shareholder funds was £36 million in the year, a fall of £3 million from 2009. The marginal change in investment return reflects changes to the mix of shareholders' fund assets. The acquired companies held a number of strategic AXA equities during 2009 and the first eight months of 2010. These were disposed of as part of the acquisition of FASLH and largely invested in cash holdings generating lower returns.

Operating expenses

	2010 12 months £m	2009 12 months £m
Acquisition	**102**	123
Maintenance	**172**	156
Development	**3**	3
Total	**277**	282

UK operating expenses, which exclude commission payments and non-recurring costs, remained largely flat at £277 million over 2010.

Acquisition expenses reduced following the closure of legacy pensions to new business in the fourth quarter of 2009. In addition, 2009 acquisition costs include the AXA UK retained bancassurance sales force. Post-acquisition, certain of these costs have been replaced with commission payments to AXA UK which are not included as initial expenses.

Maintenance expenses have increased temporarily largely due to increased service costs before integration synergies, including VAT on AXA UK provided services. In addition there is a transfer of overhead costs from period to period between maintenance and acquisition. This is driven by reduced new business volumes which in turn means that a higher proportion of acquisition expenses are allocated to the in-force book.

Friends Provident UK MCEV operating profit

	2010 12 months £m	2009 12 months £m	2009 2 months £m
Value of new business	**26**	26	–
Expected existing business contribution	**143**	163	26
Operating experience variances	**43**	(68)	(12)
Operating assumption changes	**(41)**	11	1
Other operating variances	**62**	8	–
Development costs	**(20)**	(16)	(3)
Life and pensions covered business operating profit before tax	**213**	124	12
Other income and charges	**6**	3	–
Operating profit before tax	**219**	127	12

Friends Provident UK contributed operating profit of £219 million in the year to 31 December 2010 (2009: £127 million). Adjusting for the impact of a short-term persistency provision of £64 million in 2009 and the significant one-off operating variances shown above in 2010 demonstrates an underlying fall in operating profit which is largely due to operating assumption changes in 2010 for improved annuitant mortality.

Sales across the UK are marginally down on 2009 to £391 million APE (2009: £407 million).

	Value of new business		PVNBP margin	
	2010 12 months £m	2009 12 months £m	2010 12 months %	2009 12 months %
UK corporate (principally group pensions)	**5**	11	**0.3**	0.7
UK individual (principally individual protection)	**(1)**	(8)	**(0.4)**	(1.7)
Annuities	**22**	23	**9.0**	9.8
UK total	**26**	26	**1.2**	1.1

The market for group pensions remains challenging with levels of incremental business remaining depressed (relative to long-term trends), although stable, in the current UK economic climate but the profitability of new business reduced due to a change in the timing of tax relief attributable to new business acquisition costs.

For UK individual business, individual protection sales for the period of £36 million APE are down 13% on sales in 2009. The protection market is still subdued and reflects the poor economic conditions and low housing transaction levels. This situation is not expected to improve in the near term. Price levels as a result are very competitive with the value of protection new business remaining negative but improved in 2010 as the focus on lowering the acquisition expense levels more than offsets the reduction in volumes.

The majority of the Group's value of new business is contributed by annuities, with the contribution in 2010 of £22 million marginally down compared to 2009. The annuity contribution was adversely affected by a £3 million strengthening of the base mortality and longevity improvements assumptions which follows the alignment of the Friends Provident and AXA annuity bases. The effects of volume growth partially offset this as annuity sales increased by 4% in 2010. Annuity sales peaked in the first half of the year following changes in minimum retirement age from 50 to 55, which took effect from 5 April 2010.

Expected existing business contribution

The expected existing business contribution for Friends Provident UK includes the expected return on the value of in-force business, the expected return on shareholders' net assets and an allowance for the release of non-hedgeable risk.

The expected return on the value of in-force has fallen due to the lower long-term rates of return applied to corporate bonds backing the annuity business and lower investment income following dividend payments to holding companies, as set out below.

	Rates of return 2010 %	Rates of return 2009 %
Reference rate	**1.01**	2.00
Best estimate returns:		
Corporate bonds	**2.98**	4.74
Equity	**7.30**	6.50
Property	**6.30**	5.50

Operating experience variances

Positive operating experience variances of £43 million arose in the period as follows:

- mortality and morbidity experience has resulted in a positive variance of £30 million in the year with claims on protection products at levels below long-term expectations;
- £12 million release of a historic tax provision held by Friends Provident as reported at the 2010 interim results; and
- positive expense experience of £4 million in 2010 as incurred expenses were lower than assumed offset by other negative variances totalling £3 million.

In 2009 the UK business experienced a worsening in persistency experience with more policies going off the books than had been assumed. At that time it was anticipated that this would be a short-term impact over a period of two years as the economy moved out of recession. As a result, a provision of £64 million gross of tax was set up in the 31 December 2009 MCEV results. In 2010, adverse persistency has continued at levels higher than the long-term expectation, in particular in respect of unit-linked pensions business. However, this adverse experience is within the level provided for at 31 December 2009. In aggregate, £27 million of the provision has been utilised to offset this experience and £37 million remains to be offset against further variances in 2011.

Operating assumption changes

Operating assumption changes total £41 million in the year (2009: £11 million).

In light of emerging industry and in-house views, in particular new mortality projections, and as part of the harmonisation of assumptions across the Group, the assumptions regarding future rates of annuitant mortality improvement have been strengthened for the Friends Provident UK business. The minimum annual rates of improvement have been increased in both IFRS and MCEV with a £47 million adverse effect on the Friends Provident UK MCEV result.

Other positive operating assumption changes of £6 million relate to changes to persistency and operational assumptions underlying the time value of options and guarantees.

Other operating variances

Other operating variances of £62 million (2009: £8 million) comprise a number of positive methodology and modelling enhancements.

Modelling enhancements totalling £14 million have benefited the 2010 results. Of this, £9 million relates to the inclusion of variable charging structures in the modelling of group pensions business. The remaining £5 million benefit relates to the improved modelling of corporate pensions persistency.

Methodology changes amounted to £41 million, largely due to a change in the timing of modelled tax relief on group pensions business which has resulted in a £26 million benefit to the results. In addition to this, the attribution of required capital across the UK, International and corporate segments has been updated, creating a £12 million benefit in the Friends Provident UK business with offsetting adverse impacts relating to the cost of capital in the International (£2 million) and corporate segment (£10 million).

The remaining balance of £7 million relates to a number of smaller modelling and methodology changes.

AXA UK Life Business post-acquisition MCEV operating profit

The results of the AXA UK Life Business for the post-acquisition period are presented below on an MCEV basis. Results for the period prior to acquisition are not included as the acquired companies did not prepare their results on a market consistent embedded value basis prior to acquisition.

	2010 4 months £m
Value of new business	(7)
Expected existing business contribution	67
Operating experience variances	(6)
Operating assumption changes	–
Other operating variances	34
Development costs	(1)
Life and pensions covered business operating profit before tax	**87**
Other income and charges	–
Operating profit before tax	**87**

The post-acquisition operating result of the AXA UK Life Business was £87 million and principally reflects the expected return from the in-force book. Details of the loss on new business of £7 million are shown below.

	Value of new business 2010 4 months £m	PVNBP margin 2010 4 months %
UK corporate (group pensions)	(10)	(4.8)
UK individual (predominantly protection)	(1)	(0.4)
Annuities	4	8.0
UK total	**(7)**	**(1.1)**

The VNB generated by corporate business mainly represents new members joining existing schemes, as new schemes are no longer being actively sold on the AXA UK Life Business platforms following its acquisition by Friends Provident. Maintenance expense assumptions are also temporarily impacted by the limited reduction of the corporate cost base in advance of integration activity in 2011.

Individual business is predominantly protection business where the market continues to be very competitive. The traditional trigger for purchases, housing transactions, continues to remain at low levels. Price levels as a result are very competitive. Also within the UK individual segment, investment bond sales of £20 million contributed £5 million of VNB, representing a tail of business sold through IFAs following acquisition, and the temporary sales via the AXA UK bancassurance channels. Volumes reduced following the separation from the AXA wealth management IFA sales force, with future bancassurance volumes also expected to reduce as the investment bond becomes a non-core product for the AXA UK Life Business.

Annuity sales of £5 million in the post-acquisition period have contributed £4 million to the AXA UK Life Business result and reflect the vesting of in-force pension policies.

Expected existing business contribution

The expected existing business contribution for the AXA UK Life Business includes the expected return on the value of in-force business, the expected return on shareholders' net assets and an allowance for the release of non-hedgeable risk. The opening value of in-force business was £1.9 billion at acquisition. The rates are set out in the table below.

	Rates of return 30 September 2010 %
Reference rate	1.05
Best estimate returns:	
Corporate bonds	2.77
Equity	6.10
Property	5.10

Operating experience variances

Negative operating experience variances amounting to £6 million arose in the period and include:

- a £5 million charge relating to worse than expected persistency incurred in the post-acquisition period. The year end results include a provision for future corporate pension lapses, although this has not been utilised in the four month period. The increase in lapses in the last four months of the year is not significant enough to cause a revision in the long-term rate of discontinuance assumed;
- mortality experience resulting in a negative variance of £3 million in the period. The small impact arises from a number of lines of business and again no changes to the long-term mortality assumptions are required. In addition, the use of reinsurance arrangements is anticipated to ensure mortality variances are small; and
- other favourable variances totalling £2 million including an accumulation of smaller operational experience items.

Operating assumption changes

The businesses' operating assumptions were set on acquisition and there has been no cause for these to be amended at the year end.

Other operating variances

Following various management actions including a review of the tax asset relating to the re-attributed inherited estate, there has been a £21 million increase in MCEV operating profit.

In addition, £13 million relates to ongoing review of systems and processes.

b) International operating segment

	2010 12 months	2009 12 months
APE (£m)	**238**	192
VNB (£m)	**43**	47
IFRS operating profit (£m)	**95**	57[i]
MCEV operating profit (£m)	**68**	18
PVNBP margin (%)	**3.0**	4.3
IRR (%)	**15.4**	14.4

(i) Restated.

International benefited from an improvement in customer confidence across the majority of its markets, impacting both new business volumes and profits and cash from the back book of business. International sales volumes were up 24% to £238 million (2009: £192 million), and IFRS operating profit rose by 66% to £95 million (a rise of 12% excluding the impact of principal reserving changes and one-off items). MCEV profits also improved as the negative experience variances of 2009 were not repeated.

International IFRS operating profit

	2010 12 months £m	2009 12 months £m	2009 2 months[i] result £m
New business strain	**(28)**	(23)	
In-force surplus	**120**	97	
Investment return and other items	**3**	3	
Principal reserving changes and one-off items	**2**	(26)	
Share of results of AmLife Insurance Berhad	**4**	11	
Development costs	**(6)**	(5)	
IFRS based operating profit before tax	**95**	57	9

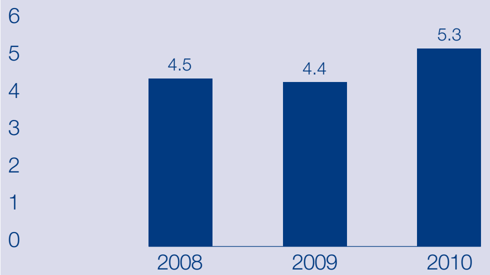
(i) Analysis not available.

International generated operating profits of £95 million in 2010 with the result reflecting the strong increase in fee generation as improved global investment markets increased assets under management.

International new business strain and in-force surplus

The level of new business strain has increased in the year in line with, and driven by, the 24% increase in new business volumes. The impact on strain was mitigated by the impact of acquisition expenses before commissions, which are less variable, rising by only 7%.

Funds under management
£bn



The surplus generated from existing business improved to £120 million in the year and principally reflects the increased size of the in-force book. As the business (excluding Overseas Life Assurance Business "OLAB") is largely unit-linked, investment values are a significant driver of profit via annual management charges. Funds under management for the business grew 16% in 2010, which has been achieved through net cash inflows of £0.6 billion, positive investment market growth and favourable exchange rate movements. The broad combination of these factors has resulted in higher levels of annual management charges generated over the year.

Principal reserving changes and one-off items

In 2010 a small positive of £2 million reflects a number of modelling improvements. The 2009 result was adversely affected by a £20 million expense reserve set up in respect of the growing German business, of which £3 million was released in 2010.

AmLife Insurance Berhad

AmLife, the 30% owned Malaysian associate, performed well over the year. The business, which mainly distributes through bancassurance and tied agency sales channels delivered sales of £10 million APE (FPH share) up 8% on 2009. The IFRS results are distorted by certain one-off items which principally comprise a positive £6 million item in 2009 reflecting a one-off regulatory reserve change, and a £6 million negative in 2010 reflecting a change in valuation methodology for a particular product. The underlying progression of operating profit year on year is positive.

International operating expenses

	2010 12 months £m	2009 12 months £m
Acquisition	**28**	26
Maintenance	**22**	20
Development	**6**	5
Other	**1**	–
Total	**57**	51

International operating expenses, which exclude commission payments and non-recurring costs have increased to £57 million from £51 million in 2009.

Expenses were constrained in 2009 in the face of recessionary impacts on new business volumes. The increase in 2010 largely reflects the reinstatement of proposition and regional infrastructure spend deferred from 2009 to develop propositions and distribution capabilities as well as volume driven increases in acquisition expenses and growth of the in-force book increasing maintenance expenses. The largest single item in 2010 development expenditure relates to the costs of improving the underlying global international policy administration platform and costs related to the ongoing development of the German business.

International MCEV operating profit

	2010 12 months £m	2009 12 months £m	2009 2 months £m
Value of new business	**43**	47	9
Expected existing business contribution	**29**	23	5
Operating experience variances	**12**	(21)	(6)
Operating assumption changes	**(2)**	(8)	–
Other operating variances	**(7)**	(18)	–
Development costs	**(6)**	(5)	(2)
Life and pensions covered business operating profit before tax	**69**	18	6
Other income and charges	**(1)**	–	–
Operating profit before tax	**68**	18	6

The International business delivered an increase in MCEV operating profit to £69 million (2009: £18 million), reflecting positive experience on the back book of business, from both persistency and expenses, although the value of new business and in-force was impacted by modelling improvements, instigated by management, to better reflect the underlying profitability of the business written.

	Value of new business		PVNBP margin	
	2010 12 months £m	2009 12 months £m	2010 12 months %	2009 12 months %
FPIL	**27**	31	**2.3**	3.6
OLAB	**12**	12	**6.7**	7.6
AmLife	**4**	4	**6.5**	6.8
International total	**43**	47	**3.0**	4.3

New business sales increased across all key territories and in total finished 24% up on 2009, reflecting improved customer confidence. This is particularly evident in the Asian and European markets where sales in Singapore and Hong Kong were up 51% and 16% respectively and sales in Germany grew by 15%.

The value of new business reduced as a result of the improvement and strengthening of internal models and operating assumptions in the period, with a corresponding impact on margins, but now reflects a more robust view of current profitability. In addition, increased volumes were offset by the impact of some margin compression reflecting both changes in mix and competitive market pressures.

Friends Provident's 30% share of AmLife VNB in the period has remained consistent with that delivered in 2009 whilst margins have been impacted by lower bond yields.

Expected existing business contribution

The expected existing business contribution of £29 million has increased year on year due to the growing size of the in-force book, a reduction in the cost of non-hedgeable risk and as the best estimate returns applied to the opening value of in-force business more than offset the decrease in reference rate.

	Rates of return 2010 %	Rates of return 2009 %
Reference rate	**1.01**	2.00
Best estimate returns:		
Corporate bonds	**2.98**	4.74
Equity	**7.30**	6.50
Property	**6.30**	5.50

Operating experience variances

Positive operating experience variances of £12 million have benefited the 2010 result (2009: £21 million negative), demonstrating an improved operational performance over the year with positive experience in persistency, mortality and levels of fund rebates. Experience includes the full release of the £7 million recessionary provision set aside at 31 December 2009 to cover short-term adverse persistency as a result of the recent recessionary conditions. This provision has not been fully utilised in 2010, but has been fully released due to the improvements in market conditions and the positive impact of management actions on persistency.

Operating assumption changes

£2 million net adverse operating assumption changes reflects the impact of stronger assumptions with regard to investment expenses, offset by positive changes across persistency and mortality, as a result of improved experience. In 2009, an £8 million net charge reflected the set-up of a £20 million reserve for OLAB expenses, and the set-up of a £6 million short-term recessionary provision for persistency, offset by positive changes relating to longer-term persistency assumptions.

Other operating variances

Other operating variances amounting to negative £7 million (2009: £18 million negative) have been incurred in the year. The principal impact relates to enhancements to internal models and methodology changes following internal review. This resulted in a £22 million charge to the International operating result.

Partially offsetting the above changes was a £10 million benefit from changes to the cost of non-hedgeable risk methodology to reflect more accurately operational risk and related capital requirements.

c) Lombard operating segment

	2010 12 months	2009 12 months
APE (£m)	**302**	274
VNB (£m)	**83**	60
IFRS operating profit (£m)	**33**	16[(i)]
MCEV operating profit (£m)	**162**	87
PVNBP margin (%)	**2.7**	2.2
IRR (%)	**26.7**	18.8

(i) Restated.

2010 was a particularly strong year for Lombard. The business achieved record results, with an emphasis on significantly improving underlying cash generation and distributable profits, whilst growing the contribution from new business by 38%.

Lombard has continued the positive sales momentum generated at the end of 2009 with volumes up 10% (15% in local currency) in the year to 31 December 2010. In this period management has successfully spread sales across the year which differs from the predominantly fourth quarter weighted sales profile of previous years.

MCEV operating profit nearly doubled benefiting from the strength of VNB, increased funds under management and the one-off effect of internal corporate restructuring resulting in a lower effective tax rate, offsetting the adverse impact of a short-term increase in lapses in Spain.

Lombard IFRS operating profit

	2010 12 months £m	2009 12 months £m	2009 2 months[i] £m
New business strain	**(28)**	(29)	
In-force surplus	**66**	55	
Investment return and other items	**(4)**	(6)	
Principal reserving changes and other one-off items	**–**	(2)	
Development costs	**(1)**	(2)	
IFRS based operating profit before tax	**33**	16	4

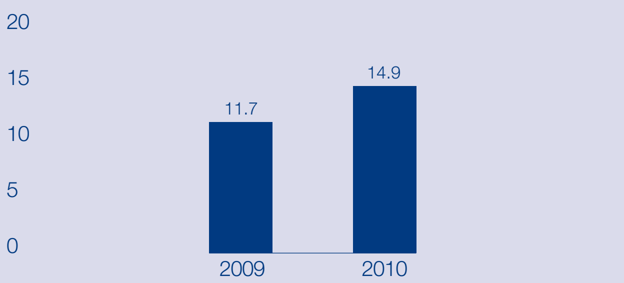
(i) Analysis not available.

Lombard generated operating profits of £33 million, up £17 million from 2009. The result highlights the focus on shareholder cash resource generation and IFRS profitability, with the enhancements made to products and distribution contributing to a reduction in new business strain notwithstanding increased sales.

Lombard new business strain and in-force surplus

New business strain is marginally down on 2009 and compares well in a period when volumes have grown 10% (15% in local currency).

Funds under management
£bn



In-force surplus has principally benefited from the growth in the existing book of business. The increase in charges generated from the in-force book has increased both as a result of investment market growth but also as a result of the significant sales volumes brought onto the book at the end of 2009 and through the first half of 2010. As a result, average funds under management have increased significantly from £11.7 billion in 2009 to £14.9 billion in 2010. In addition to this growth of the in-force book, Lombard has been able to control maintenance expenses, with these remaining at a similar level to the previous year.

Lombard operating expenses

	2010 £m	2009 £m
Acquisition	**47**	44
Maintenance	**15**	19
Development	**1**	2
Other	**2**	1
Total	**65**	66

The operating expenses of Lombard, which exclude both commission payments and non-recurring costs, are set out in the table above. Operating expenses are marginally lower than 2009 with acquisition and maintenance expenses tightly controlled in conditions of positive sales growth and increased scale of the in-force book.

Lombard MCEV operating profit

	2010 12 months £m	2009 12 months £m	2009 2 months £m
Value of new business	**83**	60	43
Expected existing business contribution	**38**	28	4
Operating experience variances	**(17)**	(8)	(7)
Operating assumption changes	**20**	(7)	–
Other operating variances	**39**	16	–
Development costs	**(1)**	(2)	–
Life and pensions covered business operating profit before tax	**162**	87	40
Other income and charges	**–**	–	–
Operating profit before tax	**162**	87	40

On an MCEV basis, Lombard contributed operating profit of £162 million in the year (2009: £87 million) as the business improved the value of in-force business whilst also benefiting from higher expected existing business contribution and positive operating variances.

	Value of new business 2010 12 months £m	Value of new business 2009 12 months £m	PVNBP margin 2010 12 months %	PVNBP margin 2009 12 months %
Lombard	**83**	60	**2.7**	2.2

Lombard new business contribution of £83 million has significantly increased in 2010 driven principally by a 10% (15% in local currency) increase in annual sales whilst acquisition costs have been maintained at a level comparable to 2009.

Sales volumes have benefited from an increased marketing effort and returning client confidence in a number of markets with particularly strong improvements in Belgium and the UK. The return in confidence is further illustrated by the increased proportion of larger cases (transactions greater than 10 million Euros) which increased from the low levels (22% of total sales) in 2009 to 30% in 2010. These cases bring significant funds onto the administrative platform but have not diluted overall margin.

The margin levels achieved in 2010 of 2.7% have increased by 50 bps compared to last year as a result of higher volumes achieved with a lower overall acquisition cost and a lower cost of frictional items such as non-hedgeable risk.

Lombard sales volumes, which have traditionally been weighted towards the fourth quarter, have been spread more evenly across the year in 2010 facilitating operational benefits and the receipt of more in-force charges during the year.

The expected existing business contribution of £38 million is £10 million higher than the previous year with this increase principally a result of the increased value of the in-force book.

Operating experiences variances

Adverse operating experience variances of £17 million include a £19 million persistency charge relating to surrenders within the Spanish book. These surrenders have been driven by the prevailing economic conditions in the Spanish market and do not reflect a wider trend for persistency across the rest of Lombard's in-force book. Excluding these surrenders persistency experience in 2010 contributed a positive £8 million.

Lombard has as a result of tight expense management seen positive expense experience of £2 million in 2010. In addition to this mortality experience has also resulted in a £3 million benefit to the business.

Other experience variances include a charge for tax experience of £4 million and other smaller variances.

Operating assumption changes

Operating assumption changes of £20 million include an £18 million benefit from improvements to expense apportionment methodology. This has been enhanced to better allow for the progression of fixed and variable expenses across the major product classes and countries. In addition to this, updated lapse assumptions reflecting recent experience have resulted in an overall benefit of £2 million. This positive experience item incorporates a provision of £6 million against further adverse persistency in the Spanish book and reflects the value of the geographic diversification across the total book.

Other operating variances

Other operating variances of £39 million include a £32 million benefit resulting from a review of Lombard's corporate structure which has resulted in the business's intermediation service company being repatriated from Jersey to Luxembourg and the reduction in the business's tax rate from 28.59% to 23.5%.

Other operating variances also include a £7 million benefit following a reassessment of the cost of non-hedgeable risk.

d) Corporate segment

The corporate segment includes the corporate holding and principal service companies of the Friends Life group.

Corporate IFRS based operating profit

The life operating segments disclosed above have been reported excluding the contribution made by the Friends Life group corporate segment. These are shown below:

	2010 12 months £m	2009 12 months £m	2009[i] 2 months £m
Investment return and other items	**(14)**	–	
Other	**(11)**	4	
IFRS based operating profit before tax	**(25)**	4	(5)

(i) Analysis not available.

In the year to 31 December 2010, the corporate segment contributed a loss of £25 million. This result is driven to a large extent by the debt composition of shareholder assets.

Investment return in the year, a cost of £14 million, increased to include interest on the £700 million lower tier 2 subordinated debt issued to Resolution holding companies in September 2010 and £7 million in respect of the Friends Life group credit facility. These are partially offset by the expected return of other shareholder net assets and the expected return on the pension asset.

Other of £11 million relates to charges for the Long Term Incentive Plan (£5 million) and £6 million of other corporate costs.

Corporate MCEV operating results

The corporate business unit consists of both non-covered and covered business. The non-covered element relates to the net assets of the Friends Life group's corporate holding and service companies whilst the covered element principally represents the net debt liabilities held at the Friends Life group level.

	2010 12 months £m	2009 12 months £m	2009 2 months £m
Expected existing business contribution	**(30)**	(38)	(7)
Other operating variances	**(63)**	–	–
Life and pensions covered business operating loss before tax	**(93)**	(38)	(7)
Other income and charges	**(16)**	10	3
Operating loss before tax	**(109)**	(28)	(4)

The negative £30 million expected return includes the expected interest costs on the external STICS and lower tier 2 subordinated debt, which are held by the Friends Life group life and pensions covered business.

At 31 December 2010, the gross MCEV carrying values of the external STICS and lower tier 2 debt, including accrued interest, were £403 million and £213 million, respectively.

The £63 million of other operating variances relate to the change in the group capital policy, the resultant increase in capital held and associated cost of capital within MCEV as described in the review of the group's MCEV results above. Whilst the additional capital required to meet the group capital policy is currently held within the life operating companies, the cost associated with the additional capital is recognised in the Friends Life group corporate segment.

Other income and charges of £(16) million include the interest payable on the lower tier 2 subordinated debt funded by Resolution holding companies, and other corporate costs, offset by the expected return on corporate assets.

Principal risks and uncertainties

The Group has actively managed its risk profile during 2010. The Group's risk appetite framework drives the identification and mitigation of strategic, financial and operational risks to support the achievement of its objectives.

The formalised risk management framework which the Company has developed to guide the management of risk is further described within the Governance section of the Annual Report and Accounts. A more detailed review of the Group's exposures to market, credit, insurance and operational risks together with the framework and instruments for their management are included in the notes to the accounts.

Following is a list of the principal risks and uncertainties to which the Group was exposed during 2010 and a description of its approach to managing these exposures:

Economic conditions

The Group is exposed to volatile and uncertain economic conditions as a result of holding a broad range of investment assets to meet the obligations arising from its insurance business. Adverse or uncertain economic conditions also impact the willingness of consumers to buy and continue to hold the Group's products.

During 2010 there was a recovery in financial markets and some reduction in volatility from the very high levels experienced in recent years, leading to improved market confidence. There have also been signs of growth in UK life insurance and pension markets. However, economic conditions remain challenging and uncertain, with extremely low levels of interest rates, volatile economic growth and insecure labour markets.

The Group's business model is designed to mitigate the impact of market conditions through measures including the matching of assets and liabilities, the use of financial instruments to reduce the volatility of returns on assets, diversification in the product portfolio, and ensuring the operating companies within the Group are robustly capitalised. The Group also actively monitors changes in the economic environment to enable proactive management of impacts to relevant markets.

The Group is aware that the impact of measures to reduce government spending in the UK and elsewhere has yet to fully feed through to the UK economy. Deterioration in, or substantially slower recovery of, the UK or other major economies throughout the world where the Group operates, could reduce the level of demand for the Group's products and services and impact its operating results. The Group continues to actively monitor these risks and will take proactive action to manage expenses and its business model in the light of economic developments.

Acquisition of target companies

The Group's business strategy is founded on the acquisition and restructuring of existing businesses in the financial services sector. Hence, a key inherent risk for the Group is the failure to identify target companies which represent a good strategic fit with its existing business and the execution of acquisitions of these targets at a price consistent with building shareholder value.

The successful enlargement of the Group's business through the acquisition of the AXA UK Life Business in September 2010 has enabled the Group to make substantive progress in building the scale of business necessary to deliver the Company's UK Life Project. Further progress has been made since the end of 2010 through completion of the acquisition of BHA, which diversifies the Group's product offering and builds market share in the Group risk and individual protection markets.

The Company is confident that it will achieve its targeted mid-teen returns on the UK Life Project without further acquisitions. Further acquisitions will only be contemplated if they do not dilute the returns likely to emerge from the three acquisitions already made. There is a high threshold for evaluating further acquisitions and therefore a correspondingly reduced level of acquisition risk in the execution of the Group's strategy.

Integration and restructuring

The Group is exposed to the risk of failing to integrate and successfully restructure the financial services businesses that it acquires, and to achieve project specific objectives. As expected, the AXA UK Life Business acquisition in September 2010 led to a step change in this inherent risk and the focus of the Group's activity to manage the risk. The Group has a well developed approach to managing integration risk. This is founded on:

- preparation of its existing businesses to be ready to support growth by acquisition;
- building capability and resilience into the resourcing model;
- rigorous planning for the governance, control and operation of new businesses from the day of completion;
- a "100 day plan" to stabilise on an integrated basis the governance, systems and controls of the acquired business pending implementation of full integration;
- review and analysis of the enlarged business to refocus and refine the business plans of the enlarged business focusing on "best of breed" products and distribution channels; and
- comprehensive analysis and planning for the integration of business platforms and systems ahead of the streamlining of operations.

This rolling programme of activity will continue with the emphasis for those acquisitions completed to date on implementation of restructuring proposals and achievement of synergy benefits.

Regulatory change and compliance

The Group operates in a highly regulated financial services market both in the UK and internationally which has a significant impact/influence on both strategic decisions and ongoing day-to-day management of acquired businesses. Unanticipated changes in legal requirements (including taxation) and regulatory regimes, or the differing interpretation and application of regulation over time, may have detrimental effects on the Group.

The current framework of regulation in the UK and throughout the world continues to evolve due to the national and, from a UK perspective, European requirements and in response to the wider recent turmoil in the global financial markets. It is impossible to predict the full nature of the regulatory changes which may occur in the future or the impact that such changes may have on the Group and its strategic objectives. The burden of regulatory change facing the Group's insurance businesses continues to grow with preparation being required for compliance with gender neutral pricing, Solvency II and associated tax changes, IFRS Phase II and the FSA's Retail Distribution Review.

The Group bases its business strategy on prevailing regulation and known/planned change. To mitigate the risk of legislation or regulation adversely impacting its business, the Group and its operational businesses engage with regulatory and legislative authorities and support lobbying activity conducted by relevant industry groups. The Group has processes in place to identify regulatory and legislative change and to monitor the timely implementation of new requirements.

Mortality and other assumption uncertainties

The writing of life assurance and pension business by the Group's insurance businesses necessarily requires the setting of assumptions for future experience of factors such as mortality/longevity, lapse/persistency rates, valuation interest rates, credit defaults and expense levels.

During 2010 the Group continued to manage actively its mortality/longevity exposure. Longevity risk in the AXA UK Life Business was further reduced through the purchase of reinsurance. This complements the longevity hedges and reinsurance of mortality risk already in place across the Friends Life group.

The Group takes a prudent approach to evaluating the appropriate level of provisions and capital for these risks and the assumptions are subject to rigorous and ongoing review. However, an extreme event causing a substantial change in mortality/morbidity experience could require assumptions to be recalibrated and impact the profitability, earnings and capital position of the Group. Stress and scenario testing is used to validate the appropriateness of key assumptions to single events and combinations of extreme events including economic conditions, investment performance and mortality/morbidity events. The management of these risks is covered further in the full financial statements.

Reliance on Resolution Operations LLP

The Group currently depends to a significant degree on ROL and key ROL personnel for the successful implementation of the Group's strategy, the provision of day-to-day oversight of the Friends Life group and the provision of certain other services to the Company in its role as a holding company. These services are provided in conjunction with the Board which independently approves every acquisition made by the Company and oversees the performance of ROL.

There was minimal change in the composition of the top team within ROL during 2010. However, the resources of ROL have increased in order to reflect the growth in the Group's business and increased requirement for oversight of the Friends Life group.

The Company has sought to mitigate the risk of reliance on ROL by aligning the interest of the key members of the ROL team through an incentive structure which rewards the founders and staff for the capital value created on each restructuring project which the Company undertakes. There is also a formal process of evaluating the performance of ROL against the services it has contracted to provide and restrictions on the termination of ROL's contract. ROL may not terminate the agreement under which it provides services to the Company until 10 December 2013 and then only subject to providing the Company with 12 months' written notice (except that the agreement may be terminated by ROL prior to December 2013 (and on shorter notice) upon a change of control of the Company and in certain other limited circumstances). Conversely, the Company is not able to remove ROL in the absence of negligence or material default or similar until 10 December 2013.

Governance

Report of the directors

The directors present their report together with the financial statements of the Company and its subsidiaries for the year ended 31 December 2010. These will be laid before shareholders at the Annual General Meeting ("AGM") to be held on Wednesday, 18 May 2011.

Business review and results

The business review and results for the period are set out on pages 12 to 52.

Principal activities

The Company was incorporated in Guernsey to provide public markets with a series of restructuring opportunities in the financial services industry within UK and Western Europe. The Company's current restructuring project is the UK Life Project. During the year the Group completed the acquisition of the majority of the AXA UK Life Business. Further information on the Company's activities can be found in the operating report by Resolution Operations LLP on pages 6 to 10.

Events after the balance sheet date

On 31 January 2011, the Group acquired 100% of the shares and business of BHA for gross consideration of £168.2 million.

Dividends

The directors have proposed a final dividend for 2010 of 12.57 pence per share (2009: 2.72 pence) payable on Thursday, 26 May 2011 to shareholders on the register at the close of business on Tuesday, 26 April 2011. Dividend details are set out on page 5 of the Chairman's statement, page 37 of the business review and in the Notes to the consolidated accounts on page 122, respectively.

The directors of the Company, at the date of approval of, and on payment of a dividend are required to consider a solvency test. The directors have considered the solvency test requirements and are satisfied that they were met at the dates of approval and payment of the final dividend for 2009 and the 2010 interim dividend and at the date of approval of the proposed 2010 final dividend.

A scrip alternative is being offered in respect of the 2010 final dividend. The scrip alternative will give shareholders the opportunity to receive new ordinary shares in the Company instead of the relevant cash dividend to which they would otherwise have been entitled.

Share capital

The Company's share capital, consists entirely of ordinary shares. Each share ranks equally and carries the same rights to vote, to receive dividends and other distributions declared, made or paid by the Company.

As part of the acquisition of the AXA UK Life Business, the Company raised new capital through a rights issue. Due to the size of the rights issue, a share consolidation of the Company's existing share capital was effected, to ensure that the resultant number of shares in issue, and the post rights issue share price were appropriate for the Company's size in the market. Further information on the acquisition of AXA UK Life Business is available on the Company's website, subject to certain restrictions, at www.resolution.gg by clicking on the "Acquisitions" link on the Investor Relations page.

In order to allot equity securities, directors require express authorisation from shareholders. The authority can be granted for a period of five years. However, the Company follows UK best practice and seeks shareholder approval annually to allot the Company's equity securities. At the 2010 AGM, the directors were granted authority to allot up to an aggregate number of 804,150,381 shares in the Company, comprising approximately one-third of the issued share capital of the Company, with an additional authority to issue shares by way of a rights issue comprising an additional one-third of issued share capital.

As a result of the changes to the Company's share capital arising from the rights issue and the share consolidation, those authorities to allot were restated and renewed at the general meeting of the Company on 20 July 2010. Accordingly, the directors currently have authority to allot up to an aggregate number of 483,640,883 shares in the Company, with an additional authority to issue shares by way of a rights issue comprising an additional 483,640,883 shares in the Company. Shareholders will be asked to renew this authority by ordinary resolution at the forthcoming AGM. Amongst the business to be transacted is a proposal to renew the authority for the Company to purchase its own shares. As at 31 December 2010, the Company had authority from shareholders for the purchase of 145,092,264 of its own shares.

The issued ordinary share capital decreased by 2,337,597,599 due to the share capital consolidation and was subsequently increased by 1,370,315,835 ordinary shares as a result of the rights issue. As at 31 December 2010, the issued ordinary share capital totalled 1,452,564,371 shares.

Substantial shareholdings

As at 22 March 2011, the Company had been notified of the following direct and indirect substantial interests in the issued ordinary shares of the Company:

	Number of shares	% of issued capital
Lloyds Banking Group Plc	155,749,139	10.72
FMR LLC	120,561,103	8.30
Schroder Investment Management Ltd (SM)	98,319,404	6.77
BlackRock, Inc	68,430,507	4.71
Aviva Plc and its subsidiaries	67,594,912	4.65
Legal & General Group Plc	62,015,051	4.27

Voting rights

All shareholders entitled to attend and vote at a general meeting of the Company may appoint a proxy or proxies to attend, speak and vote in their place. A member may appoint more than one proxy provided that each proxy is appointed to exercise the rights attached to a different share or shares held by the shareholder.

A proxy need not be a shareholder of the Company. Proxy forms must be received by the Company's Registrars at least 48 hours before the time appointed for holding a meeting as set out in any notices concerning a general meeting or in any form or proxy sent by or on behalf of the Company in relation to a meeting.

The appointment of a proxy does not preclude a shareholder from attending and voting in person at a general meeting. Further details may be found in the Notice of AGM and the proxy card sent to shareholders in advance of the AGM, copies of which are also available on the Company's website at www.resolution.gg.

Directors

In accordance with the Articles of Incorporation the appointment of new directors must be ratified by the shareholders at the Company's AGM following their appointment. A third of the directors (not including any newly appointed directors) must retire by rotation and seek annual re-election by the shareholders at each AGM. However, the Board has agreed to adopt early the recommendation of the UK Corporate Governance Code for annual re-elections and so all directors will seek re-election at the forthcoming AGM. Details of election and re-election of directors can be found in the Notice of AGM which may be viewed on the Company's website at www.resolution.gg. The governance structure and activities of the Board and its related Committees are illustrated on pages 61 to 65 of this report.

Directors' and officers' insurance

The Group maintains insurance cover for all Resolution Limited and FPH directors and senior officers against liabilities which may be incurred by them while acting as directors and officers. The indemnities of the directors of the Company whilst governed by Guernsey law, are broadly consistent with the scope of directors' indemnities that would be permitted under the UK Companies Act 2006.

Employee involvement

The Group continued its culture of informing and involving employees in matters which concern them through various channels including the use of regular meetings between management and employees, knowledge management tools, the Friends Life group's intranet, and the periodic issue of in-house briefings. The number of employees of the Group as at 31 December 2010 was 5,570 employees (2009: 2,711).

Our commitment to sustainability

The Company is developing its social responsibility programme to embed into the Group's culture. This positive step reflects the Company's commitment to ensuring the sustainability of the wider environment.

Political donations and contributions

The Company does not make any donations or contributions to political parties or organisations and no such payments were made during the year.

Remuneration report

The report by the Board on its remuneration policy and practices is set out on pages 74 to 83.

Directors' interests

Directors' interests in the shares of the Company during the year are shown on page 76 in the Remuneration report.

Auditor

Following the Audit and Risk Committee annual review, it was recommended that the Company's current external Auditor, Ernst & Young LLP, be re-appointed. Ernst & Young LLP has expressed its willingness to continue in office in accordance with the Companies (Guernsey) Law 2008 (as amended) and a resolution to re-appoint them as Auditor will be proposed at the forthcoming AGM.

Auditors' right to information

Each of the directors of the Company at the date of approval of this report confirms that:

- so far as each director is aware, there is no relevant audit information (as defined in the Companies (Guernsey) Law 2008 (as amended)) of which the Company's Auditor is unaware; and
- each of the directors has taken all the steps that he/she ought to have taken as a director to make him/her aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of the Companies (Guernsey) Law 2008 (as amended).

Secretary

The Secretary of the Company is Northern Trust International Fund Administration Services (Guernsey) Limited ("Northern Trust").

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the consolidated financial statements in accordance with applicable Guernsey law and International Financial Reporting Standards ("IFRS") adopted for use in the European Union. The directors are required to prepare consolidated financial statements for each financial year that present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and clear information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance;
- state that the Group has complied with IFRS, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies (Guernsey) Law 2008 (as amended). They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Directors' responsibility statement pursuant to Disclosure and Transparency Rule 4

Each of the directors confirms that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit and loss of the Group; and
- the business review included in the Annual Report and Accounts includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that they face.

Annual General Meeting

The Company's AGM will be held at 11.00 am on Wednesday, 18 May 2011 at The St. Pierre Park Hotel, St. Peter Port, Guernsey, Channel Islands and simultaneously broadcast via a live audio-visual link to a venue in The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The directors will continue to assess the most appropriate way shareholders not present in person may participate in the AGM.

Resolution Limited and FPH directors are expected to attend the AGM to answer shareholders' questions, with the Chairman of the Board and chairmen of the Committees present to answer any questions on the responsibilities and activities of their Committees. Resolution Limited and FPH directors attended the 2010 AGM. To ensure that the views of all shareholders are reflected proportionately, the Company intends for all resolutions to be voted on a poll. The resolutions to be proposed at the 2011 AGM are:

- adoption of the 2010 Annual Report and Accounts;
- 2010 Remuneration report;
- dividend payment;
- re-appointment of the Group's external Auditor, Ernst & Young LLP;
- authority to set remuneration of the external Auditor, Ernst & Young LLP;
- re-election of all Resolution Limited directors;
- re-election of FPH directors retiring by rotation;

- re-appointment of those FPH directors appointed since the last AGM;
- annual re-election of Clive Cowdery and John Tiner as directors of FPH;
- directors' authority to allot shares;
- disapplication of pre-emption rights; and
- authority for the Company to purchase its own shares.

Full details of the resolutions to be proposed at this year's AGM can be found in the Notice of AGM, a copy of which is enclosed with this Annual Report and Accounts and also available on the website at www.resolution.gg.

Going concern

Notwithstanding the Company's incorporation in Guernsey, the directors have undertaken a going concern assessment in accordance with "Going Concern and Liquidity Risk: Guidance for UK Directors of UK Companies 2009", published by the Financial Reporting Council in October 2009.

As a result of this assessment, the directors are satisfied that the Group and the Company have adequate resources to continue to operate as a going concern for the foreseeable future and have prepared the financial statements on that basis. In assessing whether the going concern basis is appropriate, the directors have considered the information contained in the financial statements, the latest business plan, profit forecasts, the latest working capital forecasts and estimated forecast solvency of the regulated subsidiaries of the Group. These forecasts have been subject to sensitivity tests and the directors are satisfied that the Group and Company have adequate resources to continue in operational existence for the foreseeable future.

Key information in respect of the Group's risk management report, objectives and processes for mitigating risks including liquidity risk are set out in detail on pages 65 to 68.

Future developments

An indication of likely future developments is set out in the Chairman's statement and the operating report on pages 4 to 10.

By order of the Board

Fergus Dunlop
Director

23 March 2011

Board of directors

The Board is the principal decision-making forum accountable to shareholders for the Company's performance and long-term success.

The Board focuses on areas that are important to the Company's shareholders:
- strategy;
- risk management;
- operational performance; and
- regulatory matters.

1 Michael Biggs, 58
Chairman

- Appointed independent non-executive Chairman in October 2008
- Re-elected a director by shareholders at the 2010 AGM
- Chairman of Nomination Committee
- Member of Remuneration Committee

Prior to Mike's appointment as Chairman, he was Chief Financial Officer of Resolution Life Group Limited and became Group Finance Director of Resolution plc upon the merger with Britannic Group plc in 2005. In March 2007, he was promoted to the position of Group Chief Executive of Resolution plc until May 2008.

He began his career at Williams & Glyn's Bank before joining Arthur Andersen where he became a manager within the Financial Services part of the practice. In 1984, he took up a role as Manager of Finance at Hong Kong & Shanghai Banking Corporation in the UK. After three years, he left to become Group Financial Controller of Morgan Grenfell, leaving the bank in 1991 to join Norwich Union as Group Financial Controller. In 1995, he became General Manager of Norwich Union's international operations and was a member of the team that demutualised and floated Norwich Union in 1997. He was appointed Group Finance Director of Norwich Union in that year and, following the merger with CGU plc in 2000 that created CGNU plc, he was made Group Executive Director responsible for CGNU plc's UK general insurance business. Mike was promoted to Group Finance Director in 2001, a position he held until he chose to leave Aviva, the renamed CGNU plc business, at the end of 2003.

External appointments
No external appointments.

2 Jacques Aigrain, 56
Non-executive director

- Appointed independent non-executive director in February 2010
- Member of Nomination Committee
- Member of Remuneration Committee

Jacques has spent most of his professional career in the insurance and banking sectors. He joined Swiss Re in mid-2001, where he served as Chief Executive Officer. In this role, Jacques oversaw the growth of Admin Re, Swiss Re's closed-life operation in the UK and the US. He was also a member of Swiss Re's Executive Committee between 2006 and 2009, and previously held the positions of Deputy CEO and Head of Financial Services. During this time, Jacques was Chairman of the Geneva Association and a number of international advisory associations. Prior to joining Swiss Re, Jacques was at JP Morgan for 20 years, holding several senior positions in the bank's investment banking division, including Co-Head of Investment Banking Client Coverage. He was ultimately appointed a member of JP Morgan's Global Investment Bank Management Committee.

External appointments
Jacques is currently serving on the supervisory boards of Deutsche Lufthansa AG and Swiss International Airlines. He is also Chairman of LCH Clearnet and Principal of J.A. Consulting SA.

3 Gerardo Arostegui, 61
Non-executive director

- Appointed independent non-executive director in February 2010
- Member of Nomination Committee
- Member of Remuneration Committee

Gerardo has extensive experience across the European insurance and asset management sectors. From 1985 until 2008 he worked for Aviva Spain, serving as its Chief Executive Officer throughout this period. During his 23-year career with Aviva, Gerardo led the creation, through acquisitions and organic growth, of one of the leading bancassurance businesses in Spain. Gerardo was also a member of the main Spanish insurance associations, including Unespa and Consorcio de Compensación de Seguros. Between 1995 and 2001, Gerardo was President of Pool Español de Grandes Riesgos. Before joining Aviva Spain, he was Deputy General Manager at Tubacex SA, the Spanish stainless steel tubing company.

External appointments
Gerardo is an Independent director of Tubacex SA. Board member of Qualitasa SLU and Tinsa Tasaciones Inmobiliarias.

4 Mel Carvill, 48
Non-executive director

- Appointed independent non-executive director in February 2010
- Member of Nomination Committee
- Member of Audit and Risk Committee

Mel has worked across a range of sectors in the European financial services industry, in a variety of different capacities. From 1985 until 2009 Mel worked at Generali where he held a number of senior positions in the group, including Head of Western Europe, Americas and Middle East, Head of M&A and Head of International Regulatory Affairs (2007–2009), Head of Corporate Development, Risk Management and Investor Relations (2005–2007), and Head of Corporate Finance (2000–2005). Mel was previously a Commissioner of the Guernsey Financial Services Commission, a position he held for nine years. Mel is a Fellow of the Institute of Chartered Accountants in England and Wales, holds the Advanced Diploma in Corporate Finance, and is an Associate of the Chartered Insurance Institute, a Chartered Insurer and a Fellow of the Securities Institute.

External appointments
Mel is currently the Founder and President PPF Partners' (a private equity firm) and a joint venture with Generali and PPF Group. Mel holds a number of directorships within financial service companies operating in Europe, the Americas and Asia.

5 Fergus Dunlop, 52
Non-executive director

- Appointed independent non-executive director in October 2008
- Member of Nomination Committee
- Member of Audit and Risk Committee (from 19 May 2010)
- Chairman of Remuneration Committee (to 19 May 2010)

Fergus has experience of institutional asset management for insurance companies in the UK, Germany and the Channel Islands. Between 2002 and 2007 he was Managing Director and Partner in Sudprojekt Gesellschaft fur Finanzanalysen (Munich), providing fund of fund and hedge fund advice, performance measurement and research. From 1997 to 2001 he worked in institutional sales in Mercury Asset Management KAG (Frankfurt) (later Merrill Lynch Investment Managers KAG). From 1987 to 1997 he worked for SG Warburg/ Mercury Asset Management plc (London), where he managed a joint venture with Munich Re and headed the London branch of Mercury's German regulated business.

External appointments
Fergus is a non-executive director of Schroder Oriental Income Fund Limited and Princess Private Equity Holding Limited, both traded on the London Stock Exchange and the Sanctuary Master Fund Limited (currently in formation).

6 Phil Hodkinson, 52
Non-executive director

- Appointed independent non-executive director in October 2008
- Appointed senior independent director in March 2009
- Member of Nomination Committee
- Member of Audit and Risk Committee (Chairman to 19 May 2010)

Prior to his retirement in 2007, Phil held a number of senior executive positions in the UK financial services industry including Group Finance Director of HBOS Plc, Chairman of Clerical Medical and Insight Investment, and Chief Executive of Zurich Financial Services UK Life and Eagle Star Life. Phil was previously Chair of the ABI's Raising Standards Accreditation Scheme. He is a Fellow of the Institute of Actuaries in England and Wales.

External appointments
Phil is chairman of the Community Mark Independent Approvals Panel, non-executive director of BT Group plc, Travelex Holdings Ltd and a board member of HM Revenue & Customs. He is also a trustee of BBC Children in Need, Christian Aid and Business in the Community.

7 Denise Mileham, 62
Non-executive director

- Appointed independent non-executive director in October 2008
- Member of Nomination Committee
- Member of Audit and Risk Committee
- Member of Remuneration Committee (to 19 May 2010)

Denise was previously an executive director of Kleinwort Benson (Channel Islands) Fund Services and Close Fund Services. At Kleinwort Benson, Denise acted as Deputy Head of Fund Services and as Head of Fund Administration. At Close Fund Services, she was a Director of New Business, running a team responsible for all aspects of new business, including marketing, sales and implementation of that new business. She joined Rea Brothers in 1997 which was subsequently purchased by Close Brothers Group in 1999, where she worked for nine years before moving to Kleinwort Benson. In her earlier career, Denise worked in the funds department of Barclay Trust before moving to Credit Suisse, where she undertook a number of roles, including Compliance Officer in the fund administration department. She has been a Fellow of the Securities and Investment Institute since 2006. She is a member of the Institute of Directors and the Guernsey Investment Fund Association, and is a member of their technical committee. She holds and has held a number of non-executive directorships.

External appointments
Denise is currently a director of FPP Japan Fund Inc and FPP (General Partner) Inc.

8 Peter Niven, 56
Non-executive director

- Appointed independent non-executive director in October 2008
- Member of Nomination Committee
- Member of Remuneration Committee
- Member of Audit and Risk Committee (to 19 May 2010)

From 1993 until 2004, Peter was a senior executive with the Lloyds TSB Group, holding a number of senior positions including Chief Executive of the Group's Offshore Financial Services Group, director of the Offshore Pension Fund, director of the Group's French banking subsidiary and director of numerous offshore trading companies. Peter is qualified as a Chartered Director and is a Fellow of the Chartered Institute of Bankers, a member of the Institute of Directors, the Guernsey International Insurance Company Managers Association and the Guernsey Investment Fund Association.

External appointments
Peter is currently chief executive of Guernsey Finance LBG. Peter holds a number of non-executive directorships, including six companies listed on the London and Channel Islands Stock Exchanges.

9 Gerhard Roggemann, 63
Non-executive director

- Appointed independent non-executive director in November 2009
- Chairman of Remuneration Committee (from 19 May 2010)
- Non-executive director at Friends Provident Holdings (UK) plc

Gerhard is also a director of Friends Provident Group Limited, having been previously a non-executive director since June 2007. Gerhard spent much of his professional career with financial services firm JP Morgan, where his positions included Managing Director of JP Morgan's German branch in Frankfurt and Regional Treasurer Asia Pacific located in Tokyo. He spent a total of 13 years on the management board of two German Landesbanks, joining the executive boards of Norddeutsche Landesbank in 1991, and of Westdeutsche Landesbank (WestLB AG) in 1996. Previous board appointments include AXA Lebensversicherungs AG, AXA Kapitalanlagegesellschaft mbH, Deka Bank, Fresenius AG, Hapag Lloyd AG and VHV Holding AG.

External appointments
Gerhard is currently the Vice Chairman of Hawkpoint Partners Europe and an Independent Director of F&C Asset Management Plc. He is also Chairman of the Supervisory Board of Günter Papenburg AG, Deputy Chairman of the Supervisory Board of Deutsche Börse AG as well as a member of the Supervisory Board of Deutsche Beteiligungs AG.

10 Tim Wade, 51
Non-executive director

- Appointed Independent non-executive director in May 2010
- Chairman of Audit and Risk Committee (from 19 May 2010)

Tim was formerly a Managing Director of AMP Limited. Between 1997 and 2000, Tim was Chief Financial Officer of Colonial Limited, where he was closely involved in the rationalisation of the life insurance industry in Australia, having previously held the role of Chief Taxation Counsel (1994–1997). From 1984 until 1994, Tim worked at Arthur Andersen in Melbourne and Singapore where he became a Partner in 1992. Tim is qualified as a lawyer and an accountant, and has a long career in financial services around the world.

External appointments
Tim is currently Executive Director of Finance Pronto Limited, non-executive director of Macquarie Bank International Limited and Access Bank UK Limited, and a Governor of The Coeliac Society. Tim was appointed as non-executive director of the Board of Monitise Plc on 12 January 2011.

Corporate governance report

Chairman's introduction

I believe the governance structures established at incorporation and at the time of the acquisition of Friends Provident are sound foundations on which to build the governance framework for the enlarged group.

Corporate governance in Resolution Limited

As Chairman, my role is to provide leadership of the Board and ensure that all directors bring a wide range of experience to the Board's deliberations. During the year the Board was strengthened with the appointment of four new directors with significant experience in financial services.

In addition, I am responsible for ensuring that first, appropriate and timely information is available to the Board in a clear and concise format, and second, there is an environment in the boardroom which promotes and supports independent thinking, effective decision-making, constructive and effective challenge. To achieve this successfully requires the right board composition and I believe the Company is well served by its current Board of directors.

Last year saw an increase in external scrutiny of, and changes proposed to governance processes and practices. Many of the practices put forward in the UK Corporate Governance Code are in line with the practices we already have in place, but where we can enhance good governance practices, we are doing so.

Managing risk

One of the key areas of focus for the Board is the management of risk. Risk analysis and evaluation is a key input to our decision-making process, including key strategic decisions related to acquisition opportunities and business planning.

The Board has set and continues to refine the effectiveness of its risk management framework for the Group. This is supported by the Company's Audit and Risk Committee and in the case of risk management within the Friends Life group by the FPH board and its board Risk and Compliance Committee.

Governance highlights in 2010

In the first half of the year, there were a number of changes to the Board with Mel Carvill, Jacques Aigrain and Gerardo Arostegui being appointed independent non-executive directors in February 2010, respectively. Tim Wade was also appointed an independent non-executive director and chairman of the Group's Audit and Risk Committee in May 2010. With the appointment of new directors to the Board, the Board took the opportunity to review the composition of its Committees to ensure that the expertise and experience of the Board was being fully utilised.

In June 2010, the Company announced the agreed acquisition of the majority of the AXA UK Life Business by FPH. This acquisition is currently being embedded into the existing governance structures of the Group.

A total of 15 Board meetings were held during the year with additional Board meetings, often called at short notice and I would like to thank my fellow directors for the dedication shown in attending these meetings.

Key priorities for 2011

Our focus this year remains on the execution of the UK Life Project, which means delivering on our commitments in three key areas:

- focusing new business on sustainable value;
- optimise the operating model and strategy; and
- delivering expense synergies.

Furthermore, we aim to enhance compliance with industry best practice in corporate responsibility. The scope of this commitment includes the management of relations with employees, customers, suppliers, and communities in which we operate.

Through the existing corporate social responsibility ("CSR") activities of the Friends Life group, we already have an established platform and track record of living up to these commitments. Currently, the Company is a member of Business in the Community ("BitC") and FTSE4Good Index and, it is our aim to be active participants in a number of various CSR initiatives in 2011. There will undoubtedly be some new requirements to consider for the Group, FPH and its principal subsidiaries. Details of current activities and aims are described in the CSR report on pages 72 and 73.

I am confident that the leadership and governance provided by the Board and the FPH board will ensure that we remain in a position to continue to deliver our objectives and strategy. This strong leadership is supported by established and embedded governance practices, ethical standards, robust internal controls and the Group's remuneration policy.

We will continue to review and enhance the Group's governance practices in line with current best practice. It is these governance practices that assist in achieving and protecting value to shareholders and building a sustainable business in the UK Life Project.

Michael Biggs
Chairman

23 March 2011

This report together with the Remuneration report, seeks to explain how in practice the Company applies the principles of governance advocated by the UK Combined Code on Corporate Governance (2008) ("the Combined Code") and more recently the UK Corporate Governance Code. This report also includes information required by Disclosure and Transparency Rule 7.2 to be contained in the Company's corporate governance statement.

Governance framework

The Company is firmly committed to high standards of governance and maintaining a sound framework through which the strategy and objectives of the Group are set and the means of attaining these objectives and monitoring performance is determined.

The Board has constituted the following Committees:

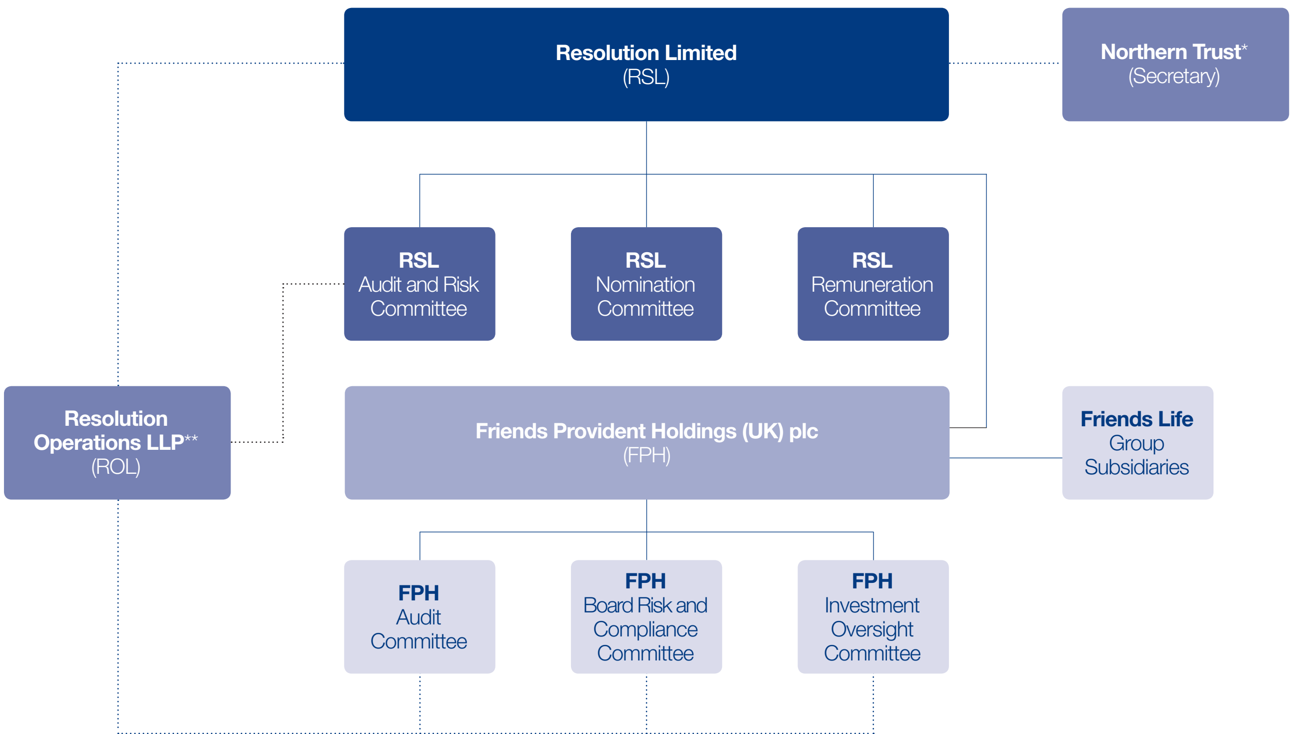
- Audit and Risk Committee;
- Nomination Committee; and
- Remuneration Committee.

The Committees provide support to the Board in discharging its responsibilities and committee membership is sourced exclusively from the Board directors of the Company. More information about the Committees and how the governance framework is implemented can be found on pages 62 to 65.

The key features of the Group's structure are:

- a wholly independent, non-executive Board responsible for the Company's objectives, business strategy and its overall supervision;
- day-to-day operations of the Company carried out primarily by a combination of Resolution Operations LLP and Northern Trust, pursuant to an operating agreement and corporate administration agreement, respectively, and overseen by the Board; and
- day-to-day management of the principal operating subsidiaries carried out by the FPH executive directors and their management team overseen directly by a combination of the FPH board, its committees and ROL. The Board and its committees exercise oversight of the FPH board and its committees by receiving regular reports from FPH directors and through the oversight function provided by ROL.

A diagram illustrating the Company's governance framework including its Committee structure is set out below and in the report that follows. The Group's risk management framework is described on pages 65 to 68.



* Northern Trust provides company secretarial and administration services to the Company under a corporate administration agreement.
** ROL provides services to the Company under an operating agreement.
···· Provision of services including oversight on behalf of the Company.
— Reporting lines within the governance framework.

How we meet our governance responsibilities in practice

Board

The directors are responsible to shareholders for ensuring that the Company is appropriately managed and that it achieves its objectives. The Board meets regularly to review its operating and financial performance ensuring that the Group is adequately resourced and effectively controlled.

In addition to scheduled Board meetings held principally to deal with operational and financial performance matters, ad hoc Board meetings are called to consider potential transactions and to oversee the execution of agreed transactions. The Board also regularly reviews feedback received from shareholders

The Board comprises 10 non-executive directors all considered to be independent for the purposes of the Combined Code. Details of current directors, including their biographies, are on pages 58 to 59.

Appointments to the Board are the responsibility of the Board as a whole, acting on the advice and recommendations of the Nomination Committee. The non-executive directors of the Board bring diverse business experience and a wide range of skills to the Company.

The composition of the Board and its Committees are regularly reviewed to ensure the right combination of skills are in place to successfully drive the Company forward. This takes place as part of the annual Board evaluation described on page 64. The Board is satisfied that, for the year under review there was no compromise to the independence of the directors. There are no relationships or involvement which might have affected their independence or judgement. The activities of the Board are guided by the principles of the Combined Code.

The Board regularly reviews the performance of the Group and its businesses against its business plan and receives regular reports from FPH and ROL on the Group's financial position, risk management, regulatory, operational and compliance controls and other material issues. Directors are regularly briefed on key business areas to enhance their understanding of the business and provide the opportunity to review critically, question assumptions and, where appropriate, challenge strategies proposed. All Board and Committee meetings during the year were held in an open atmosphere with the Chairman encouraging constructive challenge and debate.

The Board's specific duties are clearly set out in a board control manual ("BCM") addressing a wide range of governance issues with a list of items that are specifically reserved for decision by the Board. The manual sets out those matters that must be reported to the Board, such as significant litigation or material regulatory breaches, and covers how matters requiring consideration by the Board that arise between scheduled meetings should be dealt with. The schedule of matters formally reserved for the Board is regularly reviewed and updated to ensure that it remains appropriate. Key matters reserved for the Board include:

- long-term strategy and objectives;
- target return of the Company;
- quarterly review of operational reports (submitted by ROL);
- structure and capital;
- financial reporting and controls;
- internal controls and risk management;
- acquisitions, disposals and material contracts;
- board membership and appointments;
- financial statements;
- dividend policy; and
- governance matters.

During the year under review, significant matters considered by the Board included the rights issue, share consolidation, acquisition and integration of the AXA UK Life Business and BHA. Directors are briefed in advance of Board and Committee meetings on all matters to be discussed. In the event a director is unable to attend a meeting because of exceptional circumstances, he or she will still receive supporting papers and may via the Chairman provide the rest of the Board their views. This ensures that all directors' views are given due consideration. Any director who was unable to attend a meeting is briefed separately on discussions at the meeting.

In 2010, all directors committed an appropriate amount of time to fulfil their duties and responsibilities on the Board. Any instances of non-attendance at Board meetings were generally related to prior business, personal commitments or illness. Additional ad hoc meetings were often arranged at very short notice or re-arranged in light of commercial developments.

Board changes

Jacques Aigrain, Gerardo Arostegui, and Mel Carvill were appointed to the Board on 1 February 2010. Tim Wade was appointed to the Board and as Chairman of the Audit and Risk Committee on 19 May 2010. Sadly, Sir Mervyn Pedelty died on 26 January 2010.

Board attendance

The Company requires all directors to attend all meetings of the Board and Committees on which they serve and to devote sufficient time to the Company in order to perform their duties. The table below shows the attendance of directors at scheduled and additional meetings of the Board as well as the Audit and Risk, Remuneration and Nomination Committees during 2010:

	Scheduled Board	Additional ad hoc Board	Audit and Risk Committee	Nomination	Remuneration Committee
Michael Biggs	8(8)	7(7)	–	6(6)	8(9)
Jacques Aigrain	5(8)	6(6)	–	2(2)	4(6)
Gerardo Arostegui	8(8)	4(6)	–	2(2)	6(6)
Mel Carvill	6(8)	4(6)	2(4)	2(2)	–
Fergus Dunlop	8(8)	6(7)	3(3)	4(4)	3(3)
Phil Hodkinson	8(8)	6(7)	6(7)	5(6)	3(3)
Denise Mileham	8(8)	5(7)	7(7)	6(6)	3(3)
Peter Niven	8(8)	5(7)	4(4)	6(6)	7(9)
Gerhard Roggemann	8(8)	6(7)	–	–	6(6)
Tim Wade	4(4)	2(3)	3(3)	–	–

Note: Number of meetings the directors could attend is given in brackets.

Directors

The Board currently comprises the Chairman and nine independent non-executive directors. Each director is required to be elected by shareholders at the AGM following his or her appointment by the Board and to be elected at least once every three years.

The Board's policy is to appoint and retain non-executive directors, who can apply their wider knowledge and experiences to their understanding of the Group. In addition to the strengths of experience, diversity and an international perspective, the Board also seeks to comply with the requirements of the Combined Code on the independence of directors.

The Combined Code requires that at least half of the Board excluding the Chairman, should comprise independent non-executive directors as determined by the Board. The Board performs an annual review of directors' independence in which all potential or perceived conflicts, time commitments, length of service and other issues relevant to their independence are considered. It is the Board's view that an independent non-executive director should present an objective, rigorous and constructive challenge to proposals, drawing on his/her wider experiences to question assumptions and viewpoints.

To be effective, directors are required to acquire a sound understanding of the industry and the Company so as to be able to evaluate properly information provided. Directors are advised that they may seek independent professional advice, at the Company's expense.

This year the Board adopted the principle of annual elections proposed in the UK Corporate Governance Code. Each of the directors has been subject to a formal performance evaluation and took part in a peer evaluation review in 2010. Biographical details of all directors are set out on pages 58 to 59, in the Notice of the AGM and are also available on the Company's website at www.resolution.gg. The Group voluntarily seeks advisory resolutions on the appointment and re-election of directors to the FPH board at the Company's AGM. Non-executive directors may accept and maintain other non-executive appointments.

The Chairman

The Chairman's priority is the leadership of the Board and through ROL, maintaining day-to-day oversight of the Group. The Chairman currently has no external appointments. The Board considers that the Chairman gives sufficient commitment to the Company to carry out his duties.

The Senior Independent Director

Under the Combined Code the Board appoints one of the non-executive directors to act as Senior Independent Director ("SID"). The main responsibility of the SID is to be available to shareholders should they have concerns that they have been unable to resolve through normal channels, or when such channels would be inappropriate. Phil Hodkinson continues to serve as the SID having been appointed in March 2009.

Board effectiveness

The Board has recently undertaken a rigorous evaluation in order to assess how well the Board, its key Committees and directors are performing. The aim of this review is to improve the effectiveness of the Board, its Committees and the Group's performance. The process was led by the Chairman with the assistance of an external facilitator. The process involved detailed questionnaires and interviews with each member of the Board and certain members of ROL. Feedback was given on an unattributed basis and collated by the facilitator. A review of the corporate governance processes was also conducted. A report was prepared in relation to the Board and its Committees, which included recommended actions, and this was considered by the Board. Individual reports for each director were also prepared and discussed individually.

Following this comprehensive review, the directors concluded that the Board and its key Committees operate effectively. Additionally, the Chairman has concluded that each director contributes effectively and demonstrates full commitment to his/her duties. The report identified a number of areas for further work and measures were agreed for action. These included improvements to the Board support processes, director training and shareholder engagement.

Training and development

The Board believes strongly in the development of its directors and it is a requirement of each director's appointment that they commit to their continued development. The form that this development takes is subject to the individual director's requirements and the quality and relevance of the training available.

During the year, directors attended a number of internal and external briefings including an update on legislation, regulatory and governance requirements such as Solvency II. There were additional briefings and discussions on relevant, recent financial developments. The Board has an induction programme and directors are provided with the opportunity to visit the Group's main operating businesses and to receive briefings from FPH management.

Board Committees

The Board Committees operate within defined terms of reference. The Committees are also authorised to engage the services of external advisers at the Company's expense as they deem necessary in the furtherance of their duties. Details of the Committees activities during the year are provided in statements made by each Committee chairman. The terms of reference and composition for each Committee reflect the Combined Code and can be accessed via the Company's website at www.resolution.gg.

Throughout the year the chairman of each of the Board Committee provided the Board with a summary of key issues considered at each Committee meeting along with minutes of the meetings.

Membership of Committees is as follows:

	Audit and Risk Committee	Nomination Committee	Remuneration Committee
Michael Biggs*		✓ (C)	✓
Jacques Aigrain		✓	✓
Gerardo Arostegui		✓	✓
Mel Carvill	✓	✓	
Fergus Dunlop	✓		
Phil Hodkinson	✓	✓	
Denise Mileham	✓	✓	
Peter Niven		✓	✓
Gerhard Roggemann			✓ (C)
Tim Wade	✓ (C)		

(C) – denotes chairman of the Committee.
* The Board Chairman is also chairman of the Nomination Committee.

Statements of compliance

UK Combined Code on Corporate Governance

The Company has a Premium Listing on the London Stock Exchange Official List and is therefore subject to UK Listing Authority regulations as well as the UK City Code on Takeovers and Mergers.

Throughout the year ended 31 December 2010, the Company has complied with the provisions of the Combined Code except in the following respects:

- Principle A.2: – There should be a clear division of responsibilities at the head of the Company between the running of the board and the executive responsibility for the running of the Company's business. No one individual should have unfettered powers of decision.

  Resolution Limited's explanation: Due to the Company's structure and the existing operating agreement with ROL (please refer to the governance framework on page 61 of this report), Resolution Limited has an independent non-executive Chairman and does not have a Chief Executive.

The Chairman provides leadership of the Board. There are very clear divisions of responsibilities between the Chairman, SID and the non-executive directors. All of the day-to-day operations of the Group's business are undertaken by the FPH board comprised of a majority of independent non-executive directors.

Therefore the Board considers that no one individual has unfettered powers of decision.

- Principle A.3: – The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the Board's decision taking;

  Resolution Limited's explanation: The directors believe that the Board is sufficiently balanced with a wholly independent non-executive Board. All decisions are made by the Board as a whole or through clear delegated authorities to the FPH board. As previously stated, there are clear lines of responsibility such that no individual or small group of individuals can dominate the Board's decision-making process.

- Principle B.2: – There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

  Resolution Limited's explanation: As the Board does not have any executive directors that would ordinarily recommend and participate in the decision-making of non-executive director fees, the Chairman in consultation with the Chief Executive of ROL obtains independent advice from the Remuneration Committee's independent consultants.

  The Board believes that this process provides the same rigour and balance as a traditional unitary board.

Guernsey Corporate Governance Code

The directors are subject to the requirements of the Guernsey Code of Practice. Under the Guernsey Code of Practice, the directors are required to act in accordance with their duties, the Company's Articles of Incorporation and to seek advice where necessary. In addition, the directors must ensure that the Board oversees the leadership and governance of the Company.

The Guernsey Code of Practice is not a statement of the law and failure to comply with the Guernsey Code of Practice does not automatically make a director liable to any sanction or proceedings.

However, the Guernsey courts may, and the Guernsey Financial Services Commission will, take into account any breach of the Guernsey Code of Practice relevant to any decision either of them has to make. During the period under review, the Board has satisfied itself that it has complied with the Guernsey Code of Practice.

Risk management and internal control

Summary

The Board is committed to ensuring that the highest standards of corporate governance are maintained throughout the Group in line with its desired risk awareness culture. It has established robust policies, processes and procedures for the identification and evaluation of the significant risks it faces and for managing those risks across the Group in line with the Group's risk appetite.

The Board has defined its approach to internal control through the BCM and Group Policies. The BCM and Group Policies set the framework within which the Group operates day-to-day and the principles and specific policy requirements, including risk management and internal controls, are embedded in management of the business.

The Board is responsible for the Group's system of risk management and internal control, including financial, operational and compliance controls, and for reviewing its effectiveness. Due to the limitations that are inherent in any system of internal control, it is designed to manage rather than eliminate risk and can only provide reasonable, and not absolute, assurance against material misstatement or loss. In assessing what constitutes reasonable assurance, the Board has regard to materiality and to the relationship between the cost of, and benefit from, internal control systems.

FPH was established in 2009 as the intermediate holding company for businesses acquired under the Company's UK Life Project. In line with this, the Board has delegated a number of matters to the FPH board. The FPH board has primary responsibility for ensuring the embedding of the Group's risk awareness culture and maintenance of a sound system of internal control and risk management framework throughout the Friends Life group.

Risk management

The Board's philosophy underpinning the Group's risk management approach is that it should be designed, implemented and maintained in a manner that supports management's decision-making and helps management to deal effectively with uncertainty. To bring about this outcome the Board has established the following risk management aims, principles and framework.

Risk management aims

The Group's approach to risk management includes a consistent and robust set of policies, systems, processes, procedures and controls that are aimed at:

- aligning risk appetite and strategy;
- seizing opportunities;
- enhancing risk mitigation decisions;
- reducing operational surprises and losses;
- identifying and managing multiple and cross-Group risks; and
- improving deployment of capital.

Risk management principles

The Group's risk management approach deals with risks and opportunities affecting value creation or preservation and incorporates the following overall guiding principles:

- the Group has a risk awareness culture with risk management being delivered by the Board of directors, FPH senior management and other personnel across the Group at every level;
- risk appetite is set and regularly reviewed by the Board. In setting this, the Board considers the Group's capacity to bear risk and its risk profile;
- the Group has an appropriately consistent, robust and shared set of policies, processes and procedures designed to assist the achievement of its business objectives. Accordingly allowance is made for certain processes and procedures to vary across the Group where it is necessary to fit different business/operating environment dynamics;
- risk is actively considered in making business decisions, including setting strategy and business plans at subsidiary board, FPH board and Group level; and
- the identification and management of risk is constantly reviewed as part of an ongoing process.

In view of the operation of a risk and compliance committee at the FPH board level, the Board is satisfied that a separate risk committee is not required at Group level.

Risk management framework

The Group's risk management framework looks to ensure a consistent approach to risk identification, evaluation and management across the Group.

Group risk management

The Board is responsible for the establishment and maintenance of a sound system of risk management across the Group. In doing so it is supported by ROL in establishing, embedding and operating the risk management framework. The Board places reliance on the FPH board for the oversight of matters specifically delegated to it. Key activities of the Board in ensuring the ongoing effectiveness of the risk management framework and monitoring of risks against appetite include:

- approval of the Group's overall risk management framework;
- setting of the Group's risk appetite;
- review and overseeing management of the Group's risk profile; and
- receiving reports on, and reviewing the effectiveness of, risk management across the Group.

The Audit and Risk Committee reviews the Company's internal control and risk management systems to assist the Board in fulfilling its responsibilities relating to the effectiveness of those systems. This includes making recommendations to the Board in respect of its risk management framework, risk appetite, risk policies, and risk profile. It also, amongst other things, supports the Board in ensuring that the financial performance of the Company is properly monitored and reported on by reviewing the Company's financial statements and any formal statements on financial performance.

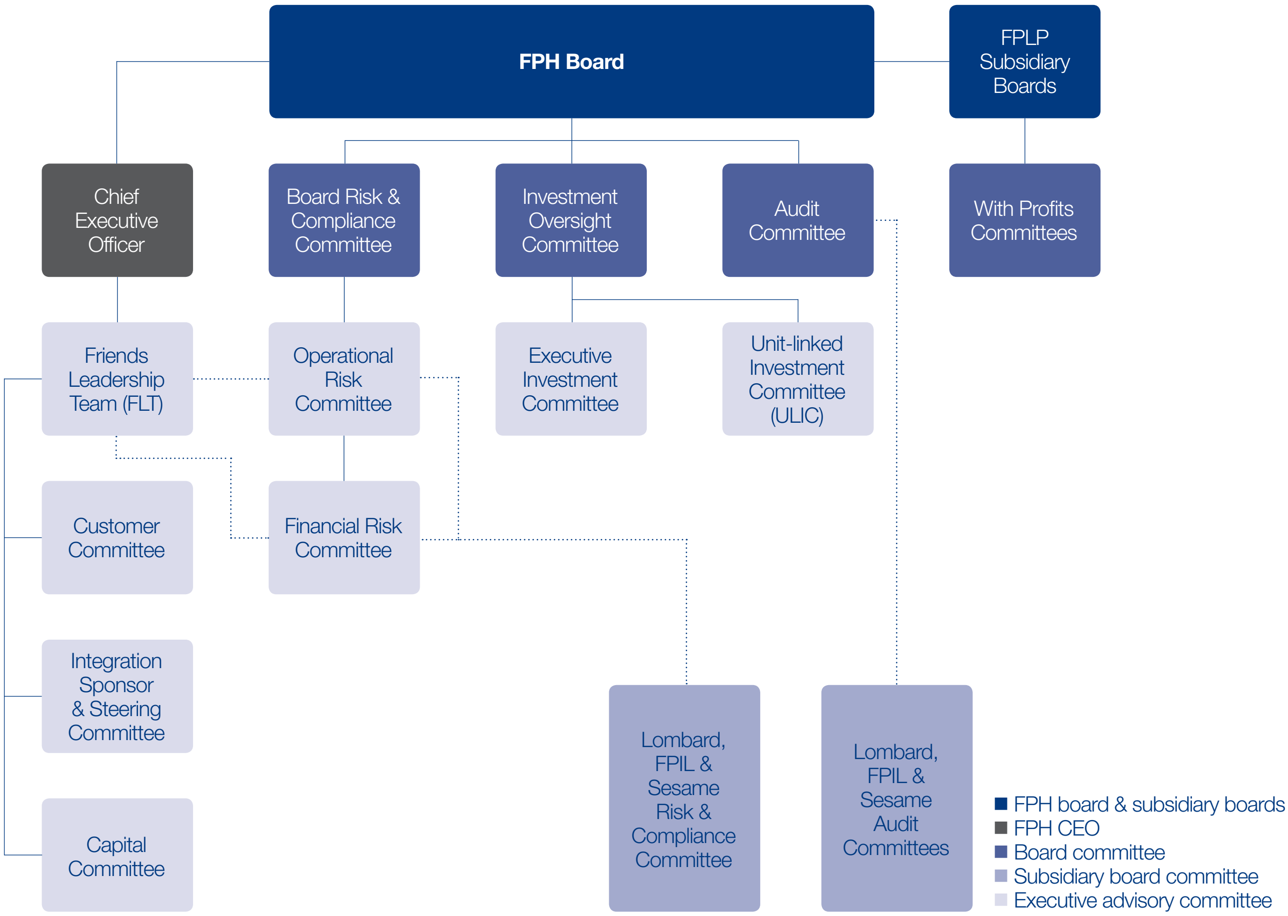
Friends Life group risk management

The FPH board is responsible for the establishment and maintenance of a sound system of risk management throughout the Friends Life group based on the Resolution Group Policies ("Group Policies") as adopted by the Board. This includes:

- approval of Friends Life group's risk management policy and framework;
- review and approval of Friends Life group's risk appetite;
- approval of Friends Life group's risk profile; and
- receiving reports on, and reviewing the effectiveness of, risk management within the Friends Life group.

The Friends Life group's governance structure for risk management is illustrated below.

Friends Life group – governance structure for risk management



To strengthen the focus on the risk management, the FPH board has delegated to the FPH Board Risk and Compliance Committee ("BRCC") authority to approve the Friends Life group's risk framework and its risk management policies, and to endorse the risk frameworks of the operating subsidiaries. The FPH executive Financial Risk and Operational Risk Committees have oversight of the management of risks across the Friends Life group within their respective remits and report directly to the BRCC.

The Friends Life group operates a separate FPH Audit Committee ("AC") to which the Group-wide internal audit function reports. The responsibilities of the AC include reviewing the effectiveness of Friends Life group's systems of internal control and financial reporting prior to review by the FPH board, recommending to the FPH board the adoption of Group Policies (referred below), the FPH board control manual (Corporate Governance Handbook) and any Friends Life group policies.

Internal control

The Board is responsible for ensuring maintenance of a sound system of internal control for the Group including:

- receiving reports on and reviewing the effectiveness of the Group's risk management and internal control processes to support its strategy and objectives;
- undertaking an annual assessment of these processes; and
- approving an appropriate statement for inclusion in the Annual Report and Accounts.

During 2010, the set of Group Policies adopted by the Board in 2009 has been updated and extended. In particular the Group has revised its policies relating to the management of inside information in order to ensure that it continues to adopt robust arrangements that meet industry best practice. The Group Policies cover the key risk areas that the Board has identified as most important to its business, but it is expected that they will continue to be refined and developed. The Group Policies set a minimum standard by which the Board expects each part of the Group to operate, creating a consistent framework for management and governance.

The Group Policies have been adopted by the FPH board and it oversees the compliance of the Friends Life group with the Policies. As part of the Group's "100 day plan" approach following an acquisition, a gap analysis of the newly acquired business policies against the Group Policies and Friends Life group policies is completed with a plan agreed for addressing any gaps or inconsistencies identified.

The delegated authorities within the BCM and the terms of reference of the Board Committees are subject to review post each acquisition made by the Group, and at least annually, to ensure they continue to reflect the needs of the Group as it expands.

The Group maintains internal audit, risk and compliance functions with specific responsibilities to audit and review risk management, internal control processes and structures across the Group. The scope of these reviews and audits are based on assessments of the risk profile of the Company and its principal subsidiaries. The results are reported formally to executive management and the relevant FPH and Resolution Committees. To ensure independence, the Group Internal Auditor reports to the Chairman of the Audit and the Risk Committee in relation to internal audit issues.

The Board reviews this internal control framework on an ongoing basis, in doing so it takes account of internal audit reports, reports from the Group's external Auditor and the regular reporting from ROL and FPH to the Board and the Audit and Risk Committee.

In addition to relying on these ongoing reporting processes, the Board may commission independent internal control reviews of elements of its business. Typically this includes reviews of the controls within newly acquired businesses at completion. Consistent with this an independent review was commissioned in 2010 to review the processes and controls that impact on the financial statements including financial and regulatory reporting within the AXA UK Life Business. The review resulted in a number of recommendations for improvement.

The Board also commissioned independent reviews of the systems and controls within two business units in the Friends Life group during 2010. Action plans to implement the recommendations from these reviews have been agreed with the senior management of the relevant business unit. The relevant local audit committee, FPH Audit Committee and ultimately the Audit and Risk Committee will oversee delivery of the action plans and that any proposed improvements to the control environment are achieved on a timely basis.

The Audit and Risk Committee, on behalf of the Board, conducted a review of the effectiveness of the Group's system of internal control during 2010. The review covered all material controls, including financial, operational and compliance controls and risk management systems. As part of the process, members of the FPH and ROL senior management teams reviewed the internal control frameworks within their respective areas of responsibility, and completed written declarations on the status of those frameworks. Any exceptions identified were reported through the structure of risk committees at a local and business unit level with any potentially material exceptions being reported through to the Audit and Risk Committee. Actions to address the exceptions identified will be monitored by the relevant local audit committee with oversight from the Audit and Risk Committee to ensure they are resolved within the planned timescales.

The Board therefore believes that a robust internal control framework has been in place during 2010, and up to the date of this document consisting of:

- delegated authorities;
- committee terms of reference;
- policies;
- risk, compliance and internal audit functions; and
- senior management responsibilities.

During the year, the framework has been successful in identifying areas of potential weakness in systems and controls and where further improvement could be made, timely action is taken to address these points. In line with the requirements of the Combined Code, the Board confirms that there is an ongoing process for identifying, evaluating and managing significant risks faced by the Group, which has been in place throughout the period covered by this report and up to 23 March 2011.

Board Committee statements

Audit and Risk Committee Chairman's statement

I took over chairmanship of the Committee from Phil Hodkinson in May 2010. I would like to take this opportunity to thank Phil for his hard work and diligence as Chairman of the Committee and for the support provided to me during the handover period and his continued support as a member of the Committee. I would also like to thank David Allvey, Chairman of the FPH Audit Committee, for his work and advice.

This Committee meets at least four times a year, or more frequently if required. In the 12 months to 31 December 2010, seven meetings were held. The Combined Code requires at least one member to have recent and relevant financial experience. Currently, three members of the Committee, myself, Phil Hodkinson and Mel Carvill, fulfil this requirement.

In 2010, the Committee focused its work on the following key areas:

- seeking feedback on the performance of the external Auditor from key stakeholders in the Group with responses being presented to, and discussed by, the Committee. The Committee concluded that it was fully satisfied with the performance of the Company's external Auditor, Ernst & Young LLP, including its qualifications, expertise and resource, effectiveness, objectivity and independence. Following this rigorous process, we recommended its re-election as the Company's Auditor to the Board and to stakeholders within the Group. We are satisfied that the Group's external Auditor provides effective, independent challenge to the Group's management and ROL, and has provided valued support to the Committee in the advice given, and the clarity of its briefings and reports. Additionally, we reviewed the independence and objectivity of the external Auditor, taking into account relevant UK and Guernsey professional and regulatory requirements and of the relationship with the external Auditor as a whole, including the provision of any non-audit services;
- reviewing and applying the Committee's policy on the engagement of the external Auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;
- reviewing the Company's financial announcements, including the Annual Report and Accounts and associated documentation (with members of management and the internal and external Auditor);
- receiving reports from ROL and the Friends Life group concerning the Company's systems of internal control;
- receiving reports from ROL in relation to compliance and key risks, including review of Group risk appetite levels;
- reviewing, approving and monitoring the annual work plan for the Group's internal audit function, ROL's audit approach and planning for 2010 year end processes;
- receiving reports from the external Auditor;
- reviewing the Company's financial reporting control framework to ensure compliance with the UK Listing Authority requirements;
- reviewing the corporate governance disclosures for the 2009 Annual Report and Accounts and considering the proposed disclosures for 2010;
- holding private meetings with the external Auditor (these meetings were held to coincide with preparation of the Company's financial statements); and
- conducting an external review of internal audit effectiveness.

A specific focus has been the acquisition and integration of the AXA UK Life Business and the impact on FPH and its principal subsidiaries, in particular, the determination of the acquisition balance sheet for both IFRS and MCEV purposes, the control environment and the integration of both internal and external financial reporting.

Additionally, at each Committee meeting, we review a variety of standing items including progress on actions taken in response to changing legislation and regulations, practice and compliance developments, for example Solvency II and IFRS 4 Phase II.

The Committee meets with the Company's external Auditor in private at least twice a year and, at each meeting with the Auditor, there is an opportunity to address any concerns and/or outstanding matters not picked up at formal Committee meetings. The Chairman, ROL Chief Financial Officer, ROL Chief Risk Officer, Group Internal Auditor, FPH Group Actuarial Director and other appropriate specialist functional heads attend meetings at my request. In addition, I have had meetings with both external and internal Auditors on a regular basis. We also had oversight of the processes by which the obligation of individual directors to ensure that the Auditor was made aware of all relevant information in connection with its audit was satisfactorily discharged.

The Committee confirms that it received sufficient, reliable and timely information from management to enable it to fulfil its responsibilities. A member of the Committee will be available at the AGM to respond to any shareholder questions on the Audit and Risk Committee's activities.

Tim Wade

23 March 2011

Nomination Committee Chairman's statement

The Committee met six times during the year and the table on page 64 of this report highlights attendance. During 2010, the Committee:

- regularly evaluated and kept under review, Board and Committee composition to ensure the right mix of skills and experience were present;
- monitored the progress of the action plan arising from the 2009/10 Board effectiveness review and oversaw the conduct of the 2010 Board effectiveness review, including reviewing the process for the Board, Committee and individual director evaluations for 2010;
- reviewed issues raised at meetings held with institutional investors and investor bodies in the lead up to the AGM;
- recommended the appointment of the new non-executive directors to the Board and changes to Committee membership;
- reviewed succession plans for the Company, FPH and its principal subsidiaries; and
- reviewed its terms of reference to satisfy itself that they enable the Committee to fulfil its duties.

Following the acquisition of the AXA UK Life Business in September 2010, there were a number of changes to the FPH board. Two new appointments were made to the FPH board upon completion of the transaction:

- David Hynam joined the FPH board as Executive Director – Operations; and
- Andy Parsons joined the FPH board as Interim Executive Director – Finance.

Also, during the year under review we made a number of recommendations to the FPH board, including the appointment of Sir Malcolm Williamson as Chairman of FPH, and the appointment of Nick Lyons, Derek Ross, Belinda Richards and Karl Sternberg as non-executive directors. This year, the Committee considered the proposals of the directors of the Company and FPH who are standing for re-election at the forthcoming AGM.

Michael Biggs

23 March 2011

Remuneration Committee Chairman's statement

I was appointed Chairman of the Committee in May 2010. I am grateful to my predecessor, Fergus Dunlop, who has provided advice and assisted me in my new role.

How the Committee goes about its business

The Committee considers the level of risk within the business when setting its remuneration policy, and ensures that there is sufficient governance in its processes by seeking input from independent remuneration advisors, ROL (including the CEO, CFO and Director of HR) as well as independent non-executive directors of FPH.

I should like to acknowledge the contribution of Sir Malcolm Williamson, the FPH Chairman, who chairs the FPH Remuneration Advisory Group (comprising independent non-executive directors) for providing the Committee with advice in relation to matters relating to FPH remuneration.

The Committee reviews the structure as well as the overall levels of director compensation, with particular attention to the mix of annual and long-term incentives. It also reviews forward-looking frameworks consistent with delivering the Company's objectives, goals and/or business plans. These frameworks are assessed against market benchmarks to inform its decision-making when considering aggregate remuneration proposals from management.

The following approach has been taken on executive directors' remuneration:

- executive directors' remuneration is considered, having regard to median data for appropriate roles and applying some discount to reflect the fact that FPH is not fully independent whereas many of the comparators are;
- the other aspects of the package are generally market consistent except that the long-term incentive plan ("LTIP") provides a focused incentive, consistent with corporate strategy, to grow shareholder value and enable a return of FPH to an independent listed company; and
- during the year, the approach to new guidelines or claw-back and deferral was considered. Claw-back has been introduced for 2011, with the proportion of bonus deferred increased from an amount in excess of 60% of salary, to one-third of any bonus earned.

The Committee's decisions on both executive and non-executive directors' pay were carefully considered and sought to ensure an appropriate share of value between employees and shareholders, with full consideration also being given to the requirements of other stakeholders. Full details of the activities of the Committee are provided later in the Remuneration report on pages 74 to 83.

Our priority for the year under review has been to ensure that the Company's policy continued to deliver results with a real focus on long-term sustainability and value to shareholders. The annual Remuneration report has been prepared by the Committee and approved by the Board for submission to shareholders.

Gerhard Roggemann

23 March 2011

Communication with shareholders

The Board ensures dialogue with shareholders takes place regularly. Shareholders are provided with sufficient information to assess and understand the risks and rewards of exposure to the Company's shares. In addition, the Board is kept informed of any concerns raised by major shareholders. The SID is available to shareholders if concerns, raised by shareholders, are not resolved through the normal channels of communication.

The primary channels of communication are the Company's Annual Report and Accounts, Interim Report and Accounts, interim management statements and the Company's website. ROL's investor relations team provides the Board with a regular update on investor views, organises meetings, road shows and conferences and prepares presentations for investors. Active and regular engagement with shareholders is essential for the Board to determine their understanding and confidence in the Company's strategy and its execution. There were over 200 investor meetings in 2010.

In 2010, the Company demonstrated further progress in its UK Life Project with the acquisition of the AXA UK Life Business financed by a fully underwritten rights issue that was approved by shareholders on 20 July 2010. Following the meeting on 20 July 2010, the opportunity was also taken to effect a share consolidation to ensure that, following the rights issue, the number of Resolution shares in issue and the likely share price was appropriate for a company of Resolution's size in the UK market. The acquisition of BHA completed on 31 January 2011.

Constructive use of AGM

To ensure our shareholders have time to consider our Annual Report and Accounts, notice of AGM and to lodge their proxy votes, shareholders are mailed more than 20 working days prior to the meeting. Shareholders who have not requested paper copies of our documentation are able to access required documentation via the Company's website www.resolution.gg.

The AGM provides an opportunity for shareholders to meet and question the directors. Both institutional and private shareholders through the Company's sponsored nominee can vote electronically. Shareholders may withhold their vote. At the AGM, the Chairman presents an update on performance and current business activities. To ensure compliance with the Combined Code at all general meetings, separate resolutions are proposed on each discrete subject and all resolutions are voted by poll. The number of proxy votes for, against and withheld for each resolution are disclosed at the meeting. The final results are published through a Regulatory Information Service and on the Company's website www.resolution.gg following the AGM.

At the 2010 AGM, votes representing approximately 52% of the issued share capital were received. Full details of the Company's AGM to be held on Wednesday, 18 May 2011, together with explanations of the resolutions to be proposed, are contained in the Notice of AGM available on the Company's website www.resolution.gg and, where applicable, posted with this Annual Report and Accounts. For the forthcoming AGM, as in 2010, shareholders will be able to participate from the UK via an audio-visual link, enabling them to ask questions and vote on the resolutions being put to the meeting.

The Board will review these arrangements in light of the level of participation by shareholders, taking into account the desire to maintain high standards of governance, accountability to shareholders and the cost of such arrangements. If considered appropriate, the Board may consider alternative means such as webcasting to broaden shareholder participation at subsequent AGMs.

Corporate responsibility

Approach

The Board's view is the fragmentation, complexity and low returns in the life assurance sector mean that consolidation and integration are inevitable. While the sector has served the needs of some of its stakeholders well, this is by no means true for all, particularly shareholders of sub-scale businesses.

The UK Life Project involves acquiring and integrating smaller life assurance businesses to create a larger, financially sustainable group. Creating such a business will address the historic underperformance experienced by investors. Equally importantly, a more sustainable group will deliver rewards for both customers and employees.

Being recognised as a trusted, responsible company enhances the Company's ability to raise funds in the market, and helps maintain the licence to acquire and dispose of assets freely. As such, the Company is committed to complying with established industry best practice in corporate responsibility.

The scope of this commitment includes the management of relations with customers, employees, suppliers and the communities in which the Group operates, its performance in respect of the environment, human rights and diversity, and the governance and ethical conduct of its business. Corporate responsibility related matters are considered both in the analysis of potential acquisitions and in the ongoing management of acquired operations.

Management framework

Phil Hodkinson, the Company's SID, is the director responsible for taking the lead on corporate responsibility for the Board. A Corporate Responsibility Committee has been established, chaired by Phil Hodkinson. It includes the Company Secretary of ROL and the Corporate Responsibility Director for the Company and FPH. The Committee meets regularly to develop the Group's corporate responsibility strategy and goals for approval by the Board, and to oversee a suitably challenging programme of actions to deliver them.

As part of its risk management and internal control processes, Resolution has established a robust Corporate Responsibility Policy. The Policy establishes a consistent set of principles and standards for the Group and all businesses must comply with these standards. Where appropriate, they are also encouraged to go beyond compliance.

Monitoring adherence with the Policy is the responsibility of ROL and in accordance with good governance this is overseen by the Audit and Risk Committee. The Company is committed to high standards of transparency and aims to report regularly and honestly on its performance.

* Figures quoted relate only to the period for which each of the acquired businesses were owned by Resolution.

Measuring success

Resolution Limited is listed on the London Stock Exchange, and consequently it is a member of Business in the Community ("BitC"), the leading business-led sustainability charity, to reinforce commitment to responsible business practice. Phil Hodkinson represents Resolution Limited on the board of BitC.

As a relatively new company, Resolution Limited is working towards inclusion in BitC's annual Corporate Responsibility Index. The Company's aim is to achieve the same status as Friends Life group which is currently rated separately as "Platinum" in the Companies that count rankings. Resolution is also a member of the FTSE4Good Index. The Corporate Responsibility Committee is currently considering a fuller set of external benchmarks, indices and measures to support its commitment to best practice.

Group-wide activity and performance*

Customers

The Group serves over five million customers. It is fully committed to the principles of Treating Customers Fairly ("TCF") and under the guidance of the FPH Customer Committee has implemented a strategy to ensure that employees work by the values of TCF and understand what it means for them and the customers with which they interact. TCF advocates, champions and business unit co-ordinators all support the embedding of TCF within the organisation and it is a compulsory requirement for all employees, including those outside the UK, to undertake TCF training on an annual basis. The Group continues to explore ways to improve the financial capability of its customers, maintaining a particular focus on members of its corporate pension schemes, as these customers are least likely to receive financial advice. In 2010, a new research project was developed to go beyond the typical transaction-based feedback and industry-wide customer impact surveys and hence give greater insight into customers' needs and provide opportunities to further enhance customer service. The business continues to offer socially responsible investment solutions for customers.

People

Consolidating and integrating businesses inevitably means difficult decisions must be taken to remove duplication and achieve economies of scale. A fair and transparent process is critical for selecting those who remain with the Group and appropriate support is provided for those that do not. The union, Unite, is recognised for the purposes of collective bargaining. Employee well-being is fostered through the new Employee Assistance programme. Introduced last year, this comprehensive programme is administered by a third party and offers all employees coaching and support to deal with a wide range of issues. The operational business has also maintained the Investor in People award, recognising the commitment to training and developing our people. All employees are covered by clear policies to protect their rights and ensure a diverse and safe working environment.

Suppliers

The Group looks to work with partner organisations whose principles are compatible with its own. During 2010 the procurement team's primary focus was on renegotiating contracts Friends Provident and the AXA UK Life Business were brought together. This created an opportunity to rework and strengthen the Company's Sustainable Sourcing Policy. Also, a new Supplier Relations team was created and ensuring corporate responsibility related issues are integrated into the ongoing management of all key suppliers will be a priority this year.

Community

Resolution Limited has established a committee in Guernsey, led by Board director Peter Niven to ensure that as one of the largest companies on the island, it plays an active role in the community and contributes positively to the local economy. Separately, a new community investment programme has been introduced across the Group. It has three core elements:

- a Charity of the Year, chosen by employee vote;
- structured volunteering opportunities, principally based around team events; and
- matched funding through Give As You Earn up to £20 per month per employee.

During 2010, the Group invested over £1 million in the community, calculated in accordance with London Benchmarking Group guidelines. Nine hundred employees participated in the community programme, volunteering 4,500 hours of the Group's time. In 2011, employees selected Macmillan as the Group's corporate partner. In addition to fundraising, the Group aims to increase awareness of Macmillan's services to support its aim of reaching every person affected by cancer and use its expertise to enhance the Group's customer claims experience.

Environment

Resolution is committed to playing its part in the transition to a low carbon economy. In 2010, 67% of our electricity was purchased through a green tariff and overall carbon emissions were 24,517 tonnes of CO_2. Like for like Scope 1, 2 and 3 emissions for Friends Provident reduced 11.5% year-on-year. Resource use and waste management are also important elements of our environmental programme. Last year we produced 943 tonnes of waste of which 65% was recycled.

The activities described above do not include the work of the Friends Provident Foundation or the Resolution Foundation, both of which operate independently of the Group. The Friends Provident Foundation does, however, continue to receive in kind support from the Company.

Taxation

Resolution Limited recognises that the taxation of Company profits and its activities in each of the countries in which it operates helps to fund the infrastructure and welfare support systems of those communities. Taxation thus represents an important contribution by the Group to those communities and the Group is committed to paying the appropriate rates of tax in each country, and to disclosing how much and where tax is paid.

The decision to establish Resolution Limited as a Guernsey-based company with its head office in St Peter Port was based primarily on the grounds that the modern, robust solvency laws of Guernsey offer the Company greater flexibility both to buy and to sell operations in a manner consistent with its strategy than would be possible in many other jurisdictions, for example the UK.

Despite the generally low tax rate currently applicable to Guernsey companies, the Company being resident in Guernsey does not reduce the tax paid by its operating businesses which are based predominantly in the UK and elsewhere in the EU. The Friends Life group which produces 99% of total Group profits continues to pay tax on profits in the UK and elsewhere in the EU in the same way today, as it did prior to acquisition.

Assurance

The community investment and carbon emissions data has been independently verified. AECOM Sustainable Development Group has undertaken verification based on the process outlined in the Greenhouse Gas Protocol and includes a rigorous examination of the methods used to record, collate, calculate and audit greenhouse gas emissions reporting. Corporate Citizenship has also provided assurance of the Group's community investment data in accordance with the London Benchmarking Group model.

More information is available on our website at www.resolution.gg.

Remuneration report

This report has been prepared by the Remuneration Committee and has been approved by the Board for submission to shareholders.

The Remuneration report has been prepared in line with the best practice provisions set out in the Combined Code and taking into consideration schedule 8 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008. This report provides further explanation of the Company's current remuneration, governance and arrangements in respect of Resolution Limited and FPH boards respectively. The report is divided into the following sections:

The Group's Auditor, Ernst & Young LLP, has audited the information contained in the tables on pages 116 to 119 of this report.

Remuneration Committee overview

Responsibilities

The Remuneration Committee is responsible to the Board. The Committee provides governance and strategic oversight of Resolution Limited and FPH non-executive and executive remuneration, and all other employee remuneration. The Committee's principal responsibilities are summarised below:

- setting, reviewing and approving the remuneration policy and the total individual remuneration packages for the Chairman, non-executive directors, executive directors and other designated executives within FPH and its principal subsidiaries;
- setting the design of, and determining targets for, any performance related pay schemes or other long-term incentive schemes operated by the Company, FPH and its principal subsidiaries for key individuals and other staff, including all employee schemes and where applicable approving the total annual payments under such schemes;
- setting the policy for and scope of pension arrangements for each executive director of FPH and its principal subsidiaries;
- setting the policy on terms and conditions to be included in service agreements or letters of appointment for the Chairman and directors of FPH, including termination payments and compensation commitments, where applicable, and determining such; and
- preparing and authorising the annual remuneration report of Resolution Limited.

In carrying out its duties in relation to directors' remuneration, the Committee takes into account the pay and employment conditions of the wider employees in the Group and the Board's policy as to risk tolerances. For example, the Committee takes into account the wider employee pay review when determining any annual increases to FPH executive directors' salaries. The Committee is also guided by the strategic and financial priorities of the Group as outlined in other sections of the Annual Report and Accounts.

The experience of individual Committee members and the size of the Committee are appropriate to ensure that the Committee maintains its independence to oversee the remuneration policies of the Company. Representatives of ROL and FPH are invited to attend all or part of its meetings. No Group employee is permitted to participate in discussions or decisions of the Committee relating to his or her own remuneration.

Advisers

The Committee's work is supported by independent professional advice. In line with the requirements of the Combined Code, the Board undertook a review of the effectiveness of the Committee during the year. Overall the Committee performed well, was sufficiently briefed on changing market practice and governance requirements.

During the year under review the Committee took advice, as appropriate, from independent remuneration consultants, Deloitte LLP, in relation to the remuneration of directors. Deloitte LLP also advised the FPH board.

The Committee reviews the appointment of advisers periodically. Following a recent review in November 2010, Hewitt New Bridge Street was appointed to advise on matters relating to the remuneration of directors with effect from 1 January 2011. Hewitt New Bridge Street will also advise the FPH board on the same basis.

Key issues considered in 2010

These were:

- implementation of the FPH LTIP and determination of initial awards under the plan;
- consideration of the updated ABI guidelines on remuneration;
- preparation and approval of the Remuneration report;
- determination of bonus payments under the FPH annual bonus plan;
- agreement of the framework and performance measures under the FPH 2010 annual bonus plan;
- consideration of the Group Employee Share Schemes and the implementation of a Share Incentive Plane ("SIP") for all FPH employees;
- determination of remuneration packages for new executive directors joining following the AXA UK Life Business transaction;
- consideration of remuneration arrangements for other key senior executives joining as part of the AXA UK Life Business transaction;
- integration of the AXA UK Pension Benefits;
- overall review of FPH remuneration following the AXA UK Life Business transaction; and
- review of remuneration philosophy.

Remuneration policy

The Company's remuneration policy is to attract, retain and motivate high calibre executives, who are aligned with and support the Company's commercial objectives and the delivery of value to shareholders. The remuneration policy is based on the following key principles:

- **Alignment** – The remuneration of individuals throughout the organisation should be aligned with shareholders' interests.
- **Accountability** – Individual accountability is critical to business success and the remuneration arrangements should reward the desired business and personal behaviour.
- **Time horizons** – There should be an appropriate balance between short- and long-term remuneration, with a significant proportion of the remuneration of key individuals within Friends Life group focused upon the success of the UK Life Project.
- **Transparency** – Remuneration arrangements should be as transparent as possible, ensuring a clear line of sight to enable each individual to understand the link between their scope to influence the performance of the business, as appropriate to their role, their behaviour, and their reward.
- **Flexibility** – Remuneration should be sufficiently flexible to accommodate significant organisational change over time. Transactions within the UK Life Project may have a large impact on the organisation of the business (and therefore the behaviour required from individuals).
- **Equity and fairness** – It will not be possible for remuneration arrangements to anticipate all potential events. The Committee should have the discretion to make fair and equitable decisions about the remuneration of individuals.
- **Shareholder awareness and shareholder value** The Company should engage actively with shareholders to ensure they understand how each remuneration structure is ultimately aligned with their interests. Shareholder value should be maximised by, amongst other things, treating customers fairly and actively managing risk.

Contractual arrangements/letters of appointment

Resolution Limited directors

All Resolution Limited non-executive director appointments were confirmed by individual letters of appointment which include a six months' notice provision. Details of non-executive directors who served during the year can be located on pages 58 and 59. No compensation is payable to non-executive directors on leaving office.

Service contracts

Non-executive directors of Resolution Limited and FPH do not have service contracts and do not have any entitlement to pensions, share options or long-term incentives.

Resolution Limited directors' share interests

With the exception of the interests disclosed in the table below, none of the non-executive directors has any interest in the share capital of the Company or any of its principal subsidiaries.

Director	No. of ordinary shares at 1 January 2010 (pre-consolidation and rights issue)	No. of ordinary shares at 4 August 2010 (post-consolidation and rights issue)	No. of ordinary shares at 31 December 2010	% of issued share capital at 31 December 2010
Jacques Aigrain	130,000(i)	77,999	77,999	0.005
Gerardo Arostegui	150,000(ii)	90,000	90,000	0.006
Michael Biggs	317,577	113,487	113,487	0.008
Mel Carvill	104,000(iii)	62,400	62,400	0.004
Denise Mileham	30,992	18,595	18,595	0.001
Gerhard Roggemann	30,000	18,000	18,000	0.001
Tim Wade	0	0	40,000(iv)	0.003

(i) Mr Aigrain purchased shares on 26 March 2010.
(ii) Mr Arostegui purchased shares on 30 June 2010.
(iii) Mr Carvill purchased shares on 24 March 2010.
(iv) Mr Tim Wade purchased shares on 18 August 2010.

FPH executive directors

With the exception of Andy Parsons, executive directors of FPH have service contracts which provide for 12 months notice by the employer and six months' notice by the director. Andy Parsons' contract provides for six months' notice by either side. No executive director left during the year under review. Contracts provide for payment in respect of fixed remuneration only and, with the exception of Andy Parsons, permit mitigation through phasing.

On the change in Trevor Matthews' role, his contract will remain largely unchanged except that his salary will reduce to £495,000 and compensation on termination will continue to be assessed by reference to £720,000 if either side gives notice on or before 31 January 2012.

FPH has also reconfirmed that, provided he is not dismissed for cause or if FPH gives notice to him, he may be entitled to a pro-rata bonus for any period worked (but not for any period in lieu of notice), to be treated as a good leaver under the LTIP (with credit for any notice period in assessing the pro-rating calculation) and to early release of any bonus deferred into shares. He will also be entitled to any deferred bonus shares on resignation.

A summary of the notice provisions in the FPH executive directors' service contracts are set out below.

Executive	Date of contract	Notice period due from FPH	Notice period due from director
Chief Executive Officer	30 July 2008	12 months	6 months
Executive Director – Strategy, Capital and Risk	1 May 2009	12 months	6 months
Executive Director – Operations	15 September 2010	12 months	6 months
Interim Executive Director – Finance	1 June 2008	6 months	6 months

FPH executive directors' non-executive directorships

With specific approval of the FPH board, FPH executive directors may accept external appointments as non-executive directors of other companies and retain any related fees paid to them. Except as noted below, no FPH executive director received a fee in relation to external appointments in 2010.

For the year under the review, Trevor Matthews waived the fees for the Financial Services Skills Council to support the finance of that organisation and as a result has received no fees regarding his external directorships. External fees, from The Children's Mutual, retained by Evelyn Bourke for the year ended 31 December 2010, amounted to £35,148.

Resolution Limited non-executive director fees

Non-executive directors receive a fee in respect of the services provided to the Company. These fees are determined by the Chairman, in consultation with the Chief Executive of ROL, who obtains independent advice from the Group's remuneration consultants.

In determining fee levels for the Company's non-executive directors consideration has been given to the scope of the roles within the Company, FPH and its principal subsidiaries. This has taken into account external influences such as the additional responsibilities required following the Walker Review and the nature of the Group's operations.

The Company's business model is based around business restructuring and substantial activity outside what may ordinarily be considered usual is anticipated. As a result, the time commitment required from the non-executive directors is greater than that usually expected from a non-executive director and often required at short notice.

Fee levels for Resolution Limited non-executive directors

Fee levels for the Company's non-executive directors were reviewed in 2009 following the acquisition of Friends Provident. No changes to fee levels have been made during 2010 and fee levels remain as set out below.

The Chairman continues to receive an annual fee of £360,000 per annum in respect of all duties, including Committee chairmanship and memberships. All the other non-executive directors of the Company receive a basic fee of £67,500, with additional fees being paid for chairmanship or membership of Committees as set out in the table below. An additional fee of £25,000 is paid to the SID.

Committee	Members' fee (£)	Chairman's fee (£)
Audit and Risk Committee	£25,000	£50,000
Remuneration Committee	£15,000	£30,000
Nomination Committee	£10,000	N/A

Fee levels for FPH non-executive directors

As with the Resolution Board, the FPH board deals with a substantial amount of activity outside what may ordinarily be considered to be the normal course of business. Non-executive directors have significant responsibilities in the context of integration of the acquired businesses and the likely time commitment required is also substantially greater than that normally expected.

However, the FPH non-executive directors fees have been set at a lower level to Resolution Limited non-executive director fees to reflect the subsidiary nature of the FPH board. No changes to fee levels have been made during 2010. The Chairman of FPH receives an annual fee of £300,000 per annum.

All non-executive directors of FPH receive a basic fee of £60,000, with additional fees being paid for chairmanship or membership of committees.

Committee	Members' fee (£)	Chairman's fee (£)
Audit Committee	£25,000	£45,000
Board Risk and Compliance Committee	£15,000	£30,000
Investment Oversight Committee	£15,000	£30,000

2010 remuneration review

Summary of FPH executive director arrangements for 2010

Following the acquisition of the AXA UK Life Business, there were four executive directors of FPH during 2010. This section of the report provides details of the remuneration arrangements for these roles during the year:

- Trevor Matthews – Chief Executive Officer;
- Evelyn Bourke – Executive Director – Strategy, Capital and Risk (previously Finance Director);
- David Hynam – Executive Director – Operations (recruited following acquisition of AXA UK Life Business); and
- Andy Parsons – Interim Executive Director – Finance (joined upon acquisition of AXA UK Life Business).

2010 base salary and benefits (this information has been audited)

Executive directors' salaries are reviewed on an annual basis having regard to Company performance, individual performance and related responsibilities, remuneration policy within the Group and salary levels in comparable organisations of a similar size in terms of market capitalisation.

The base salary for the Chief Executive Officer was £720,000 and this remains at the same level as prior to the completion of the transaction with Friends Provident in 2009.

Evelyn Bourke received a base salary of £385,002 in respect of her role as Finance Director. Following her change in role to Executive Director – Strategy, Capital and Risk, her base salary was increased to £450,000 effective from 15 September 2010. The increase in base salary reflects both the increase in the size and complexity of FPH and the increase in the scope of her new role.

David Hynam was recruited from AXA and was appointed to the FPH board as Executive Director – Operations with a base salary of £400,000. Andy Parsons joined as a result of the acquisition of the AXA UK Life Business and was subsequently appointed to the FPH board as Interim Executive Director – Finance with a base salary of £300,000. The base salary of Andy Parsons was deliberately set below the market rate due to the interim nature of his role.

2010 annual bonus arrangements (this information has been audited)

Trevor Matthews and Evelyn Bourke

The 2010 annual bonus arrangements for Trevor Matthews and Evelyn Bourke in respect of their roles as Chief Executive Officer and Finance Director are set out below.

Executive	Maximum bonus opportunity	Target bonus opportunity
Trevor Matthews	125% of salary	62.5% of salary
Evelyn Bourke	100% of salary	50% of salary

The majority of the FPH annual bonus is assessed by reference to corporate performance targets, which are designed to support the objectives of the UK Life Project. The balance of the annual bonus is determined with reference to performance against detailed and specific performance objectives. The performance measures and their relative weightings in respect of 2010 performance were as follows:

Type	Measure	Weighting
Company Financial	Cash generation before tax	20%
	IRR on New Business	15%
	EEV underlying profit before tax	15%
	Expense Gap	10%
Company Non-Financial	Customer and Business Partner Satisfaction	10%
Individual	Individual Key Performance Indicators	30%

Individual Key Performance Indicators typically include financial, customer, risk management, people management and business improvement targets.

The Remuneration Committee assessed performance against these criteria at the year end and based on performance a bonus payment of 89.1% of salary earned in 2010 was payable to Trevor Matthews, the Chief Executive Officer and 63.3% to Evelyn Bourke, the Executive Director – Strategy, Capital and Risk. Any 2010 bonus in excess of 60% of salary is payable in the Company's shares and deferred for a period of three years. Deferred shares will only vest subject to continued employment at the end of the vesting period.

David Hynam and Andy Parsons

The annual bonus arrangements for David Hynam and Andy Parsons were agreed as part of their appointments. Andy Parsons was a member of the transferring population from the AXA UK Life Business and his 2010 annual bonus payment relates to his AXA bonus opportunity. Upon completion of the acquisition, performance against the corporate element of the bonus was considered to reflect "on-target" performance. The final value of the bonus was then adjusted based on the extent to which he achieved the personal performance objectives that were set by AXA at the start of the year, which were amended following the acquisition for the period to the year end. For 2010 he received a bonus payment of 62.5% of salary.

David Hynam was not part of the transferring AXA UK Life Business population and therefore he has participated in the 2010 FPH bonus plan (with a maximum opportunity of 200% of salary) on a time pro-rated basis from his date of joining. 70% of his annual bonus opportunity was therefore based on 2010 performance against the same corporate measures as for Trevor Matthews and Evelyn Bourke. The remaining 30% of his annual bonus opportunity was based on the achievement of personal objectives over the period from the completion of the transaction to the end of the financial year. Under the 2010 FPH bonus plan, David Hynam received a bonus of 126.5% of salary earned in 2010 from his date of joining.

2010 LTIP arrangements

Executive directors participated in the LTIP in 2010 and further details on this plan are provided on page 81.

2010 directors' emoluments (this information has been audited)

The following tables provide details of each of the directors' and former directors' emoluments for the relevant financial year.

Resolution Limited directors' emoluments

Non-executive	Fees £'000	2010 Total £'000	2009 Total £'000
Jacques Aigrain	83	83	N/A
Gerardo Arostegui	83	83	N/A
Michael Biggs	360	360	360
Mel Carvill	89	89	N/A
Fergus Dunlop	98	98	81
Phil Hodkinson	143	143	146
Denise Mileham	108	108	101
Peter Niven	102	102	101
Sir Mervyn Pedelty	6	6	11
Gerhard Roggemann	86	86	11
Tim Wade	73	73	N/A
Total	**1,231**	**1,231**	**811**

The tables below provide details of emoluments paid to FPH executive directors in the period from 1 January 2010 to 31 December 2010. 2009 comparative figures are also provided and include payments to directors in the capacity as directors of Friends Provident Group Limited ("FPG"), prior to the acquisition by Resolution Limited.

FPH executive directors' emoluments

Executive	Basic salary/fee £'000	Benefits in kind £'000	Pension allowance £'000	Annual bonus £'000	2010 Total £'000	2009 Total £'000
Trevor Matthews	720	25	119	641(ii)	1,505	1,313
Evelyn Bourke	404	13	56	256(ii)	729	442
David Hynam	118	4	16	150(ii)	684(iii)	–
Andy Parsons	92	2	7	55(i)	157	–

(i) Andy Parsons received a full-year bonus of £187,500 under the terms of his AXA bonus arrangement.
(ii) As described above the 2010 bonus awards over 60% of salary includes an element to be paid in deferred shares. The bonuses paid to Trevor Matthews, Evelyn Bourke and David Hynam includes £209,365, £13,189 and £78,622 respectively that will be deferred into Resolution Limited shares for three years. In addition, Trevor Matthews has an entitlement to 8,208 deferred shares from his 2009 bonus.
(iii) In addition, David Hynam also received a payment of £396,000 in respect of accepting office as a director. This was compensation for loss of bonus and long-term incentive arrangements with his previous employer.

FPH non-executive directors' emoluments

Non-executive	Fees £'000	2010 Total £'000	2009 Total £'000
David Allvey	113	113	16
Nicholas Lyons	96	96	–
Sir Mervyn Pedelty(i)	25	25	112
Robin Phipps(ii)	134	134	78
Belinda Richards	41	41	–
Gerhard Roggemann	103	103	101
Derek Ross	104	104	–
Karl Sternberg	54	54	–
Sir Malcolm Williamson	273	273	9
Total	**943**	**943**	**316**

(i) Sir Mervyn Pedelty was a director until 26 January 2010.
(ii) Includes a fee of £30,000 received as chairman of the FPH With-Profits Committee.

2010 directors' share interests (this information has been audited)

Directors	Number of ordinary shares at 31 December 2010	% of issued share capital at 31 December 2010
Evelyn Bourke	170,277	0.012%
David Hynam	270	0.000%
Trevor Matthews(i)	764,003	0.053%
Andy Parsons	697	0.000%
Robin Phipps	2,100	0.000%
Gerhard Roggemann	18,000	0.001%
Sir Malcolm Williamson	47,738	0.003%

(i) In addition, Trevor Matthews will be awarded 8,208 shares in respect of deferred shares under his 2009 bonus award.

2011 remuneration review

Summary of FPH executive arrangements for 2011

Element	Purpose	Policy	Operation
Base salary	• To recruit and retain key employees • Reflect individual's role and responsibility within FPH	• To set base salaries competitively when assessed against companies of a similar size in terms of market capitalisation • Take into account FPH performance, and individual performance and responsibilities • Review base salaries of executive directors in the context of the wider employee pay review	• Paid monthly in cash • Salary reviews will take place annually in April (previously salaries have been reviewed in January) • No base salary increases are proposed for executive directors in April 2011 • Executive directors also receive benefits in kind in the form of a car allowance and medical insurance
Annual bonus	• Incentivise executives to achieve key goals on an annual basis • To focus on the key financial metrics of the business and performance against a set of individual objectives	• Maximum awards are set broadly in line with FTSE 100 market practice • Target bonus opportunities are 50% of the maximum award • One-third of any bonus will be deferred into shares for a period of three years	• Measured annually, with bonus levels determined by the Committee following the year end based on performance against set targets • Performance assessed against a number of financial and strategic corporate targets as well as individual performance • 2011 criteria being finalised following acquisition of AXA UK Life Business
LTIP	• To act as the sole long-term incentive arrangement for the duration of the UK Life Project • Incentivise key individuals over the long term in a way which is aligned with the strategy of Resolution and the delivery of value to shareholders • Retain key individuals during the UK Life Project	• Awards entitle participants to a percentage share in the difference between the value realised on completion of the UK Life Project and the aggregate cost of the acquisitions • The total value of the pool available for distribution to participants will be 2% of the increase in value of the Project • An IRR of 12% pa over the life of the Project must be achieved before any realised value is delivered to participants • Top up awards may be made during the life of the plan to individuals identified as high performers and critical to the business	• Initial awards were made in March 2010 • Subsequent awards have been made to key individuals who joined FPH following the acquisition of the AXA UK Life Business • Awards to new joiners will be pro-rated to take into account that they have joined part-way through the Project • If an amount becomes due under an award, it will be paid in three tranches. One-third at the time the entitlement arises and the remaining two-thirds in equal instalments after 12 and 24 months • Initial awards made to executive directors have ranged between 1.5% to 11% of the pool
Pension	• Provide a framework to save for retirement	• Provide market competitive post-retirement benefits within a defined contribution scheme	• All executives participate in the FRIENDS Pension Plan • Executive directors receive c.13% of the notional earning cap into the plan • In addition, executive directors receive a pension allowance equal to 20% of the difference between their annual base salary and the notional earnings cap

2011 base salary

Historically salaries have been reviewed and are effective from 1 January each year. Going forward any salary review will be effective from 1 April. No base salary increases are proposed for any executive directors in April 2011.

As announced on 24 January 2011, Trevor Matthews will move to a new role of Vice Chairman following the arrival of Andy Briggs as Chief Executive Officer later this year. At that time, his salary will reduce from £720,000 to £495,000 and his annual bonus will be assessed on a pro-rated basis as between the two salaries. Andy Briggs' starting salary will be £600,000 which, reflecting the corporate structure of the Group, represents a discount to the salary of his predecessor.

2011 annual bonus arrangements

Following the acquisition of the AXA UK Life Business and changes to the structure of the FPH board, the maximum annual bonus opportunity for the Chief Executive Officer (and, following the change in roles, the Vice Chairman), has been increased from 125% of salary to 150% of salary. In addition, the bonus opportunity for Evelyn Bourke in her new role as Executive Director – Strategy, Capital and Risk has increased from 100% of salary to 120% of salary.

These increases correspond to an increase in the size and scope of the roles following the acquisition of the AXA UK Life Business and the changes in responsibilities of the executive directors. At the same time, the Committee has made changes to the performance criteria under the annual bonus to further align these objectives with the interests of shareholders and ensure the delivery of stretching short-term goals to create long-term shareholder value.

The revised bonus opportunities are positioned more in line with FTSE 100 market practice, but remain slightly below market median. The table below provides a summary of the annual bonus opportunities for 2011.

Executive	Maximum bonus opportunity	Target bonus opportunity
Chief Executive Officer	150% of salary	75% of salary
Vice Chairman	150% of salary	75% of salary
Executive Director – Operations	200% of salary	100% of salary
Executive Director – Strategy Capital and Risk	120% of salary	60% of salary
Interim Executive Director – Finance	120% of salary	60% of salary

The performance criteria for the 2011 annual bonus will be similar to the measures used to assess performance in 2010. These are being finalised following the acquisition of the AXA UK Life business, to ensure that they are appropriate for the combined entity and that targets are significantly stretching. Full disclosure of the performance measures will be provided in the 2011 Remuneration report.

2011 executive long-term incentive arrangements

Current long-term incentive awards

The Remuneration Committee has recommended that key individuals within FPH be incentivised over the longer term in a way which is aligned with the strategy of the Group as a whole, and the delivery of value to shareholders. A LTIP was established early in 2010 to reflect value created in the Group from the UK Life Project.

Awards entitle the executive directors and other key individuals to a percentage share in the difference between the value realised on completion of the UK Life Project and the aggregate cost of the acquisitions. Initial awards were made under the LTIP in March 2010 with subsequent awards mainly being made to certain individuals who joined FPH following the completion of the acquisition of the AXA UK Life Business.

Over the duration of the LTIP an IRR of 12% pa must be achieved before any realised value will be delivered to participants. If this threshold is achieved, participants will be entitled to share in the entire increase in value created from the UK Life Project. In this way, participants will not receive any payment until such time as the UK Life Project is successful in achieving value for shareholders, thus ensuring that the interests of plan members and shareholders are directly aligned.

If an amount becomes due under an award, it will normally be paid in three tranches. A third of the amount will be paid at the time that the entitlement arises. Two further payments will be made after 12 months and 24 months, subject to the participant remaining in service or being a "good leaver" at the time the payment is made. The first tranche will be paid in cash and FPH has discretion to make the latter two payments as cash or other assets (eg appropriate shares).

The total value of the pool available for distribution to participants will be 2% of the increase in value from the project. Trevor Matthews has been made an initial award of units representing a maximum 10% of the pool and Andy Briggs will receive an initial allocation representing a maximum of 11% of the pool. The FPH Executive Director – Strategy, Capital and Risk (previously Finance Director) has been awarded units representing a maximum 7% of the pool. Following their appointment to the FPH board, the Executive Director – Operations has been awarded units representing a maximum 5% of the pool and the Interim Executive Director – Finance representing a maximum 1.5% of the pool.

It is envisaged that new or "top-up" awards will be made during the life of the plan to individuals who are identified as high performers and critical to the ongoing success of the business, within the constraints of the total pool outlined above. This provides for the flexibility to differentiate and reward key individuals for their contribution over the life of the UK Life Project. A review of award levels is due to take place later in the year and details of any further awards will be disclosed in the 2011 Remuneration report.

Where awards are made to individuals who were not in FPH employment at the start of the UK Life Project, participation will be pro-rated on a time basis (unless the Committee determines otherwise) (eg the awards to the Executive Director – Operations and Interim Executive Director – Finance will be pro-rated to take account of the fact that they joined 10 months into the UK Life Project and Andy Briggs more than one year into it). Executive directors of FPH will not be entitled to participate in any other executive long-term remuneration arrangements. The total amount awarded in the LTIP at the date of this report was 32.25%.

Transitional arrangements for David Hynam and Andy Parsons

Prior to his appointment to the FPH board, Andy Parsons was also awarded an additional one-off award of 63% of salary to aid his retention due to the interim nature of the role. This award was allowed to continue following his appointment to the FPH board and will be paid 12 months following the completion of the acquisition.

Upon his recruitment from AXA, David Hynam received a one-off payment of £250,000 to compensate him for remuneration opportunities foregone as a result of joining FPH. Given his strong track record, David is viewed as being critical to the future of the combined entity and this payment considered appropriate in order to secure his services.

Transitional arrangements for Andy Briggs

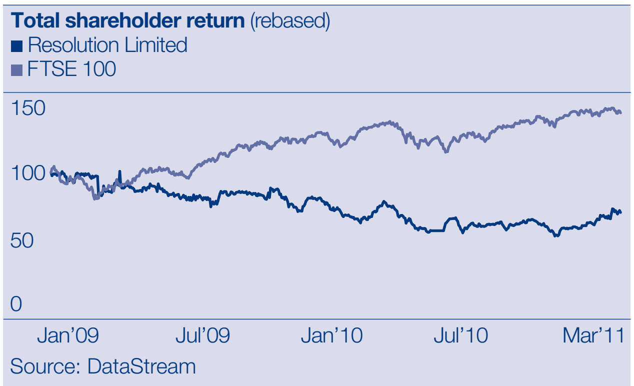
As part of the terms of his appointment, Andy Briggs will receive £498,000 in cash (with 50% paid on joining and 25% on each of the first and second anniversaries) and shares to the value of £1,757,000 in the Company (with one-third vesting on the date of joining and each of the two anniversaries) to compensate for awards lost from his previous employer as a result of his joining FPH. The Committee is satisfied that these payments were necessary and not excessive and has protected the Company's position by providing for full claw-back if Mr Briggs resigns or is summarily dismissed before the third anniversary of his joining.

FPH employee share scheme

During 2010, the Committee has implemented an HMRC approved Share Incentive Plan. All employees and executive directors in Friends Life group may participate in the plan, which provides the opportunity to purchase Partnership and Dividend shares under the plan.

Performance graph

The performance graph is included to provide a guide to shareholders' return from a hypothetical £100 holding in Resolution Limited's shares from 1 January 2009 to 31 December 2010. The FTSE 100 has been chosen as being the most relevant comparator index.



Pensions

No element of FPH executive directors' remuneration other than salary is pensionable. Trevor Matthews, Evelyn Bourke, David Hynam and Andy Parsons are members of the FPH defined contribution scheme, the FRIENDS Pension Plan. With the exception of Andy Parsons, FPH contributes 13% of their basic annual salary (subject to a maximum equal to the notional earnings cap formerly applied by HM Revenue & Customs) into the FRIENDS Pension Plan.

Andy Parsons' pension entitlement is on the same terms as all transferring AXA employees participating in the scheme. The employer contribution rate for his pension is 12.6% up to the notional earnings cap.

In addition, executive directors receive a pension allowance equal to 20% of the difference between their annual basic salary and the notional earnings cap. In 2010, Trevor Matthews contributed 5% of his annual basic salary up to the notional earnings cap as well as sacrificing his pension allowance into the scheme. Evelyn Bourke contributed £25,000 per annum into the scheme which is approximately 20% of her annual basic salary up to the notional earnings cap. David Hynam contributed 5% of his uncapped annual basic salary and Andy Parsons contributed 6% of his annual basic salary up to the notional earnings cap.

On behalf of the Board

Gerhard Roggemann
Chairman of the Remuneration Committee

23 March 2011

IFRS financial statements

Independent auditor's report to the members of Resolution Limited

We have audited the Group financial statements of Resolution Limited for the year ended 31 December 2010 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of IFRS based operating profit, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes 1 to 44. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with the provisions of our engagement letter dated 26 November 2010 and Section 262 of the Companies (Guernsey) Law, 2008. Our audit work has been undertaken so that we might state to the Company'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 Company and the Company'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

As explained more fully in the Directors' Responsibilities Statement set out on page 56, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. The Directors are also responsible for the preparation of the Corporate Governance Report and the Remuneration Report.

Our responsibility is to audit the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Notwithstanding the Company's incorporation in Guernsey, the Company has also instructed us to:

- review the Directors' statement on going concern which, for a listed UK-incorporated company, is specified for review by the Listing Rules of the Financial Services Authority; and
- audit the section of the Directors' Remuneration Report that has been described as audited and state whether it has been properly prepared in accordance with the basis of preparation described therein.

Scope of the audit of the financial statements

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

In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies (Guernsey) Law, 2008.

Opinion on other matters

In our opinion the part of the Directors' Remuneration Report that has been described as audited has been properly prepared in accordance with the basis of preparation as described therein.

We have reported separately on the parent company financial statements of Resolution Limited for the year ended 31 December 2010.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

The Companies (Guernsey) Law, 2008 requires us to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

The Directors' statement set out on page 56, in relation to going concern, which the Company has requested that we review.

John Headley
for and on behalf of Ernst & Young LLP
London

23 March 2011

Consolidated income statement

For the year ended 31 December 2010

	Notes	2010[ii] £m	As restated 2009[iii] £m
Revenue			
Gross earned premiums	4	**1,288**	133
Premiums ceded to reinsurers	4	**(241)**	(15)
Net earned premiums	4	**1,047**	118
Fee and commission income and income from service activities		**751**	126
Investment return	5	**8,426**	1,267
Total revenue		**10,224**	1,511
Other income	4	**891**	1,305
Claims, benefits and expenses			
Gross claims and benefits paid	6	**(2,004)**	(211)
Amounts receivable from reinsurers	6	**322**	32
Net claims and benefits paid	4	**(1,682)**	(179)
Change in insurance contract liabilities	27	**(891)**	129
Change in investment contract liabilities	31	**(5,863)**	(1,189)
Transfer to unallocated surplus		**(4)**	(3)
Movement in net asset value attributable to unit-holders	34	**(139)**	(31)
Movement in policyholder liabilities		**(6,897)**	(1,094)
Acquisition expenses	7	**(392)**	(74)
Administrative and other expenses	8	**(1,061)**	(167)
Finance costs	11	**(127)**	(20)
Total claims, benefits and expenses		**(10,159)**	(1,534)
Share of profits of associates and joint venture	19	**–**	5
Profit before tax from continuing operations		**956**	1,287
Policyholder tax	12	**(244)**	(1)
Profit before shareholder tax from continuing operations		**712**	1,286
Total tax (charge)/credit	12	**(136)**	21
Policyholder tax	12	**244**	1
Shareholder tax	12	**108**	22
Profit for the period		**820**	1,308
Attributable to:			
Equity holders of the parent[i]		**765**	1,280
Non-controlling interests		**55**	28
Profit for the period		**820**	1,308

	Notes	2010 pence	As restated 2009 pence
Earnings per share:			
Basic earnings per share from continuing operations	14	**81.10**	550.58
Diluted earnings per share from continuing operations	14	**80.47**	549.63
Earnings per share prior to restatement for 21 July 2010 share consolidation and rights issue:			
Basic earnings per share from continuing operations	14	**n/a**	137.09
Diluted earnings per share from continuing operations	14	**n/a**	136.86

(i) All profit attributable to equity holders of the parent is from continuing operations.
(ii) The consolidated income statement includes the results of AXA UK Life Business from the date of acquisition on 3 September 2010.
(iii) In accordance with the requirements of the 2010 IASB "Improvements to IFRSs" the Group has restated the 2009 valuation of the STICS to their acquisition fair value. This has resulted in an increase in other income and profit of £119 million.

Consolidated statement of comprehensive income

For the year ended 31 December 2010

	Equity holders of the parent £m	Non-controlling interests £m	2010 £m	As restated 2009 £m
Profit for the period	**765**	**55**	**820**	1,308
Actuarial (losses)/gains on defined benefit pension schemes	**(46)**	**–**	**(46)**	25
Foreign exchange adjustments(i)	**(6)**	**–**	**(6)**	(2)
Revaluation of owner occupied properties	**–**	**–**	**–**	1
Shadow accounting(ii)	**(3)**	**–**	**(3)**	(4)
Aggregate tax effect of above items	**25**	**–**	**25**	5
Other comprehensive (loss)/income, net of tax	**(30)**	**–**	**(30)**	25
Total comprehensive income, net of tax	**735**	**55**	**790**	1,333

(i) Foreign exchange adjustments relate to the translation of overseas subsidiaries.
(ii) Shadow accounting relates to revaluation of owner-occupied properties and foreign exchange adjustments on translation of overseas subsidiaries held by the with-profits fund of FPLP.

Consolidated statement of IFRS based operating profit
For the year ended 31 December 2010

	Notes	2010 £m	As restated 2009[i] £m
Profit before tax from continuing operations	4	**956**	1,287
Policyholder tax	12	**(244)**	(1)
Returns on Group-controlled funds attributable to third parties		**(23)**	(23)
Profit before tax excluding return generated within policyholder funds		**689**	1,263
Other non-recurring items	4	**(787)**	(1,309)
Amortisation of acquired present value of in-force business	15	**364**	59
Amortisation of other intangible assets	15	**64**	10
Interest payable on step-up tier one insurance capital securities (STICS)	39	**(31)**	(5)
Short-term fluctuations in investment return		**(24)**	(12)
Operating profit before tax		**275**	6
Tax on operating profit		**16**	14
Operating profit after tax attributable to equity holders of the parent		**291**	20

		2010 pence	2009 pence
Earnings per share			
Operating earnings per share	14	**30.85**	8.60
Operating earnings per share prior to restatement for 21 July 2010 share consolidation and rights issue	14	**n/a**	2.14

(i) The Group has revised the definition of IFRS based operating profit in order to reduce the impact of investment volatility on operating profit. Operating profit excludes: (a) all investment variances from expected investment return which is calculated on a long term rate of return; (b) policyholder tax; (c) returns attributable to non-controlling interests in policyholder funds; (d) significant non-recurring items; and (e) amortisation and impairment of present value of acquired in-force business and other intangible assets and is stated after deducting interest payable on STICS. Operating profit is considered to be a better measure of the performance of the Group and this measure of profit is used internally to monitor the Group's IFRS results. Further details are included in note 3.

Consolidated statement of financial position

At 31 December 2010

	Notes	2010 £m	As restated(i) 2009 £m
Assets			
Pension scheme surplus	9	**22**	38
Intangible assets	15	**5,140**	3,251
Property and equipment	16	**46**	47
Investment properties	17	**3,189**	1,546
Investments in associate and joint ventures	19	**32**	30
Deferred tax assets	23	**4**	12
Financial assets	20	**99,445**	48,315
Deferred acquisition costs	21	**358**	46
Reinsurance assets	22	**2,637**	1,972
Current tax assets		**22**	4
Insurance and other receivables	24	**976**	444
Cash and cash equivalents	25	**9,288**	5,386
Assets of operations classified as held for sale	42	**1,206**	–
Total assets		**122,365**	61,091
Liabilities			
Insurance contracts	27	**35,081**	12,107
Unallocated surplus		**1,098**	273
Financial liabilities:			
– investment contracts	31	**72,411**	40,495
– loans and borrowings	32	**1,212**	590
– amounts due to reinsurers	33	**1,666**	1,610
Net asset value attributable to unit-holders	34	**1,173**	668
Provisions	35	**221**	72
Deferred tax liabilities	23	**1,115**	535
Current tax liabilities		**11**	15
Insurance payables, other payables and deferred income	36	**903**	456
Liabilities of operations classified as held for sale	42	**925**	–
Total liabilities		**115,816**	56,821
Equity attributable to equity holders of the parent			
– Share capital	37	**4,317**	2,349
– Other reserves	38	**1,910**	1,306
		6,227	3,655
Attributable to non-controlling interests(i)	39	**322**	615
Total equity		**6,549**	4,270
Total equity and liabilities		**122,365**	61,091

(i) In accordance with the requirements of the 2010 IASB "Improvements to IFRS", the Group has restated the 2009 valuation of the STICS to their acquisition fair value.

The financial statements were approved by the Board of directors on 23 March 2011.

Fergus Dunlop
Director

Consolidated statement of changes in equity

For the year ended 31 December 2010

	Attributable to equity holders of the parent				
	Share capital £m	Other reserves £m	Total £m	Non-controlling interests £m	Total £m
At 31 December 2009 as previously reported	**2,349**	**1,187**	**3,536**	**780**	**4,316**
Prior year adjustment[i]	–	119	119	(165)	(46)
As restated at 1 January 2010	2,349	1,306	3,655	615	4,270
Profit for the year	–	765	765	55	820
Other comprehensive loss	–	(30)	(30)	–	(30)
Total comprehensive income	–	735	735	55	790
Interest paid on STICS	–	–	–	(31)	(31)
Dividends paid	–	(144)	(144)	(7)	(151)
Appropriations of profit	–	(144)	(144)	(38)	(182)
Tax relief on STICS interest	–	9	9	–	9
Shares issued in lieu of dividend	9	–	9	–	9
Rights issue	1,979	–	1,979	–	1,979
Disposals of businesses	–	–	–	(310)	(310)
Share-based payments	–	4	4	–	4
Treasury shares	(20)	–	(20)	–	(20)
At 31 December 2010	**4,317**	**1,910**	**6,227**	**322**	**6,549**

(i) Adjustment to reflect the fair value of the STICS at the date of acquisition of Friends Provident.

For the year ended 31 December 2009 (restated)

	Attributable to equity holders of the parent				
	Share capital £m	Other reserves £m	Total £m	Non-controlling interests £m	Total £m
At 1 January 2009	650	–	650	–	650
Profit for the period	–	1,280	1,280	28	1,308
Other comprehensive income	–	25	25	–	25
Total comprehensive income	–	1,305	1,305	28	1,333
Interest paid on STICS	–	–	–	(7)	(7)
Dividends paid to non-controlling interests	–	–	–	(4)	(4)
Appropriations of profit	–	–	–	(11)	(11)
Tax relief on STICS interest	–	1	1	–	1
Issue of share capital	1,699	–	1,699	–	1,699
Acquired through business combinations	–	–	–	598	598
At 31 December 2009	2,349	1,306	3,655	615	4,270

Consolidated cash flow statement

For the year ended 31 December 2010

	Notes	2010 £m	As restated 2009 £m
Operating activities			
Profit for the period		**820**	1,308
Adjusted for:			
– other income		**(891)**	(1,305)
– net realised and unrealised gains on assets at fair value		**(6,379)**	(810)
– finance costs		**127**	20
– amortisation of intangible assets		**428**	69
– depreciation of property and equipment		**4**	1
– movement in deferred acquisition costs		**(312)**	(46)
– total tax charge/(credit)		**136**	(21)
– purchase of shares and other variable yield securities		**(21,985)**	(8,828)
– sale of shares and other variable yield securities		**19,029**	7,717
– purchase of loans, debt securities and other fixed income securities		**(33,869)**	(4,082)
– sale of loans, debt securities and other fixed income securities		**34,880**	3,751
– purchase of investment properties		**(67)**	–
– sale of investment properties		**81**	46
– increase/(decrease) in insurance contract liabilities		**925**	(158)
– increase in investment contract liabilities		**7,372**	2,936
– increase in unallocated surplus		**2**	2
– decrease in provisions		**(3)**	(17)
– net increase/(decrease) in receivables and payables		**667**	(50)
Pre-tax cash inflow from operating activities		**965**	533
Tax received		**15**	11
Net cash inflow from operating activities		**980**	544
Investing activities			
Acquisition of subsidiaries, net of cash acquired		**969**	4,271
Disposal of investment securities		**–**	652
Other income net of related costs		**–**	4
Additions to internally generated intangible assets		**(4)**	(1)
Net (additions)/disposals of property and equipment		**(1)**	3
Net cash inflow from investing activities		**964**	4,929
Financing activities			
Proceeds from issue of ordinary share capital, net of transaction costs		**1,979**	(4)
Proceeds from issue of long-term debt		**428**	–
Repayment of long-term debt		**(123)**	–
Finance costs		**(113)**	(17)
STICS interest		**(31)**	(7)
Net movement in other borrowings, net of expenses		**15**	(45)
Dividends paid to equity holders of the parent		**(135)**	–
Dividends paid to non-controlling interests		**(7)**	(3)
Net cash inflow/(outflow) from financing activities		**2,013**	(76)
Increase in cash and cash equivalents		**3,957**	5,397
Balance at beginning of period	25	**5,386**	1
Exchange adjustments on the translation of foreign operations		**(55)**	(12)
Balance at end of period	25	**9,288**	5,386

Notes to the consolidated accounts

The notes on pages 92 to 186 form an integral part of these financial statements.

1. Accounting policies

1.1 Basis of preparation

The financial statements of the Company as at and for the year ended 31 December 2010 comprise the consolidated financial statements of the Company and its subsidiaries (together referred to as "the Group") and the Group's interests in associates and jointly controlled entities.

On 3 September 2010, the Company acquired all of the share capital of FASLH, a life insurance business which at that date was owned by AXA UK. The consolidated income statement therefore includes the result of this business from that date.

Under the terms of the acquisition of the AXA UK Life Business certain portfolios of business have been purchased that are currently still legally owned by AXA UK and similarly certain portfolios of business legally owned by the Group as a result of the acquisition are to be transferred back to AXA UK.

In particular, it is intended that the assets and liabilities of two portfolios of insurance contracts, the GOF and TIP business, will be transferred under the provisions of Part VII of the Financial Services and Markets Act 2000 back to AXA UK and they are therefore classified as held for sale assets and liabilities.

The WLUK book of business, which has been purchased by the Group, is still legally owned by AXA UK and the Company is expected to acquire the shares of WLUK in 2011. This is contingent upon a transfer under Part VII of the Financial Services and Markets Act 2000 of AXA retained business out of WLUK and FSA approval for change of control being received. The results and net assets of WLUK have therefore not been included in these financial statements.

The 2009 comparatives include the consolidated income statement of the Company for the full year and those of Friends Provident Group Limited ("FPG") from the date of acquisition (4 November 2009).

The consolidated financial statements as at and for the year ended 31 December 2010 have been prepared in accordance with IFRS as adopted by the European Union.

The presentation currency of the Group is Sterling. Unless otherwise stated the amounts shown in these financial statements are in millions of pounds Sterling (£ million).

The preparation of the financial statements under IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Further information on the use of judgement, estimates, and assumptions is set out in note 2.

The IASB issued the following new standards, changes to standards and interpretations which are effective for accounting periods beginning on or after 1 January 2010:

- IFRS 2: *Share-based payment: group cash-settled share-based payment transactions*. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. The Group adopted this amendment as of 1 January 2010. It does not have an impact on the financial position or performance of the Group;
- IAS 39: *Financial instruments: recognition and measurement – eligible hedged items*. The amendment, which is effective from 1 July 2009, clarifies that an entity is permitted to designate a portion of the fair value change or cash flow variability of a financial instrument as a hedged item. This also covers the designation of inflation as a hedged risk. The Group has not entered into any such hedges;
- Annual improvements to IFRSs (April 2009). The Group has evaluated the impact of these annual improvements and incorporated them where appropriate. The Group has assessed that they do not have a material impact;
- IFRIC 17: *Distribution of non-cash assets to owners*, effective for annual periods beginning on or after 1 July 2009. This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. The Group has determined that this interpretation does not have a material impact on the Group; and
- IFRIC 18: *Transfers of assets from customers*, effective for transfers of assets received on or after 1 July 2009. The Group has determined that this interpretation does not have a material impact on the Group.

Below is a list of new standards, changes to standards and interpretations that have been issued by the IASB with effective dates for accounting periods beginning after 1 January 2010, but where earlier adoption is permitted.

The Group has elected to only adopt the following in the financial statements for the year ended 31 December 2010:

- IFRS 3 (revised): *Business combinations* which requires that non-controlling interests in an acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets, in the event of liquidation are measured at either fair value or as the present ownership instruments' proportionate share in the recognised amounts of the acquiree's net identifiable assets. All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by IFRS.

1. Accounting policies continued

The impact of early adopting this annual improvement for the year ended 31 December 2010 is that non-controlling interests, which do not entitle their holders to a proportionate share of net assets, previously held at principal less issue costs plus interest have been measured at their fair value. This results in a decrease in the carrying amount of the STICS of £165 million; and

- Amendments to IFRIC 14: *Prepayments of a minimum funding requirement.* The amendment to IFRIC 14 is effective for annual periods beginning on or after 1 January 2011 with retrospective application. The amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset. The Group has decided to adopt this amendment early but it has no effect on the financial statements as the Group has not made any prepayments.

The Group has elected to adopt the following when they become effective:

- IAS 32: *Financial instruments: presentation – classification of rights issues*. This amendment, effective for annual periods beginning on or after 1 February 2010, addresses the accounting for rights issues that are denominated in a currency other than the functional currency of the issuer. Provided certain conditions are met, such rights issues are now classified as equity regardless of the currency in which the exercise price is denominated. Previously, these issues had to be accounted for as derivative liabilities. This amendment will not have a material impact on the Group;
- IFRS 7: *Financial instruments: disclosures*. This amendment is effective for annual periods beginning on or after 1 July 2011 and amends IFRS 7 to improve the disclosure requirements in relation to transferred financial assets. It also emphasises the interaction between quantitative and qualitative disclosures about the nature and the extent of risks associated with financial instruments;
- IFRS 9: *Financial instruments: classification and measurement*. This standard reflects the first phase of the Board's work on the replacement of IAS 39 and applies to classification and measurement of financial assets as defined in IAS 39. The standard is effective for annual periods beginning on or after 1 January 2013. This IFRS has not yet been endorsed by the EU. The adoption of IFRS 9 will have a material effect on the classification and measurement of the Group's financial assets and the Group will require adequate time to assess its impact;
- IAS 24 (revised): *Related party disclosures*. The revised IAS 24 is required to be applied to annual periods beginning on or after 1 January 2011. It clarifies the definition of a related party and provides a partial exemption for government controlled activities. This exemption is not applicable to the Group;
- Annual improvement to IFRSs (May 2010) – the IASB issued improvements to its IFRSs in May 2010. Apart from the annual improvement that amended IFRS 3 (Revised), the other improvements and amendments have not been adopted as they become effective for annual periods on or after either 1 July 2010 or 1 January 2011. The Group does not expect a material impact on its financial position or performance from the annual improvements that have not been adopted; and
- IFRIC 19: *Extinguishing financial liabilities with equity instruments.* This interpretation, effective for annual periods beginning on or after 1 July 2010, clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case this cannot be reliably measured, they are measured at the fair value of the liability extinguished. Any gain or loss is recognised immediately in profit or loss. The adoption of this interpretation will have no effect on the financial statements of the Group.

The financial statements comply with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005 (as amended in December 2006) insofar as these requirements do not contradict the requirements of IFRS.

The Group presents its balance sheet in order of liquidity. Where applicable, for each asset and liability line item that combines amounts expected to be recovered or settled both within and beyond 12 months after the balance sheet date, disclosure of the amount due beyond 12 months is made in the respective note.

Financial assets and financial liabilities are not offset, unless there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by an accounting standard or interpretation, as specifically disclosed in the accounting policies of the Group.

1. Accounting policies continued

1.2 Accounting policies

The principal accounting policies set out below have been consistently applied in these consolidated financial statements.

1.2.1 Business combinations

Business combinations are accounted for under IFRS 3: *Business combinations*, as revised in 2008 and amended in 2010, using the purchase method. The cost of a business combination is measured as the fair value of the consideration transferred. Identifiable assets acquired, including intangible assets arising on acquisition, and liabilities assumed in a business combination are measured initially at their fair value at the business combination date. Any excess of the cost of the business combination over the fair value of the net assets acquired is recognised in the balance sheet as goodwill. To the extent that the fair value of the acquired entity's net assets is greater than the cost of the acquisition, a gain is recognised immediately in the income statement. Acquisition related costs are expensed as incurred except insofar as they relate to the raising of debt or equity when such expenses are capitalised.

a) Subsidiaries

Subsidiaries are all entities over which the Group has the power, directly or indirectly, to govern the financial and operating policies so as to obtain economic benefits, generally accompanying a shareholding of more than one half of the voting rights. Potential voting rights that are presently exercisable or convertible are also taken into account. Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

Open-ended investment companies and unit trusts in which the Group has a percentage holding in excess of 50% are consolidated as special purpose vehicles under SIC12 (the Group obtains the majority of the benefits). The units not owned by the Group are treated as a liability referred to as "net asset value attributable to unit-holders".

The consolidated financial statements incorporate the assets, liabilities, results and cash flows of the Company and its subsidiaries. The results of subsidiaries acquired or sold during the period are included in the consolidated results from the date of acquisition or up to the date of disposal. Intra-group balances and income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

Profits or losses arising from changes in holdings in subsidiaries that do not impact the Group's control over that subsidiary are recognised directly in the statement of comprehensive income.

b) Associates and joint ventures

Associates are all entities over whose operating policies the Group has significant influence but not control, generally arising from holding between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost.

The Group's investment in associates includes goodwill (net of any impairment loss) identified on acquisition.

Joint ventures are those entities where the terms of the contractual agreement ensure that the parties involved jointly control the entity, notwithstanding that the Group's share of the underlying assets and liabilities may be more or less than 50%. The Group recognises its interests in joint ventures using the equity method.

Under the equity method, an investment is included as a single line item in the consolidated balance sheet as the Group's share of the fair value of the investee undertaking's net assets plus goodwill, which equates to the cost of the investment plus the Group's share of post-acquisition reserves. The Group's share of post-tax profits or losses is presented as a single line item in the consolidated income statement, adjusted for the effect of measuring assets and liabilities to fair value on acquisition.

c) Classification of a non-current asset or disposal group as held for sale

Where the Group holds a non-current asset or disposal group which is held exclusively with a view to its disposal in the near future, then it is classified as an asset held for sale.

An asset or disposal group is classified as held for sale when:

- management is committed to a plan to sell;
- the asset is available for immediate sale;
- an active programme to locate a buyer is initiated;
- the sale is highly probable, within 12 months of classification as held for sale (subject to limited exceptions);
- the asset is being actively marketed for sale at a sales price reasonable in relation to its fair value; and
- actions required to complete the plan indicate that it is unlikely that plan will be significantly changed or withdrawn.

Non-current assets or disposal groups that are classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current liabilities are presented separately on the balance sheet.

1.2.2 Product classification

a) Insurance contracts

Contracts under which the Group accepts significant insurance risk from another party (the policyholder), by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder, are classified as insurance contracts. Under IFRS 4: *Insurance contracts* insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of: a specified interest rate, security price, commodity price, foreign exchange rate, index of price or rates, a credit rating or credit index or other variable. Insurance contracts may also transfer some financial risk.

1. Accounting policies continued

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

b) Investment contracts

Policyholder contracts not considered insurance contracts under IFRS 4 are classified as investment contracts. Contracts classified as investment contracts are either unit-linked or contracts with Discretionary Participation Features ("DPF") with no significant insurance risk. The latter are mainly unitised with-profits contracts.

A contract with DPF is a contractual right held by a policyholder to receive, as a supplement to guaranteed minimum payments, additional payments:

- that are likely to be a significant portion of the total contractual payments; and
- whose amount or timing is contractually at the discretion of the issuer and that are contractually based on:
  - the performance of a specified pool of contracts, or a specified type of contract; or
  - realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
  - the profit or loss of the company that issues the contracts.

1.2.3 Segment reporting

Operating and reportable segments are presented in a manner consistent with the internal reporting information provided to the chief operating decision maker.

An operating segment is a component of the Group that engages in business activities from which it earns revenues and incurs expenses. Minor operating segments are combined to derive the Group's reportable segments in accordance with the requirements of IFRS 8: *Operating segments*.

Revenue information for geographical segment reporting is based on the geographical location of the customer. Non-current assets for geographical segment reporting is based on the location of the assets.

1.2.4 Foreign currency translation

a) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of each company in the Group at the foreign exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the exchange rate ruling at the balance sheet date, and any exchange differences arising are taken to the income statement. Non-monetary assets and liabilities measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not subsequently restated. Non-monetary assets and liabilities stated at fair value in a foreign currency are translated at the rate on the date the fair value was determined.

When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in the income statement, any exchange component of that gain or loss is recognised in the income statement. Foreign exchange adjustments recognised in equity are reported in the Group's foreign currency translation reserve within retained earnings and reported in the statement of comprehensive income.

b) Overseas subsidiaries and associates

The assets and liabilities of overseas subsidiaries and associates, including goodwill and intangible assets attributable to the acquisition of the overseas subsidiary or associate, and fair value adjustments arising on consolidation, are translated to Sterling (the presentational currency of the Group) at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of overseas subsidiaries and associates are translated to Sterling at average foreign exchange rates for the period.

Foreign exchange differences arising on the translation to Sterling are classified as equity movements and recognised in the Group's foreign currency translation reserve, and reported in the statement of comprehensive income. These exchange differences are recognised in the income statement in the period in which the overseas subsidiary or associate is sold.

1.2.5 Revenue recognition

a) Premiums

Premium income in respect of single premium insurance policies, new generation group pensions business and pensions business not subject to contractual regular premiums, is accounted for when the premiums are received.

For all other insurance contracts, premium income is accounted for in the year in which it falls due.

b) Fee and commission income and income from service activities

Investment contract policyholders are charged for policy administration services, investment management services and for surrenders. Investment management services comprise primarily fees and charges from unit-linked investment contracts issued by the life and pensions business. Fees earned on investment management contracts relate to the sale and management of retail investment products and from managing investments in the institutional market.

These fees and charges are recognised as revenue in the accounting period in which the services are rendered.

Front-end fees charged at the inception of certain investment contracts are recognised as income over the expected term of the contract on a straight-line basis with the unrecognised amount at the end of the year presented as a liability.

1. Accounting policies continued

Regular fees charged to the policyholder periodically (monthly, quarterly or annually), are recognised on a straight-line basis over the period that the service is rendered.

A number of contracts have performance fees based on an agreed level of performance over a set period. Performance fees are recognised when the quantum of the fee can be estimated reliably. Generally this is where the performance period ends on or before the reporting date or where there is a period of less than six months remaining to the end of the performance period and there is evidence at the reporting date which suggests that current performance will be maintained.

c) Investment income

All income received from investments is recognised in the income statement and includes dividends, interest, rental income, the movement in financial assets and investment properties, at fair value through the income statement, and realised losses and gains on assets classified as available-for-sale.

Dividend income from listed and unlisted securities is recognised as revenue when the right to receive payment is established. For listed securities this is the date the security is listed as ex-dividend.

Interest income is recognised in the income statement as it accrues, taking into account the relevant coupon rate, and applicable floating rate or, for loan assets at amortised cost, the effective interest rate method. Interest income includes the amortisation of any discount or premium.

Rental income from investment properties under operating leases is 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 income.

Determination of gains and losses and the movement in financial assets and investment properties at fair value through the income statement are explained in their respective accounting policies.

1.2.6 Expense recognition

a) Claims and benefits paid

Insurance claims reflect the cost of all claims incurred during the year on insurance contracts, including claims handling costs. Death claims and surrenders are recognised on the basis of notifications received. Maturities and annuity payments are recorded when due. Claims and benefits recorded are accrued to the policyholder and included within insurance and investment contracts liabilities, as appropriate.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any general administrative costs directly attributable to the claims function.

Reinsurance recoveries are accounted for in the same period as the related claim.

b) Finance costs

The interest expense recognised in the income statement under finance costs, is calculated using the effective interest rate method. Interest accrued on variable rate interest-bearing loans and borrowings is recognised under insurance payables, other payables and deferred income and not included in the carrying value of interest-bearing loans and borrowings.

c) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives paid are recognised in the income statement over the period of the lease.

d) Expenses related to investment properties

Expenses related to investment properties are treated as administrative expenses and are recognised when incurred.

1.2.7 Impairment

The Group assesses at each reporting date whether there is an indication that an asset other than goodwill, investment property and financial assets at fair value may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's fair value less costs to sell and its value in use, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses on continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount of the asset is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

1. Accounting policies continued

1.2.8 Intangible assets

Intangible assets acquired separately from a business are carried initially at cost. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably.

a) Goodwill

Goodwill arising on business combinations is the future economic benefit arising from assets that are not capable of being individually identified and separately recognised. Goodwill is not amortised but assessed for possible impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses, with the carrying value being reviewed for impairment at least annually and whenever events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of impairment testing, goodwill is allocated to the related cash generating units. Where the recoverable amount of the cash generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement. The carrying amount of goodwill allocated to a cash generating unit is taken into account when determining the gain or loss on disposal of the unit, or of an operation within it. Each cash generating unit to which goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes and is not larger than any of the Group's primary or secondary segments used for segment reporting.

The gain on acquisition, sometimes referred to as negative goodwill, arises in a business combination when the purchase consideration is less than the fair value of the net assets acquired; a gain on acquisition is recognised in the income statement in the period in which it arises.

b) Acquired value of in-force business ("AVIF")

On acquisition of a portfolio of insurance contracts and/or investment contracts, either directly or through the acquisition of a subsidiary undertaking, the net present value of the Group's interest in the expected pre-tax cash flows of the in-force business is capitalised in the balance sheet as an intangible asset. AVIF is amortised over the anticipated lives of the related contracts which typically vary between five and 35 years.

c) Other intangible assets

Customer relationships, distribution relationships and brands acquired are capitalised at cost, being the fair value of the consideration paid. Software is capitalised on the basis of the costs incurred to acquire and bring it into use.

These intangible assets have finite useful lives and are consequently carried at cost less accumulated amortisation and impairment. Amortisation is calculated using the straight-line method to allocate the cost over the estimated useful lives of the intangible assets with typical ranges as shown below:

	Years
Customer relationships	8–12
Distribution relationships	5–10
Brands	10–15
Computer software	3–4

Subsequent expenditure on other intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

1.2.9 Property and equipment

a) Owned assets

Land and buildings are initially recognised at cost and subsequently measured at fair value. Revaluations are performed annually by independent valuers, who hold a recognised and relevant professional qualification and have recent experience in the location and category of properties being valued. Valuations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date. The fair value is the amount for which a property could be exchanged between knowledgeable and willing parties in an arm's length transaction.

Properties occupied by the Group are held at fair value on the basis of open market value at the date of revaluation. Revaluation surpluses, and their reversal, are recognised in accumulated revaluation surplus in shareholders' equity. Revaluation losses, and their reversal, are recognised in the income statement.

Equipment is recognised at cost less accumulated depreciation and impairment losses.

b) Depreciation

	Years
Motor vehicles	3–4
Computer hardware	1–4
Fixtures, fittings and office equipment	3–10

Depreciation is charged so as to write off the cost of certain assets net of the estimated residual value, using the straight-line method, over the estimated useful life of equipment, as follows:

Residual values and useful lives are reviewed at each financial year end and adjusted if appropriate.

1. Accounting policies continued

c) Disposal and derecognition

An item of property and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset is included in the income statement in the year the asset is derecognised.

Any revaluation reserve relating to the particular asset being disposed of or no longer in use is transferred to retained earnings.

1.2.10 Investment properties

Investment properties comprise land and/or buildings that are not occupied by the Group and are held either to earn rental income or for capital appreciation, or for both.

In accordance with IAS 17: *Leases*, properties held by the Group under operating leases are classified as investment properties when the properties otherwise meet the definition of investment properties.

Investment property is initially included in the balance sheet at cost and subsequently measured at its fair value, which is supported by market evidence, based on annual valuations by independent valuers who hold a recognised and relevant professional qualification and have recent experience in the location and category of investment property being valued. Movements in the fair value of investment properties are taken to the income statement in the period in which they arise.

1.2.11 Financial assets

The Group classifies its financial assets as either financial assets at fair value through profit or loss, or as loans. Loans are stated in the balance sheet at either amortised cost less impairment losses, or at fair value. Invested cash held by the parent Company, Resolution Limited, qualifies for inclusion as cash equivalents.

Purchases and sales of financial assets are recognised on the date the Group commits to purchase or sell the asset, generally the trade date.

A financial asset is derecognised when and only when the contractual right to receive cash flows expires or when the asset, together with substantially all the risks and rewards of ownership, has been transferred.

a) Financial assets at fair value through the income statement

Financial assets at fair value through profit or loss comprise assets which are designated as such on initial recognition, and derivatives, which are classified as held for trading in accordance with IAS 39: *Financial instruments: recognition and measurement*.

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

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

Fair values for unlisted securities are derived from cash flow or other models designed to reflect the specific circumstances of the issuer. Securities for which fair value cannot be measured reliably are recognised at cost less impairment.

Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged and of the hedge.

b) Loans

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

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

1.2.12 Derecognition of a financial asset

A transfer of a financial asset is accounted for as a derecognition only if substantially all of the asset's risks and rewards of ownership are transferred or control is transferred in the event that not substantially all of the asset's risks and rewards of ownership are transferred. However, if substantially all of the risks and rewards are retained, the asset is not derecognised. Control is transferred if the transferee has the practical ability to sell the asset unilaterally without needing to impose additional restrictions on the transfer.

1.2.13 Acquisition costs

For both insurance contracts and investment contracts with DPF, acquisition costs comprise all direct and indirect costs arising from writing the contracts, which are incurred during a financial period. Acquisition costs are amortised over the life of the contracts where their recovery has not been reflected in the valuation of policyholder liabilities, but only to the extent that they are recoverable out of future margins.

1. Accounting policies continued

The rate of amortisation of acquisition costs on such contracts is proportional to the future margins expected to emerge in respect of the related policies, over the life of those policies.

For investment contracts without DPF, acquisition costs comprise all incremental costs that are directly related to the writing of the contract, which are incurred during a financial period, and are amortised on a straight-line basis over the lifetime of the contract if they are recoverable out of future margins.

1.2.14 Reinsurance

Amounts due to and from reinsurers are accounted for in accordance with the relevant reinsurance contract. Premiums ceded and claims reimbursed are individually presented on a gross basis.

Contracts that do not give rise to a significant transfer of insurance risk to the reinsurer are considered financial reinsurance and are accounted for and disclosed in a manner consistent with financial instruments.

1.2.15 Taxation

a) Current tax

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

The tax charge is analysed between tax in respect of income and investment return on the policyholders' interest in the with-profits and linked fund assets, representing policyholders' tax, with the balance being tax on equity holders' investment return and profits, representing shareholders' tax.

b) Deferred tax

Deferred tax is the tax expected to be payable or recoverable on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit. This is accounted for using the balance sheet liability method and the amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities. The tax rates used are the rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is recognised in the income statement for the period, except to the extent that it is attributable to items that are recognised in the same or a different period outside the income statement, in which case the deferred tax will be recognised in other comprehensive income or equity, as applicable. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable future profits will be available against which deductible temporary differences can be utilised.

The deferred tax charge is analysed between tax in respect of the policyholders' interest in the with-profits and linked fund assets, and the balance, representing shareholders' tax.

1.2.16 Insurance and other receivables

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

1.2.17 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdraft facilities repayable on demand to the extent that they form an integral part of the Group's cash management.

1.2.18 Financial liabilities

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

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

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

A financial liability is recognised when, and only when, the Group becomes a party to the contractual provisions of a financial instrument.

A financial liability is derecognised when, and only when, the obligation specified in the contract is discharged, or cancelled or expires.

1.2.19 Insurance contracts

For UK operations the liabilities are calculated based on the relevant FSA rules contained in the Prudential Sourcebook for Insurers. For overseas operations, insurance contract liabilities are calculated on recognised actuarial principles, based on local regulatory requirements.

1. Accounting policies continued

For the conventional with-profits policies in FPLP, the liabilities to policyholders include both declared and constructive obligations for future bonuses not yet declared (excluding the shareholders' share of future bonuses) and include the cost of options and guarantees measured on a market consistent basis. The basis of calculation does not recognise deferred acquisition costs, but allows for future profits of non-profit and unit-linked business written in the with-profits fund to be recognised. The calculation of liabilities to policyholders includes a deduction for the present value of in-force business on the with-profits policyholders' share of non-profit business written within the with-profits fund.

The calculation of the liabilities to policyholders in respect of conventional with-profits contracts in FPLA includes an implicit provision for future regular bonuses, but not final bonuses, by means of a reduction in the valuation interest rate and an assessment of options and guarantees on a deterministic basis.

For with-profits contracts in both FLC and FLAS the liabilities to policyholders include both declared and future bonuses estimated in a manner consistent with the Principles and Practices of Financial Management ("PPFM") for the respective fund and include the cost of options and guarantees measured on a market-consistent basis. The basis of calculation allows for future profits of non-profit business written in the with-profits fund.

The calculation of liabilities to policyholders for non-profit contracts includes explicit allowance for future expenses and allows for lapses where appropriate.

The value of unit linked insurance contract liabilities includes provision for tax losses in the unit linked funds whose benefit will ultimately accrue to policyholders.

As an insurance special purpose vehicle ("ISPV"), Friends Annuities Limited ("FAL") is not required to value liabilities on an FSA basis. The valuation is, however, undertaken on a prudent basis which is generally similar to an FSA basis. The assumptions include a margin to allow for adverse variation of experience to assumptions.

The Group applies shadow accounting in relation to certain insurance contract liabilities, which are supported by owner-occupied properties and overseas subsidiaries, on which unrealised gains and losses are recognised in equity. Adjustments are made to the insurance contract provisions to reflect the movements that would have arisen if the unrealised gains and losses had been recognised in the income statement. The corresponding change in the value of these insurance contract liabilities is recognised in equity.

The Group carries out an annual liability adequacy test on its insurance contract liabilities less related deferred acquisition costs and other related intangible assets to ensure that the carrying amount of its liabilities is sufficient in the light of estimated future cash flows. Where a shortfall is identified, an additional provision is made.

1.2.20 Investment contracts

Investment contracts are either unit-linked or contracts with DPF (mainly unitised with-profits contracts that have no significant insurance risk).

A unit-linked investment contract is recognised at fair value through the income statement. The fair value is calculated as the number of units allocated to policyholders in each of the unit-linked funds multiplied by the bid price of the units which reflects the fair value of the assets in the fund at the balance sheet date. In addition to this the fair value of the investment contract liability includes a provision for tax losses in the unit linked funds whose benefit will ultimately accrue to the policyholders. Provision is made for renewal commissions at the inception of an investment contract as intermediaries are not required to perform any service once the policy is incepted.

Investment contracts with DPF held within the with-profits funds (which are mainly unitised with profits contracts) are measured on a basis that is consistent with a measurement basis for insurance contracts held within those funds.

1.2.21 Unallocated surplus

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

All UK life business, with the exception of FPLA, measure insurance and investment contract liabilities within with-profits funds on a realistic basis and therefore include amounts attributable in respect of future bonuses. Such amounts are estimated in accordance with the published PPFM and represent a constructive obligation. The realistic liabilities include an estimate of the fair value of policyholder options and guarantees. The unallocated surplus within the with-profits funds represents the excess of assets of the fund relative to the realistic liabilities and other current liabilities not included within the realistic liability measurement. The unallocated surplus can be considered to represent the working capital of the funds combined with the value of future transfers to shareholders from the with-profits funds.

Within FPLA, the unallocated surplus represents the value of future regular and final bonus payments to policyholders.

1.2.22 Interest bearing loans and borrowings

Borrowings are recognised initially at fair value, which is generally the cash consideration received, net of transaction costs incurred, and subsequently stated at amortised cost. Any difference between the proceeds, net of transaction costs, and the redemption value is recognised in the income statement over the period of the borrowings, using the effective interest rate method.

1. Accounting policies continued

1.2.23 Provisions and contingent liabilities

A provision is recognised when the Group has a present legal or constructive obligation, as a result of a past event, which is likely to result in an outflow of resources and where a reliable estimate of the amount of the obligation can be made. If the effect is material, the provision is determined by discounting the expected future cash flows at a pre-tax risk-free rate and, where appropriate, the risks specific to the liability.

The Group recognises a provision for onerous contracts when the expected benefits to be derived from the contracts are less than the related unavoidable costs.

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reliably estimated.

1.2.24 Insurance payables, other payables and deferred income

Insurance and other payables are recognised when due and measured on initial recognition at the fair value of the consideration paid. Subsequent to initial recognition, payables are measured at amortised cost using the effective interest rate method.

1.2.25 Financial instruments as equity

A financial instrument is treated as equity if:

- there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on terms that may be unfavourable; and
- the instrument is a non-derivative that contains no contractual obligations to deliver a variable number of shares or is a derivative that will be settled only by the Group exchanging a fixed amount of cash or other assets for a fixed number of the Group's own equity instruments.

Incremental external costs which are directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds of the issue.

1.2.26 Dividends

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

1.2.27 Employee benefits

a) Pension obligations

i) Defined benefit schemes
Pension schemes are in operation for employees of certain subsidiary undertakings. A significant proportion of employees belong to a funded defined benefit type with uninsured assets. The schemes provide benefits based on final pensionable salary. The assets of the schemes are held in separate trustee administered funds.

The pension asset and liability recognised in the balance sheet is the present obligation of the employer, which is the estimated present value of future benefits that employees have earned in return for their services in the current and prior years, less the value of the plan assets in the schemes. A pension surplus is recognised to the extent it is recoverable. The rate used to discount pension obligations is determined by reference to market yields at the end of the reporting period on high quality corporate bonds. A qualified actuary performs the calculation of the present value of the defined benefit obligation annually using the projected unit credit method.

The pension costs for the schemes are charged to the income statement and consist of current service cost, past service cost, interest cost on scheme liabilities, the effect of any settlements and curtailments and the expected return on pension assets. Past service costs are recognised in the income statement on a straight-line basis over the period in which the increase in benefits vest.

The actuarial gains and losses, which arise from any new valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date and any restrictions to recognised surpluses, are taken to the statement of comprehensive income for the period.

ii) Defined contribution schemes
Contributions made to these schemes are charged to the income statement as they become payable in accordance with the rules of the scheme.

iii) Other long-term employee benefits
Other long-term employee benefits are recognised at the discounted present value of the defined benefit obligation at the balance sheet date. The obligation is calculated using the unit credit method. Movements in the value of the obligation are charged to the income statement.

iv) Termination benefits
Termination benefits are recognised as a liability and an expense when the Group is demonstrably committed to terminating the employment of an employee before the normal retirement date, or to provide benefits as a result of an offer made to encourage voluntary redundancy.

b) Share-based payment schemes

A subsidiary undertaking Lombard International Assurance SA ("Lombard") provides an incentive scheme to eligible employees that entitles the participants, subject to achievement of performance conditions, to shares in the Company.

The fair value of awards made under this equity-settled scheme was measured at the acquisition date and is being expensed on a straight-line basis over the vesting period in the income statement. A corresponding amount is credited to equity. The fair value is measured using scenario based modelling techniques that take into account the terms and conditions upon which these shares would be issued.

1. Accounting policies continued

At each balance sheet date, the Group revises its estimate of the number of shares that are expected to be issued. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity over the remaining vesting period.

During 2010, FPH introduced a LTIP for eligible employees. The participants are entitled, subject to achievement of performance conditions, to a percentage share of the net value generated from the acquisition of life companies referred to as the UK Life Project.

The scheme is a cash-settled share-based payment scheme and the fair value of the awards in issue, being the relevant percentage of the gain expected to arise on completion of the UK Life Project, is measured at each reporting date, with any changes in fair value being recognised in the income statement for the period.

Where the terms of share options are modified after they have been issued, the change in the fair value is recognised over the remainder of the vesting period if they have not yet vested, or immediately where they have already vested. Where there is a reduction in the vesting period or a change to performance conditions, this is considered to be a change in a non-market condition and is taken into account when estimating the number of options expected to vest. Where the options are cancelled before the vesting date, they are treated as if they have vested early. The accounting treatment is to recognise immediately the amount that would have been recognised in respect of services provided by employees over the remainder of the vesting period.

2. Use of judgements, estimates and assumptions

The Group makes judgements in the application of critical accounting policies that affect the reported amounts of assets and liabilities. The Group also makes key assumptions about the future and other sources of uncertainty. These are continually evaluated and based on historical experience and other factors, including expectations of future events that are considered to be reasonable under the circumstances.

a) Product classification

IFRS 4: *Insurance contracts* requires contracts to be classified as either “insurance contracts” or “investment contracts” based on the significance of insurance risk present in the contract with consequential impacts on the accounting policies applied to the valuation of policyholder liabilities, deferral of acquisition costs and pattern of revenue recognition.

b) Liabilities arising from insurance contracts and investment contracts with DPF

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

The most significant assumptions are:

- mortality, morbidity and persistency assumptions;
- for with-profits policies, the stochastic models used to value liabilities are sensitive to risk-free rates, assumed asset volatilities and the assumed correlation between asset volatilities. Risk-free rates are set in accordance with current market gilt rates;
- valuation interest rate for annuities in payment – fixed-interest assets, predominantly corporate bonds, are held to match the expected benefit outgo of the annuity portfolio. The excess yields on corporate bonds over that on gilts are called bond spreads and these reflect compensation for the higher risk of default (credit-risk premium) and lower liquidity (illiquidity premium) compared to gilts. One of the key judgements is the assessment of how much of the spread is attributable to illiquidity premium. The illiquidity premium is derived by deducting an allowance for defaults (based on an analysis of historical defaults) from the total bond spread. This approach is consistent with current industry practice;
- other valuation interest rates have been calculated by reference to changes in consistent economic indices. The impact of all interest rate changes on liabilities is included within the impact of economic basis changes in note 27. The impact of these liability changes on surplus is generally to offset some or all of the corresponding impact on the value of fixed-interest assets backing the liabilities;
- for guaranteed annuity options (one of the principal guarantees written by the Group) the cost depends on assumptions such as the level of policy discontinuance and the tax-free cash take-up rate; and
- changes in assumptions behind the valuation techniques for assets that are not quoted in active markets could have a significant impact on the value of assets that are backing insurance and investment contract liabilities.

The carrying value of insurance contract liabilities at 31 December 2010 is £35,081 million (2009: £12,107 million) and investment contract liabilities with DPF is £9,123 million (2009: £3,974 million).

c) AVIF and other intangible assets

The most significant intangible asset recognised upon the acquisition of AXA UK Life Business is AVIF which is reflected in the acquisition balance sheet at £2,192 million before allowing for amortisation. AVIF of £2,943 million was recognised upon the acquisition of Friends Provident. The calculation of AVIF relies on a number of assumptions, and is based on a market consistent embedded value methodology. Details of assumptions are given in the supplementary information section.

2. Use of judgements, estimates and assumptions continued

Other intangible assets of £150 million were also recognised following the acquisition of AXA UK Life Business. The comparable figure for Friends Provident is £363 million. Both figures are before allowing for amortisation. Information relating to the methods used to value other intangible assets is set out in note 15.

d) Fair value determination of financial instruments at fair value through the income statement

Financial assets are designated at fair value where they are managed on a fair value basis or at amortised cost. Financial liabilities such as investment contracts are designated at fair value to eliminate mismatch with corresponding assets which are managed on a fair value basis.

Fair values of financial instruments that are quoted in active markets are based on bid prices for the assets held. When independent prices are not available, fair values are determined by using valuation techniques which refer to market observable data. These include comparison with similar instruments when market observable prices are available.

Corporate bond valuations are generally obtained from brokers and pricing services. Where the number of transactions has declined under the current market conditions, valuations have become more subjective. Bond prices provided by pricing services are based on the best estimate of market price determined by market makers based on a variety of factors and are considered to be observable prices. In determining fair value, market makers will take into account transactions they have observed in identical or similar assets as well as movements in market indices and any other factors that they regard as relevant. In some cases, consensus prices have been based on fewer, and potentially more historic, transactions.

Fair values of private equity investments are based on the revaluation of the underlying investments using International Private Equity and Venture Capital Valuation guidelines. The valuations use earnings multiples reflecting similar multiples applying to quoted investments.

Methods considered when determining fair values of unlisted shares and other variable securities include discounted cash flow techniques and net asset valuation.

The value of derivative financial instruments is estimated by applying valuation techniques, using pricing models or discounted cash flow methods. Where pricing models are used, inputs – including future dividends, swap rates and volatilities – based on market data at the balance sheet date are used to estimate derivative values. Where discounted cash flow techniques are used, estimated future cash flows and discount rates are based on current market swap rates.

For units in unit trusts and shares in open-ended investment companies, fair value is by reference to published bid values.

Participation in investment pools mainly relates to property investments. Property is independently valued in accordance with the Royal Institute of Chartered Surveyors' ("RICS Red Book") guidelines on the basis of open market values as at each year end.

The carrying amount of financial assets at fair value through the income statement that are not based on observable market data at 31 December 2010 is £4,452 million (2009: £5,408 million). An analysis of financial assets by category is disclosed in note 20.

e) Staff pension schemes assumptions

In assessing the pension benefit obligation, assumptions are made as to the life expectancy of all current, deferred and retired members, rates of increases of salaries and pensions, and interest and inflation rates. Material assumptions used and sensitivities are explained in detail in note 9. Estimates are made for the recoverability of any surplus through expected refunds or reductions in contributions and the surplus will be restricted accordingly.

The carrying value of the pension asset of the Group at 31 December 2010 is £22 million (2009: £38 million).

f) Deferred tax assets and liabilities

In assessing deferred tax assets, an estimate of probable future taxable profits is made, against which the temporary differences, being the carry forward of excess tax expenses, and tax losses are utilised. These involve management's best estimate based on past profit experience, adjusted for possible future deviations that management considers might occur. Details of deferred tax assets recognised are in note 23.

The principal deferred tax liabilities relate to deferred tax on purchased value of in-force business. On the acquisition of AXA UK Life Business a deferred tax liability of £578 million was set up (Friends Provident 2009: £605 million) which is subsequently being released in line with the run-off of the underlying asset. The deferred tax liability was calculated using detailed actuarial forecast cash flows.

g) Fair value determination of investment properties and owner-occupied properties

Investment properties and properties occupied by the Group are measured at fair value at least annually at the balance sheet date. Fair values are measured by external independent valuers on the basis of open market value using methods set out in the RICS Red Book.

The valuations used are based on valuation techniques using multiples of future rental incomes. The rental multiples are based on multiples observed in recent similar transactions in the market. Key assumptions include occupancy and rental income.

3. Restatement of prior period figures

a) Restatement of IFRS based operating profit

IFRS based operating profit is used internally to monitor the Group's performance and is included within these financial statements to give shareholders a better understanding of the Group's underlying performance.

Operating profit is based on a longer term investment return with the impact of short-term investment fluctuations shown separately as a non-operating item. The Group has amended its definition of operating profit to exclude the impact of investment volatility in the non-profit funds. This has been recorded as a restatement of prior year figures.

The table below reconciles the previous basis of IFRS operating profit for the year ended 31 December 2009 to the amended basis.

Year ended 31 December	As reported 2009 £m	Effect of restatement £m	Restated 2009 £m
Operating profit before tax from continuing operations	20	(14)	6
Tax on operating profit	10	4	14
Operating profit for the period after tax attributable to ordinary shareholders of the parent	30	(10)	20

b) Restatement due to adoption of amendments to IFRS 3 (revised)

The application of annual improvements to IFRS 3 (revised): *Business combinations* results in certain non-controlling interests arising from the acquisition of Friends Provident being restated at fair value whereas they were previously shown at their nominal value less issue costs and interest adjustments.

This results in the equity attributable to STICS holders decreasing by £165 million at 31 December 2009. The impact of this change in accounting policy is to increase the gain on acquisition of Friends Provident recognised in the previous period by £119 million (£165 million net of deferred tax of £46 million).

The effect of the restatement on the financial statements is summarised below.

Year ended 31 December	As reported 2009 £m	Effect of restatement £m	Restated 2009 £m
Other income	1,186	119	1,305
Profit before tax from continuing operations	1,168	119	1,287
Attributable to non-controlling interests	780	(165)	615
Deferred tax liabilities	489	46	535
Equity attributable to equity holders of the parent	3,536	119	3,655

4. Segmental information

Summary

Segmental information is presented on the same basis as internal financial information used by the Group to evaluate operating performance. Segmental information relating to revenue, net income, products and services for the years ended 31 December 2010 and 31 December 2009 includes Friends Provident from 4 November 2009 and AXA UK Life Business from 3 September 2010. No segmental information is presented in respect of the year ended 31 December 2009 for the acquired AXA UK Life Business as the acquisition had not occurred at this point.

The Group's management and internal reporting structure is based on the following operating segments which all meet the definition of a reportable segment under IFRS 8:

- UK – comprising Friends Provident UK life and pensions business, the acquired AXA UK Life Business, Sesame Bankhall and, for the period prior to its disposal, Pantheon;
- International comprising FPIL, the overseas life assurance business within the UK life and pensions subsidiaries and the Group's share of AmLife; and
- Lombard.

4. Segmental information continued

Corporate functions are not strictly an operating segment, but are reported to management and are provided in the analysis below to reconcile the Group's reportable segments to total profit.

Operating segment information

Operating profit

Year ended 31 December 2010	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Total £m
Life and pensions operating profit	176	94	38	–	–	308
Longer-term return on shareholders' funds	30	1	(4)	(14)	–	13
Other income and charges	2	6	–	(11)	(15)	(18)
Development costs	(21)	(6)	(1)	–	–	(28)
Operating profit before tax	**187**	**95**	**33**	**(25)**	**(15)**	**275**
Tax on operating profit						16
Operating profit after tax attributable to ordinary shareholders of the parent						**291**
Operating earnings per share (pence)						**30.85**

Year ended 31 December 2009 (restated)	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Total £m
Life and pensions operating profit	10	11	4	–	–	25
Longer-term return on shareholders' funds	4	–	–	–	–	4
Other income and charges	–	–	–	(5)	(13)	(18)
Development costs	(3)	(2)	–	–	–	(5)
Operating profit before tax	11	9	4	(5)	(13)	6
Tax on operating profit						14
Operating profit after tax attributable to ordinary shareholders of the parent						20
Operating earnings per share (pence)						8.60
Operating earnings per share prior to restatement for 21 July 2010 share consolidation and rights issue (pence)						2.14

4. Segmental information continued

Reconciliation of operating profit before tax to profit before tax from continuing operations

Year ended 31 December 2010	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Total £m
Operating profit/(loss) before tax	**187**	**95**	**33**	**(25)**	**(15)**	**275**
Non-recurring items[(i)]	**(121)**	**(6)**	**–**	**928**	**(14)**	**787**
Amortisation of acquired present value of in-force business	**(169)**	**(123)**	**(72)**	**–**	**–**	**(364)**
Amortisation of other acquired intangible assets	**(27)**	**(8)**	**(28)**	**(1)**	**–**	**(64)**
Interest payable on STICS	**31**	**–**	**–**	**–**	**–**	**31**
Short-term fluctuations in investment return	**28**	**2**	**1**	**(7)**	**–**	**24**
Profit/(loss) before tax excluding profit generated within policyholder funds	**(71)**	**(40)**	**(66)**	**895**	**(29)**	**689**
Policyholder tax	**244**	**–**	**–**	**–**	**–**	**244**
Returns on Group-controlled funds attributable to third parties	**23**	**–**	**–**	**–**	**–**	**23**
Profit/(loss) before tax from continuing operations	**196**	**(40)**	**(66)**	**895**	**(29)**	**956**

(i) Corporate items include £883 million in respect of the gain on acquisition of AXA UK Life Business. Further details are set out in note 41. A further £96 million of non-recurring costs comprises £34 million of separation and integration costs in respect of the acquired AXA UK Life Business, £28 million in respect of expensed acquisition costs, £24 million in respect of Solvency II and other finance transformation costs and £10 million of other items. Segment results also include £80 million of non-recurring items comprising recharges to the life companies for pension scheme contributions. The net impact of the recharge for the Group is nil.

Year ended 31 December 2009 (restated)	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Total £m
Operating profit/(loss) before tax	11	9	4	(5)	(13)	6
Non-recurring items[(i)]	5	–	–	1,320	(16)	1,309
Amortisation of acquired present value of in-force business	(27)	(9)	(23)	–	–	(59)
Amortisation of other acquired intangible assets	(5)	(1)	(4)	–	–	(10)
Interest payable on STICS	5	–	–	–	–	5
Short-term fluctuations in investment return	5	(1)	–	8	–	12
Profit/(loss) before tax excluding profit generated within policyholder funds	(6)	(2)	(23)	1,323	(29)	1,263
Policyholder tax	1	–	–	–	–	1
Returns on Group-controlled funds attributable to third parties	23	–	–	–	–	23
Profit/(loss) before tax from continuing operations	18	(2)	(23)	1,323	(29)	1,287

(i) In 2009, the corporate non-recurring item of £1,305 million was in respect of the gain on acquisition of Friends Provident, being the excess of the interest in the fair value of assets acquired over cost, net of acquisition costs of £16 million.

4. Segmental information continued

Revenue and expenses

Year ended 31 December 2010	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Elimination of inter-segment amounts[ii] £m	Total £m
Gross earned premiums on insurance and investment contracts	3,457	1,063	3,021	–	–	–	7,541
Investment contract premiums[i]	(2,181)	(1,051)	(3,021)	–	–	–	(6,253)
Gross earned premiums	1,276	12	–	–	–	–	1,288
Premiums ceded to reinsurers	(240)	(1)	–	–	–	–	(241)
Net earned premiums	1,036	11	–	–	–	–	1,047
Fee and commission income	373	266	111	1	–	–	751
Investment income	6,477	569	1,374	22	20	(36)	8,426
Total revenue	7,886	846	1,485	23	20	(36)	10,224
Other income[iii]	8	–	–	883	–	–	891
Inter-segment revenue	3	1	–	14	18	(36)	–
Total external revenue	7,883	845	1,485	9	2	–	10,224
Net claims and benefits paid	(1,678)	(4)	–	–	–	–	(1,682)
Movement in insurance and investment contract liabilities	(4,768)	(694)	(1,292)	–	–	–	(6,754)
Transfer to unallocated surplus	(2)	(2)	–	–	–	–	(4)
Movement in net assets attributable to unit-holders	(139)	–	–	–	–	–	(139)
Acquisition expenses	(329)	(15)	(48)	–	–	–	(392)
Administrative and other expenses	(670)	(169)	(208)	18	(32)	–	(1,061)
Finance costs	(108)	(6)	(3)	(29)	(17)	36	(127)
Total claims, benefits and expenses	(7,694)	(890)	(1,551)	(11)	(49)	36	(10,159)
Inter-segment expenses	(3)	(1)	–	(32)	–	36	–
Total external claims, benefits and expenses	(7,691)	(889)	(1,551)	21	(49)	–	(10,159)
Share of profits/(losses) of associates and joint venture	(4)	4	–	–	–	–	–
Profit/(loss) before tax from continuing operations	196	(40)	(66)	895	(29)	–	956
Policyholder tax	(244)	–	–	–	–	–	(244)
Shareholder tax	99	7	21	(19)	–	–	108
Segmental result after tax	51	(33)	(45)	876	(29)	–	820

(i) Accounted for as deposits under IFRS.
(ii) Eliminations include inter-segment fee income and loan interest. Inter-segment transactions are undertaken on an arm's-length basis.
(iii) Includes £883 million in respect of the gain on acquisition of the AXA UK Life Business.

4. Segmental information continued

Year ended 31 December 2009 (restated)	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Elimination of inter-segment amounts(ii) £m	Total £m
Gross earned premiums on insurance and investment contracts	746	150	1,935	–	–	–	2,831
Investment contract premiums(i)	(615)	(148)	(1,935)	–	–	–	(2,698)
Gross earned premiums	131	2	–	–	–	–	133
Premiums ceded to reinsurers	(15)	–	–	–	–	–	(15)
Net earned premiums	116	2	–	–	–	–	118
Fee and commission income	63	46	18	–	–	(1)	126
Investment income	713	174	380	5	4	(9)	1,267
Total revenue	892	222	398	5	4	(10)	1,511
Other income(iii)	–	–	–	1,321	(16)	–	1,305
Inter-segment revenue	2	–	5	3	–	(10)	–
Total external revenue	890	222	393	2	4	–	1,511
Net claims and benefits paid	(178)	(1)	–	–	–	–	(179)
Movement in insurance and investment contract liabilities	(512)	(197)	(351)	–	–	–	(1,060)
Transfer to unallocated surplus	(3)	–	–	–	–	–	(3)
Movement in net assets attributable to unit-holders	(31)	–	–	–	–	–	(31)
Acquisition expenses	(55)	(14)	(5)	–	–	–	(74)
Administrative and other expenses	(75)	(17)	(65)	–	(17)	7	(167)
Finance costs	(20)	–	–	(3)	–	3	(20)
Total claims, benefits and expenses	(874)	(229)	(421)	(3)	(17)	10	(1,534)
Inter-segment expenses	(3)	–	–	(7)	–	10	–
Total external claims, benefits and expenses	(871)	(229)	(421)	4	(17)	–	(1,534)
Share of profits of associates and joint venture	–	5	–	–	–	–	5
Profit/(loss) before tax from continuing operations	18	(2)	(23)	1,323	(29)	–	1,287
Policyholder tax	(1)	–	–	–	–	–	(1)
Shareholder tax	8	3	8	3	–	–	22
Segmental result after tax	25	1	(15)	1,326	(29)	–	1,308

(i) Accounted for as deposits under IFRS.
(ii) Eliminations include inter-segment fee income and loan interest. Inter-segment transactions are undertaken on an arm's-length basis.
(iii) £1,305 million in respect of the gain on acquisition, being the excess of the interest in the fair value of assets acquired over cost arising on the acquisition of Friends Provident, net of acquisition costs of £16 million. This amount has been restated to reflect the adoption of amendments to IFRS 3 (revised).

4. Segmental information continued

Products and services

Year ended 31 December 2010	Protection £m	Investment £m	Annuities £m	Individual pensions £m	Group pensions £m	Other(i) £m	Total £m
Gross earned premiums	598	312	327	42	9	–	1,288
Net earned premiums	480	310	207	41	9	–	1,047
Fee and commission income	(3)	423	–	145	6	180	751
Total external revenue	**477**	**733**	**207**	**186**	**15**	**180**	**1,798**

(i) Other includes revenue streams from Sesame Bankhall and Pantheon for the period prior to its disposal.

Year ended 31 December 2009	Protection £m	Investment £m	Annuities £m	Individual pensions £m	Group pensions £m	Other(i) £m	Total £m
Gross earned premiums	51	37	42	2	1	–	133
Net earned premiums	37	36	42	2	1	–	118
Fee and commission income	–	54	–	19	–	53	126
Total external revenue	37	90	42	21	1	53	244

(i) Other includes revenue streams from Sesame Bankhall and Pantheon.

Assets and liabilities

At 31 December 2010	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Elimination of inter-segment amounts(i) £m	Total £m
Segment assets	96,551	7,184	17,930	1,325	911	(1,568)	122,333
Investments in associates and joint venture	5	27	–	–	–	–	32
Total assets	**96,556**	**7,211**	**17,930**	**1,325**	**911**	**(1,568)**	**122,365**
Total liabilities	**91,237**	**6,814**	**17,487**	**936**	**910**	**(1,568)**	**115,816**

(i) Eliminations mainly comprise intercompany loans.

At 31 December 2009 (restated)	UK £m	Int'l £m	Lombard £m	FPH corporate £m	RSL corporate £m	Elimination of inter-segment amounts(i) £m	Total £m
Segment assets	39,490	5,858	15,367	575	315	(544)	61,061
Investments in associates and joint venture	7	23	–	–	–	–	30
Total assets	39,497	5,881	15,367	575	315	(544)	61,091
Total liabilities	36,718	5,386	14,865	388	8	(544)	56,821

(i) Eliminations mainly comprise intercompany loans.

4. Segmental information continued

Geographical segmental information

In presenting geographical segment information, segment revenue is based on the geographical location of customers. The Group has defined two geographical areas: UK and the rest of the world. AXA UK Life Business is reported as UK, as its customers are located in the UK.

Year ended 31 December 2010	UK £m	Rest of the world £m	Total £m
Gross earned premiums	1,276	12	1,288
Fee and commission income	398	353	751
Revenue from external customers	1,674	365	2,039
Investment return			8,426
Premiums ceded to reinsurers			(241)
Total revenue			10,224

Year ended 31 December 2009	UK £m	Rest of the world £m	Total £m
Gross earned premiums	131	2	133
Fee and commission income	85	41	126
Revenue from external customers	216	43	259
Investment return			1,267
Premiums ceded to reinsurers			(15)
Total revenue			1,511

5. Investment return

a) Net investment return

Year ended 31 December	2010 £m	2009 £m
Interest income:		
– assets at fair value through profit or loss	1,219	149
– other	2	4
Expected return on pension scheme assets, net of interest cost	5	1
Dividend income	701	222
Rental income	120	19
Movement in fair value:		
– investment properties	143	132
– financial assets or financial liabilities at fair value through profit or loss ("FVTPL"):		
financial derivative instruments	(134)	847
financial assets designated on initial recognition	6,370	(107)
Total net investment return	8,426	1,267

5. Investment return continued

b) Longer term investment return – operating profit

The longer term investment return used in arriving at operating profit before tax is calculated in respect of equity and fixed-interest investments of shareholder funds and surplus assets held within long-term funds, by applying the longer term rate of return for each investment category to the quarterly weighted average of the corresponding assets, after adjusting for the effect of any short-term market movements. The longer term rates of return are based on assumed gilt and cash returns, adjusted where appropriate to reflect the additional risks associated with the type of investment. The directors have determined the assumptions to be as follows:

	2010 %	2009 %
Equities	**7.30**	6.70
Government fixed interest	**4.30**	3.70
Other fixed interest	**6.05**	6.70

Investment variances arising from the mismatching of fixed-interest assets and the liabilities they are backing are excluded from operating profit. This reported variance reflects profit in excess of the expected investment return on the assets and the impact of the corresponding economic assumption change on the liabilities.

c) Sensitivity of longer term investment return – operating profit

	2010 £m	2009 £m
Longer term investment return:	**13**	4
– After the impact of a 1% increase in the longer term rates of investment return	**30**	6
– After the impact of a 1% decrease in the longer term rates of investment return	**(6)**	2

d) Comparison of shareholder longer term and actual investment return – IFRS based operating profit

	2010 £m	2009 £m
Actual investment return attributable to shareholders	**3**	2
Longer term shareholder investment return	**(13)**	(4)
Deficit of actual shareholder return over longer term return[(i)]	**(10)**	(2)

(i) Excludes £34 million of investment variances (2009: £14 million) in relation to fixed interest investment variances largely in respect of the annuity portfolio.

6. Net claims and benefits paid

Year ended 31 December 2010	Gross claims and benefits paid £m	Amounts receivable from reinsurers £m	Total net claims and benefits paid £m
Protection	**694**	**(81)**	**613**
Investment	**460**	**(1)**	**459**
Individual pensions	**488**	**(1)**	**487**
Group pensions	**18**	**–**	**18**
Annuities	**344**	**(239)**	**105**
Total	**2,004**	**(322)**	**1,682**

Year ended 31 December 2009	Gross claims and benefits paid £m	Amounts receivable from reinsurers £m	Total net claims and benefits paid £m
Protection	23	(12)	11
Investment	94	–	94
Individual pensions	19	–	19
Group pensions	16	–	16
Annuities	59	(20)	39
Total	211	(32)	179

7. Acquisition expenses

Year ended 31 December	2010 £m	2009 £m
Commission	**317**	51
Other acquisition expenses	**355**	61
Deferral	**(294)**	(39)
Amortisation of deferred acquisition costs	**14**	1
Net acquisition expenses	**392**	74

8. Administrative and other expenses

a) Analysis of administrative and other expenses

Year ended 31 December	2010 £m	2009 £m
Amortisation of intangible assets	**428**	69
Employee remuneration	**132**	16
Auditor's remuneration (8b)	**10**	7
Investment expenses and charges	**185**	36
Investment property expenses	**4**	1
IT costs	**28**	–
Operating lease rentals, land and buildings	**14**	2
Renewal commission	**36**	3
Non-recurring costs (8c)	**96**	–
Other administrative expenses	**128**	33
Total administrative and other expenses	**1,061**	167

8. Administrative and other expenses continued

b) Auditor's remuneration

During the year the Group obtained the following services from the Group's auditor, Ernst & Young LLP, at costs as detailed in the table below.

Year ended 31 December	2010 £m	2009 £m
Fees payable for the audit of the Group's financial statements	**0.2**	0.5
Fees for the audit of subsidiaries pursuant to legislation	**4.5**	1.7
Other assurance services pursuant to legislation:		
– audit related	**0.8**	0.1
– services as reporting accountants	**2.0**	1.7
Corporate finance transactions	**3.4**	3.0
Other services:		
– audit related assurance	**0.6**	–
– other assurance	**0.3**	–
– audit of Market Consistent Embedded Value ("MCEV") supplementary information	**0.5**	0.2
– other	**0.1**	–
	12.4	7.2

Included in the analysis above are £2 million (2009: £nil) of fees related to services as reporting accountants that were capitalised against proceeds arising from the rights issue and hence are not included in administrative and other expenses.

c) Non-recurring costs

Non-recurring costs include charges related to separation and integration activities concerning the acquired AXA UK Life Business, transaction costs associated with its acquisition from AXA UK and expenditure on enhancing systems and reporting processes including Solvency II costs.

9. Staff pension schemes

a) Introduction

The Friends Life group operates a defined benefit scheme: the Friends Provident Pension Scheme ("FPPS"). In addition, defined contribution schemes are operated by FPMSL, FPIL and Sesame Bankhall. Lombard does not operate a pension scheme.

On an IAS 19 basis, a gross surplus of £66 million has been recognised in respect of the FPPS at 31 December 2010 (£59 million at 31 December 2009). The last triennial actuarial valuation as at 30 September 2008 showed a deficit on a funding basis of £65 million. To meet the deficit, a revised funding agreement was entered into in June 2010 whereby deficit reduction contributions of £20 million per annum will be made over the next four years, commencing in July 2010.

Under IFRIC 14, deficit reduction contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available after they are paid into the scheme, a liability is recognised when the obligation arises. An additional liability of £44 million has been recognised (£21 million at 31 December 2009), reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £126 million (£60 million contributions plus the current surplus of £66 million). A deferred tax asset of £16 million (2009: £16 million) has also been recognised to reflect tax relief at a rate of 27% that is expected to be available on the contributions, once paid into the scheme.

Employees of the acquired AXA UK Life Business have been placed into a new defined contribution arrangement for service accruing after the acquisition date. The pension obligation for service accruing up to the date of the acquisition is not borne by the Group. AXA UK will continue to manage the defined benefit pension scheme in respect of deferred and existing pensioners and will be responsible for future funding of this scheme. Therefore, for the purposes of these consolidated financial statements the impact of any AXA defined benefit scheme IAS 19 deficit insofar as it relates to relevant employees acquired by the Group has been excluded.

9. Staff pension schemes continued

b) Total schemes

The pension surplus is recognised in the statement of financial position net of 35% (2008: 35%) penal tax payable on refund.

	2010 £m	2009 £m
IAS 19 pension surplus	**66**	59
Authorised payments surplus charge at 35% of available surplus following deficit reduction contributions	**(44)**	(21)
Net pension surplus	**22**	38

Movement in IAS 19 pension surplus

	2010 £m	2009 £m
Pension surplus at 1 January	**59**	–
Acquired through business combinations	**–**	(4)
Current service cost[(i)]	**(13)**	(3)
Interest cost[(i)]	**(55)**	(9)
Expected return on pension assets	**60**	10
Augmentations and termination benefits[(i)]	**(3)**	(1)
Prior service credit	**–**	10
Employer contributions	**41**	10
Actuarial (losses)/gains	**(23)**	46
Pension surplus at 31 December (excluding authorised payments surplus charge)	**66**	59
Deficit reduction contributions	**60**	–
Available surplus subject to authorised payments surplus charge	**126**	59

(i) Recognised in the consolidated income statement.

Analysis of net pension surplus and related deferred tax asset

As at 31 December 2010	Pension surplus £m	Deferred tax £m
Gross IAS 19 pension surplus and related deferred tax asset	**66**	**(18)**
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	**(44)**	**–**
Reversal of deferred tax asset due to pension surplus arising	**–**	**18**
Tax relief available on deficit reduction contributions	**–**	**16**
Net pension surplus and related deferred tax asset	**22**	**16**

As at 31 December 2009	Pension surplus £m	Deferred tax £m
Gross IAS 19 pension surplus and related deferred tax asset	59	(16)
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	(21)	–
Reversal of deferred tax asset due to pension surplus arising	–	16
Net pension surplus and related deferred tax asset	38	–

9. Staff pension schemes continued

Amounts recognised in the consolidated statement of comprehensive income

	2010 £m	2009 £m
Actuarial (losses)/gains	(23)	46
Reverse authorised payments surplus charge on opening surplus	21	–
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	(44)	(21)
Actuarial (losses)/gains on defined benefit schemes	(46)	25
Taxation	25	5
Actuarial (losses)/gains on defined benefit schemes after tax	(21)	30

Tax relief of £16 million available on deficit reduction contributions and £9 million in respect of other movements in the pension scheme are included in the aggregate tax line of the consolidated statement of comprehensive income.

c) Friends Provident Pension Scheme

The FPPS is a UK defined benefit scheme to which the majority of the Group's UK life and pensions employees belong. The scheme's assets, which are administered by three external investment managers are held under the control of the Trustee and used to secure benefits for the members of the scheme and their dependants in accordance with the Trust Deed and Rules.

The Trustee board consists of a chairman who is appointed by the employer and six additional directors of which three are employer-appointed directors, two member-selected directors and one pensioner-selected director.

i) Principal assumptions used by the Scheme Actuary

Year ended 31 December	2010 %	2009 %
Rate of increase in salaries*	1.50	1.50
Rate of increase in pensions in payment	Relevant swap curve	Relevant swap curve
Discount rate for active and deferred members	5.60	5.93
Discount rate for pensioners	5.42	5.70

* Plus allowance for salary scale increases.

The 2010 inflation rate assumptions have been based on the consumer price index (2009: retail price index). The change of reference index has impacted actuarial gains and losses by £29 million.

ii) Mortality assumptions

Mortality assumptions for pensioners are based on the appropriate 2000 series mortality tables published by the Continuous Mortality Investigations ("CMI") in 2006. In addition, allowance is made for future improvements in mortality according to each individual's year of birth through the use of the 'medium-cohort' projections (with certain amendments) published by the CMI in 2002. The amendments are to allow for 75% of the medium-cohort projections for females (with a minimum annual rate of improvement in future longevity of 1.25%), and 100% of medium-cohort projections for males (with a minimum annual rate of improvement in future longevity of 1.50%). The mortality assumptions have been updated from those used in 2009 with the minimum rate of improvement being increased by 0.5% for males and females.

The mortality assumptions provide the following average life expectancies of future members retiring at the age of 60, and current pensioners.

Year ended 31 December	2010 years	2009 years
Expected age at death of future male pensioner	91	89
Expected age at death of future female pensioner	92	90
Expected age at death of current male pensioner	88	88
Expected age at death of current female pensioner	90	89

9. Staff pension schemes continued

The present value of providing an annuity of £1 per annum for members aged 60, based on the above assumptions, is as follows:

Cost of annuities	2010 £	2009 £
Male annuity	**23.49**	22.02
Female annuity	**22.95**	21.56

These rates assume a monthly payments model with a discount rate of 5.60% (2009: 5.93%). The rates also assume two-thirds of the members' benefit will be paid to the spouse on the death of the member. A guarantee is provided for pensioners who die within five years of retiring and pensions in excess of the Guaranteed Minimum Pension ("GMP") will increase in line with the LP15% swap curve at 31 December 2010 (2009: LP15% swap curve).

Cost of annuities	2010 % age of total membership	2009 % age of total membership
Active members	**12**	14
Deferred members	**62**	62
Pensioners	**26**	24
	100	100

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

Assumption	Change in assumption	Impact on scheme liabilities
Inflation	Increase/decrease by 0.5%	Increase/decrease by 8.4%
Salaries	Increase/decrease by 0.5%	Increase/decrease by 1.6%
Pensions	Increase/decrease by 0.5%	Increase/decrease by 5.9%
Discount rate	Increase/decrease by 0.5%	Decrease/increase by 10.2%
Rate of mortality	Increase/decrease by 1 year	Increase/decrease by 2.4%

iii) Changes in the present value of obligations of defined benefit scheme

	2010 £m	2009 £m
Present value of obligations at 1 January	**953**	–
Acquired through business combinations	**–**	1,004
Current service cost	**13**	3
Interest cost	**55**	9
Prior service credit	**–**	(10)
Contributions by plan participants	**1**	–
Actuarial loss/(gain)	**67**	(47)
Benefits paid	**(45)**	(7)
Termination benefits	**1**	1
Augmentation	**2**	–
Present value of obligations at 31 December	**1,047**	953

iv) Analysis of defined benefit obligations

	2010 £m	2009 £m
Wholly or partly funded plans	**1,047**	953

9. Staff pension schemes continued

The profile of the obligations is analysed as follows:

	2010 £m	2009 £m
Active members	**208**	213
Deferred members	**389**	361
Pensioners	**450**	379
	1,047	953

v) Changes in present value of defined benefit plan assets

	2010 £m	2009 £m
Fair value of plan assets at 1 January	**1,012**	–
Acquired through business combinations	**–**	1,000
Expected return on plan assets	**60**	10
Actuarial gains/(losses)	**44**	(1)
Employer contributions	**41**	10
Contributions by plan participants	**1**	–
Benefits paid	**(45)**	(7)
Fair value of plan assets at 31 December	**1,113**	1,012

At 31 December 2010, there are no investments in internal linked funds (2009: £nil).

vi) Assets in the defined benefit scheme and the expected rate of return

	Expected rate of return 2010 %	Value 2010 £m	Expected rate of return 2009 %	Value 2009 £m
Equities	**6.70**	**192**	7.30	167
Liability-driven investment pools	**5.60**	**284**	5.93	427
Fixed interest (LDI in specie)	**5.60**	**148**	5.93	71
Insured assets	**5.42**	**447**	5.70	300
Cash	**3.20**	**42**	3.80	47
Total market value of assets		**1,113**		1,012
Present value of scheme liabilities		**(1,047)**		(953)
Surplus in the scheme		**66**		59

The expected return on net pension scheme assets is calculated using the assumptions and the market value of pension scheme assets as stated in the table above for the preceding year. In May 2008, the FPPS entered into a bulk annuity arrangement with Aviva Annuity UK Limited. The purchase of the annuity was partly funded by a £160 million loan from a Group company. The loan was repayable over a maximum of two years and incurred interest at three months' LIBOR plus 2%. The loan had been fully repaid at 31 December 2010 (2009: £68 million was outstanding). The insured assets shown above in respect of the prior year are net of this loan.

vii) Amounts recognised in the income statement in respect of the defined benefit scheme

	2010 £m	2009 £m
Interest cost	**(55)**	(9)
Current service cost	**(13)**	(3)
Prior service credit	**–**	10
Augmentations and termination benefits	**(3)**	(1)
Expected return on plan assets	**60**	10
Total amounts recognised in the income statement	**(11)**	7
Actual return on plan assets	**104**	9

9. Staff pension schemes continued

viii) Amounts recognised in the consolidated statement of comprehensive income in respect of the defined benefit scheme

	2010 £m	2009 £m
Actuarial (losses)/gains on defined benefit schemes (net of tax)	**(21)**	30

ix) Experience gains and losses of defined benefit scheme

	2010 £m	2009 £m
Present value of defined benefit obligation	**(1,047)**	(953)
Fair value of plan assets	**1,113**	1,012
Surplus	**66**	59
Difference between the expected and actual return on scheme assets(i)		
Amount	**36**	(66)
Percentage of closing scheme assets	**3%**	(7%)
Experience gains and losses on scheme liabilities(i)		
Amount	**3**	(5)
Percentage of the present value of the scheme liabilities	**0%**	(1%)
Total amount recognised in the statement of comprehensive income		
Amount	**(21)**	30
Percentage of the present value of the scheme liabilities	**2%**	(3%)

(i) For 2009 and 2010 represents results for 12 months.

x) Future funding

The most recently completed triennial actuarial valuation of FPPS was performed by an independent actuary and was carried out as at 30 September 2008. From 1 July 2007, the scheme had already been closed to new members.

Existing member contributions are 6% in 2009 and 2010, and 7% for 2011, for benefits with a pension age of 60, and 2% for benefits with a pension age of 65. The Group increased its contributions from 20% to 25% in 2009 and will pay an extra 1% in 2011 for pension age 60 members, as their rate has been held at 6% in 2010.

Under a review of the key employment benefits and following consultation, the Group has amended the provision of defined benefits under the FPPS from 1 January 2011 as follows:

- the future service accrual rate will reduce from one-sixtieth to one-eightieth for each year of pensionable service;
- the inflation limit on increases to pensions in deferment and payment will reduce from 5% to the statutory level of 2.5% for future service;
- final pensionable salary will be phased in to become a three-year average for all pensionable service (with pensionable salary becoming fixed at 1 January each year). For past service, final pensionable salary will be not less than the rate of pensionable salary at 31 December 2010; and
- member contributions for pension age 60 benefits will be 7% and for pension age 65 benefits will be 2%.

The Group is scheduled to reduce its future service contribution to 15% from October 2011.

A Statement of Funding Principles has been agreed by the Group and the Trustee. That statement provides the principles around assumption setting, in particular, choosing the discount rate, future price inflation, future pension increases, rates of mortality, future pay increases, employee turnover, pension commencement age, and typical partner or dependant information and assumes:

- the discounted value of the annuity contract will exactly match the discounted liabilities for pensioners insured under the contract;
- the strategic allocation to matched assets will normally be maintained at around 75% of non-insured assets and provide a return equal to the yield available on swaps contracts of a tenor that matches the liability cash flows;
- the strategic allocation to return seeking assets will normally be maintained at around 25% of non-insured assets and provide a return that is 3% in excess of the return on the matched assets; and
- the discounted value of non-insured liabilities will be broadly equal to swaps plus 0.75% in excess of the yields available on swaps contracts of the appropriate tenor.

9. Staff pension schemes continued

In addition the Trustee has the following objectives for investments, as set out in the Statement of Investment Principles:

- to achieve and maintain a minimum funding level of 100% on a long-term ongoing basis; and
- to agree the cost of providing the benefits and consult the Employer on any material changes that may be required to the agreed funding arrangements in light of experience.

Amounts paid to FPPS in the past three years, including an additional contribution of £20 million in 2008 but excluding special termination payments, and expected future payments over the next three years are as follows:

	£m
FPPS (DB) Contributions paid	
2008	**43**
2009	**28**
2010	**40**
FPPS (DB) Contributions expected to be paid	
2011	**32**
2012	**28**
2013	**28**

A defined contribution plan is in operation for new employees, to which the Principal Employer contributes 8% plus up to a further 5% to match contributions by employees.

xi) Risk management

The Trustee has established a separate Risk and Investment Subcommittee ("RISC") which is responsible for assisting the Trustee in investment policy and monitoring the Scheme's investments. The RISC seeks advice from the investment adviser and believes it has sufficient skills and expertise to make investment decisions based on this advice.

The Trustee sets general investment policy but delegates day-to-day responsibility for the selection of specific investments (other than investments in respect of members' voluntary contributions) to the Investment Manager.

The Trustee has set performance and risk targets for the Investment Manager on non-insured assets. The performance objectives are long term (five years), however, the Trustee monitors the Investment Manager on a regular basis in order to ensure that it is on track to meet its long-term objectives.

Interest rate and inflation risk

The fund adopted a Liability-Driven Investment ("LDI") strategy in 2003 to reduce exposure to interest rate and inflation risk. This strategy has been carried out more recently through investing in a pooled LDI product managed by F&C, and through investing in an insured bulk annuity buy-in contract.

F&C's LDI product is designed to hedge the Fund against inflation and interest rate movements, based on the liability to pay the future benefits promised to members, and to provide an investment return similar to cash, benchmarked against three months' LIBOR.

F&C's LDI product provides a flexible series of investment pools spread over a duration of the next 50 years to match the inflation and interest rate sensitivities based on this expected annual cash flow as it changes each year. These LDI pools are collateralised daily and are managed within a controlled leverage range by F&C; the LDI pools have a weekly investment valuation. The flexibility of F&C's LDI product will mean that the scheme can review the liabilities periodically to ensure the interest rate and inflation sensitivities are well matched based on the latest cash flow data for non-insured members.

The allocation to matched assets under the LDI strategy, including LDI pools, cash and fixed interest is 75% of the non-insured assets.

The Trustee has also purchased a bulk annuity buy-in contract as a fully matching asset, mitigating a wider range of risks (market and longevity risk in addition to interest rate and inflation risk) on benefits reassured under the contract.

Market risk

The Trustee with the full support of the Group has agreed and implemented a strategic asset allocation to return seeking assets of 25% of the non-insured fund.

9. Staff pension schemes continued

Longevity risk

The Trustee, with the full support and involvement of the Group, invested 37% of the scheme's assets in a bulk annuity contract with Aviva Annuity UK Limited as a buy-in investment in 2008 with a further 4% in 2009. The contract between the Trustee and Aviva reassures benefits for pensioners in payment up to 1 July 2009 and includes a facility for the Trustee to invest further tranches of benefits up to 30 June 2013.

The contract is an investment of the Trustee and includes additional security to that of a standard bulk annuity contract with an insurance company. The ownership of the scheme's assets are being drip fed to Aviva over the duration of the contract. This additional protection has been negotiated by the Trustee to mitigate the risk of any decline in the financial strength of Aviva as the counterparty under the contract. This was a general requirement of the tender process for any counterparty to be selected. These assets have been set up under a ring-fenced Trustee Investment Plan that is managed by Aviva and with the title to those assets secured in the Trustee's name through a safekeeping custody account set up with Citibank. These ring-fenced assets would only be accessed by the Trustee in the event of Aviva failing to meet its obligations under this long-term contract.

Currency risk

From December 2009 the Trustee has invested its return-seeking assets through two new managers, Aberdeen Unit Trust Managers Limited and Walter Scott & Partners Limited in their global equity pooled funds. These managers take account of currency risks within their pooled fund vehicles.

Operational risk

The Investment Managers do not directly hold the scheme's securities for non-insured assets. These non-insured assets are held in separate accounts with custodians, as appointed by the Investment Manager for pooled vehicles or by the Trustee for non-pooled investments. Special arrangements noted above apply to insured assets under the Aviva contract.

d) Other pension schemes

The Group operates three defined contribution schemes: the schemes are operated by FPMSL, FPIL and Sesame Bankhall. The employees of the AXA UK Life Business are included in the existing FPMSL defined contributions plan. Contributions for the period were £2.8 million, £1.2 million, £0.8 million, and £2.8 million respectively (2009: £2.2 million, £0.7 million, £0.7 million and £nil).

Lombard does not operate a staff pension scheme.

10. Share-based payments

Lombard International Assurance SA

Description of the scheme

Lombard management have been incentivised through a scheme that entitles them to share in the growth in value in Lombard. Subject to achievement of performance conditions, the scheme entitles participants to shares in Resolution Limited. The Plan lasts for six years, with 25% of the value accruing on the third, fourth, fifth and sixth anniversary of the Plan, with an effective start date of 1 January 2009.

The scheme is an equity-settled share-based payment scheme and the acquisition date fair value, being the best estimate of the cost of the scheme, will be recognised over the vesting period. This results in a fair value of £10 million being expensed over the six-year term of the ongoing pre-modification scheme. The scheme has been valued based on probability-weighted performance scenarios using the level of sales to estimate the number of awards expected to vest.

The terms of the scheme were modified during 2010. This modification has resulted in the fair value of the scheme increasing from £10 million to £22 million. This will increase the total expense by £12 million spread over the years 2010 to 2015. The incremental value has been calculated using probability weighted performance scenarios. A charge of £4 million has been recognised in the income statement (2009: Nil for the period from 5 November to 31 December 2009) with a corresponding credit to equity.

Scheme participants at 31 December 2010 have purchased 1.4 million shares (2009: 1.5 million shares).

Friends Provident Holdings (UK) plc

Description of the scheme

FPH introduced a LTIP in 2010 to incentivise key individuals in the business by entitling them to a percentage share in the difference between the value realised on the completion of the UK Life Project and the aggregate cost of the acquisitions.

10. Share-based payments continued

The scheme is a cash-settled share-based payment scheme and the fair value of the awards in issue, being the relevant percentage of the gain expected to arise on completion of the UK Life Project, is measured at each reporting date, with any changes in fair value being recognised in the income statement for the period.

The gain expected to arise has been estimated using forecasts and scenario-based modelling of likely outcomes based on varying levels of profitability of the business. This is reassessed at each reporting date.

The total number of units capable of being awarded is 10,000, and awards are allocated in single units of 1/10,000th of this number. The number of awards issued in the period was 3,525 and 25 were forfeited. At 31 December 2010 there were 3,500 awards in issue and a charge of £4 million has been recognised in the income statement and a corresponding liability is included in the Group statement of financial position.

11. Finance costs

Year ended 31 December	2010 £m	2009 £m
Subordinated loan interest	17	4
Debenture loan interest	11	1
Deferred consideration notes interest	10	–
Interest paid to reinsurers	68	14
Interest on acquisition finance facility	8	–
Interest paid to credit institutions	13	1
Total finance costs	**127**	20

Interest expense is calculated using the effective interest rate method.

Interest paid to reinsurers represents payments in relation to a reinsurance treaty as detailed in note 33.

12. Taxation

Tax recognised in the income statement

	2010 £m	2009 £m
Current tax		
UK corporation tax at 28%	16	(8)
Adjustments in respect of prior periods	(15)	–
Overseas taxation	6	–
Total current tax charge/(credit)	**7**	(8)
Deferred tax		
Origination and reversal of temporary differences	121	(13)
Adjustments in respect of prior periods	8	–
Total deferred tax charge/(credit)	**129**	(13)
Total tax charge/(credit)	**136**	(21)
Analysis:		
– policyholder tax	244	1
– shareholder tax	(108)	(22)
Total tax charge/(credit)	**136**	(21)

Policyholders' tax is tax on the income and investment returns charged to policyholders of linked and with-profits funds. Shareholders' tax is charged to shareholders on the profits of the Group. During the year legislation has been introduced to bring in a phased decrease in the rate of corporation tax commencing with a reduction to 27% on 1 April 2011 and further reductions of 1% per annum until it reaches 24% on 1 April 2014. Under IFRS deferred tax is calculated using substantively enacted rates and as such only the reduction to a 27% rate has been taken into account in the deferred tax balance.

12. Taxation continued

Factors affecting tax charge for period

Year ended 31 December	2010 £m	Restated 2009 £m
Profit before tax from continuing operations	**956**	1,287
Profit before tax from continuing operations determined with reference to the standard rate of corporation tax in the UK of 28%	**268**	360
Effects of:		
– non-taxable income	**(115)**	(9)
– deductions not allowable for tax purposes	**46**	1
– tax on reserving adjustments	**7**	–
– overseas tax	**–**	(1)
– tax relief for share based payments	**–**	3
– utilisation of excess expenses brought forward	**(8)**	5
– valuation of tax losses	**(43)**	(14)
– with-profits minority interest(i)	**(8)**	(6)
– adjustments in respect of prior periods	**(7)**	–
– non taxable gain on acquisition	**(247)**	(369)
– reduction in corporation tax rate from 28% to 27%	**(8)**	–
– non-taxable result of Resolution holding companies	**7**	8
– policyholder tax	**244**	1
Total tax charge/(credit)	**136**	(21)

(i) This relates to tax on F&C CPT prior to deconsolidation.

13. Appropriations of profit

a) Dividends paid on ordinary shares

A final dividend in respect of 2009 of 2.72 pence per ordinary share was paid on 28 May 2010 comprising £60 million of cash and £5 million of shares issued in lieu of dividends. An interim dividend of 5.46 pence per new ordinary share (after the share consolidation and rights issue described in note 37) was paid to shareholders on the register at the close of business on 8 September 2010 comprising £75 million of cash and £4 million of shares issued in lieu of dividends. As required by IAS 10: *Events after the balance sheet date*, dividends declared after the balance sheet date are not accrued in these accounts. Also as required by IFRS, the costs of these dividends are taken directly to reserves. Subject to the approval of shareholders at the annual general meeting on 18 May 2011, a dividend of 12.57 pence per share will be paid on 26 May 2011 amounting to £183 million. Accordingly, this amount is not reflected in these financial statements.

b) STICS interest

The STICS are accounted for as equity instruments under IFRS and consequently the interest on the STICS is recorded in the financial statements as though it were a dividend.

Interest on the 2003 STICS is paid in equal instalments in May and November each year at a rate of 6.875%. During the year ended 31 December 2010, interest of £14 million (period ended 31 December 2009: £7 million) was paid to the 2003 STICS holders.

Interest on the 2005 STICS is paid annually in June at a rate of 6.292%, and interest of £17 million was paid on 30 June 2010.

These interest payments are shown as movements in reserves in these financial statements together with the related tax relief.

14. Earnings per share

a) Basic and operating earnings per share from continuing operations

Earnings per share have been calculated based on the profit after tax and on the operating profit after tax, attributable to ordinary shareholders of the parent and the weighted number of shares in issue. The directors consider that underlying earnings per share provides a better indication of operating performance. The earnings per share figures for 2009 have been recalculated to reflect the share consolidation and rights issue undertaken in 2010 (see note 37) in accordance with IAS 33: *Earnings per Share*. The 2009 earnings have also been restated to reflect restated profit measures as set out in note 3. In addition, to aid comparability the earnings per share figures in respect of the year ended 31 December 2009, are also presented on a pre-share consolidation and rights issue basis.

	2010 Earnings £m	**2010 Per share pence**	As restated 2009 Earnings £m	As restated 2009 Per share pence	As restated 2009(i) Earnings £m	As restated 2009(i) Per share pence
Profit after tax attributable to equity holders of the parent	**765**	**81.10**	1,280	550.58	1,280	137.09
Short-term fluctuations in investment return	**(24)**	**(2.54)**	(12)	(5.16)	(12)	(1.29)
Non-recurring items	**(787)**	**(83.43)**	(1,309)	(563.06)	(1,309)	(140.19)
Amortisation and impairment of acquired intangible assets	**428**	**45.37**	69	29.68	69	7.39
Tax credit on items excluded from operating profit	**(91)**	**(9.65)**	(8)	(3.44)	(8)	(0.86)
Operating profit after tax attributable to equity holders of the parent	**291**	**30.85**	20	8.60	20	2.14

(i) Disclosures made on a pre-share consolidation basis as included in the 2010 interim report.

b) Diluted basic earnings per share from continuing operations

	2010 £m	**2010 Weighted average number of shares number**	**2010 Per share pence**
Profit after tax attributable to ordinary shareholders of the parent	**765**	**943,284,481**	**81.10**
Dilution	**–**	**7,347,287**	**(0.63)**
Diluted profit after tax attributable to ordinary shareholders of the parent	**765**	**950,631,768**	**80.47**

	As restated 2009 £m	2009 Weighted average number of shares number	2009 Per share pence
Profit after tax attributable to ordinary shareholders of the parent	1,280	232,483,943	550.58
Dilution	–	400,500	(0.95)
Diluted profit after tax attributable to ordinary shareholders of the parent	1,280	232,884,443	549.63

14. Earnings per share continued

The following table shows the earnings per share for 2009 based on restated profit after tax and the shares in issue in 2009 before the share consolidation and rights issue.

	As restated 2009 £m	2009 Weighted average number of shares number	2009 Per share pence
Profit after tax attributable to ordinary shareholders of the parent	1,280	933,670,453	137.09
Dilution	–	1,608,435	(0.23)
Diluted profit after tax attributable to ordinary shareholders of the parent	1,280	935,278,888	136.86

c) Weighted average number of ordinary shares

	2010 Actual	**2010 Weighted**
Issued ordinary shares at beginning of period	**2,412,451,145**	**2,412,451,145**
Effect of:		
– scrip dividend (final 2009)	**5,753,268**	**3,436,198**
– share consolidation	**(2,337,597,599)**	**(2,335,357,765)**
– rights issue	**1,370,315,835**	**865,193,173**
– scrip dividend (interim 2010)	**1,641,722**	**382,319**
– treasury shares	**(8,579,292)**	**(2,820,589)**
Number of ordinary shares at end of period	**1,443,985,079**	**943,284,481**

	2009 Actual	2009 Weighted	2009 Adjusted(i)
Issued ordinary shares at beginning of period	660,000,000	660,000,000	660,000,000
Effect of:			
– ordinary shares issued	1,752,451,145	273,670,453	1,752,451,145
Number of shares before share consolidation and rights issue	2,412,451,145	933,670,453	2,412,451,145
– share consolidation	–	(902,548,104)	(2,332,036,107)
– rights issue	–	201,361,594	520,285,297
Number of ordinary shares at end of period	2,412,451,145	232,483,943	600,700,335

(i) Adjusted to include impact of share consolidation and rights issue.

15. Intangible assets

Movements in intangible assets during 2010 were as follows:

Year ended 31 December 2010	AVIF £m	Other £m	Total £m
Cost			
1 January 2010	**2,938**	**382**	**3,320**
Acquisition of AXA UK Life Business	**2,192**	**150**	**2,342**
Other additions	**–**	**4**	**4**
Foreign exchange adjustments	**(23)**	**(8)**	**(31)**
At 31 December 2010	**5,107**	**528**	**5,635**
Amortisation			
At 1 January 2010	**59**	**10**	**69**
Amortisation charge for the period	**364**	**64**	**428**
Foreign exchange adjustments	**(1)**	**(1)**	**(2)**
At 31 December 2010	**422**	**73**	**495**
Carrying amounts at 31 December 2010	**4,685**	**455**	**5,140**

Year ended 31 December 2009	AVIF £m	Other £m	Total £m
Cost			
1 January 2009	–	–	–
Acquisition of Friends Provident	2,943	363	3,306
Other additions	–	19	19
Foreign exchange adjustments	(5)	–	(5)
At 31 December 2009	2,938	382	3,320
Amortisation			
At 1 January 2009	–	–	–
Amortisation charge from date of acquisition of Friends Provident	59	10	69
At 31 December 2009	59	10	69
Carrying amounts at 31 December 2009	2,879	372	3,251

An analysis of intangible assets by significant cash generating unit ("CGU") is set out below:

At 31 December 2010	Cost £m	Amortisation £m	Net book value £m
UK – Friends Provident (life and pensions including Sesame Bankhall)	**1,457**	**(142)**	**1,315**
UK – AXA	**2,342**	**(86)**	**2,256**
International	**1,057**	**(141)**	**916**
Lombard	**779**	**(126)**	**653**
Total	**5,635**	**(495)**	**5,140**

15. Intangible assets continued

At 31 December 2009	Cost £m	Amortisation £m	Net book value £m
UK – Friends Provident (life and pensions including Sesame Bankhall)	1,457	(32)	1,425
International	1,052	(10)	1,042
Lombard	811	(27)	784
Total	3,320	(69)	3,251

A detailed exercise was undertaken to identify intangible assets, categorised by CGU, as part of the acquisition of AXA UK Life Business on 3 September 2010. As a result of this review it was decided that the acquired business represented an additional CGU in its own right.

The valuation exercise excludes intangible assets related to WLUK that will be valued upon legal completion of the Part VII transfers which are expected to take place towards the end of 2011. The value of intangible assets related to GOF/TIP business, have been excluded from intangible assets and included within held for sale assets.

The AVIF is the value attributed on acquisition to a portfolio of long-term business contracts which are in-force at the date of acquisition. It represents the difference between the fair value of the contractual rights and obligations and the long-term business IFRS net assets acquired. AVIF is shown gross of policyholder and shareholder tax of £1,076 million (2009: £594 million), with the offsetting balance included in deferred taxation. The AVIF is based on the value of in-force business calculated on a market consistent embedded value basis, as detailed in the supplementary information section.

Intangible assets relating to customer relationships and distribution channels have been valued using an income approach method, specifically the Multi-period Excess Earnings Method ("MEEM"). The principle behind the MEEM is that the value of an intangible asset is equal to the present value of the after-tax cash flows attributable only to that intangible asset.

Other intangibles include in-house developed IT systems and databases which have been valued using a replacement cost approach which assesses the cost of reproducing the equivalent technology in its current form.

The "AXA" brand and associated brands that existed within the acquired business have been retained by AXA and as such no value has been attributed to them.

For each type of asset, the useful economic life was determined, being the period over which the asset is expected to contribute directly or indirectly to future cash flows. The value of the assets will be amortised over the respective useful economic lives as set out in note 1.2.8.

Overview
Business review
Governance
IFRS financial statements
MCEV financial statements
Additional information

15. Intangible assets continued

i) UK

An analysis of the intangible assets in respect of UK – Friends Provident is as follows:

At 31 December 2010	Cost £m	Amortisation £m	Net book value £m
AVIF	1,304	(116)	1,188
Distribution and customer relationships	122	(18)	104
Brand	28	(6)	22
Other	3	(2)	1
Total	**1,457**	**(142)**	**1,315**

At 31 December 2009	Cost £m	Amortisation £m	Net book value £m
AVIF	1,304	(27)	1,277
Distribution and customer relationships	111	(3)	108
Brand	28	(1)	27
Other	14	(1)	13
Total	1,457	(32)	1,425

An analysis of the intangible assets in respect of the acquired AXA UK Life Business is as follows:

At 31 December 2010	Cost £m	Amortisation £m	Net book value £m
AVIF	2,192	(80)	2,112
Distribution and customer relationships	122	(4)	118
Other	28	(2)	26
Total	**2,342**	**(86)**	**2,256**

ii) International

An analysis of the intangible assets in respect of International is as follows:

At 31 December 2010	Cost £m	Amortisation £m	Net book value £m
AVIF	995	(132)	863
Distribution and customer relationships	40	(7)	33
Brand	9	(2)	7
Other(i)	13	–	13
Total	**1,057**	**(141)**	**916**

At 31 December 2009	Cost £m	Amortisation £m	Net book value £m
AVIF	995	(9)	986
Distribution and customer relationships	35	(1)	34
Brand	9	–	9
Other(i)	13	–	13
Total	1,052	(10)	1,042

(i) The Group acquired a 100% interest in Finance Partners Business AG (FpB) on 22 December 2009. In connection with this acquisition, goodwill of £13 million has been recognised.

15. Intangible assets continued

iii) Lombard

An analysis of the intangible assets in respect of Lombard is as follows:

At 31 December 2010	Cost £m	Amortisation £m	Net book value £m
AVIF	616	(94)	522
Distribution and customer relationships	135	(25)	110
Brand	12	(2)	10
Other	16	(5)	11
Total	779	(126)	653

At 31 December 2009	Cost £m	Amortisation £m	Net book value £m
AVIF	644	(23)	621
Distribution and customer relationships	141	(3)	138
Brand	13	–	13
Other	13	(1)	12
Total	811	(27)	784

Impairment

All identifiable intangible assets are reviewed at each reporting date to assess whether there are any circumstances that might indicate that they are impaired. If such circumstances exist, impairment testing is performed and any resulting impairment losses are charged to the income statement. As at 31 December 2010, based on an impairment review of each of the CGUs, the directors are satisfied that none of the Group's intangible assets are impaired.

16. Property and equipment

	Owner occupied properties at valuation £m	Computer equipment £m	Fixtures, fittings and office equipment £m	Total £m
Cost				
At 1 January 2010	39	7	2	48
Acquisition through business combinations	–	–	2	2
Other additions	–	–	2	2
Disposals	(1)	–	(1)	(2)
At 31 December 2010	38	7	5	50
Depreciation				
At 1 January 2010	–	1	–	1
Depreciation charge	–	2	2	4
Disposals	–	–	(1)	(1)
At 31 December 2010	–	3	1	4
Carrying amounts at 31 December 2010	38	4	4	46

16. Property and equipment continued

If owner occupied properties were measured on a depreciated cost basis, the carrying amount would be £38 million (2009: £38 million).

	Owner occupied properties at valuation £m	Computer equipment £m	Fixtures, fittings and office equipment £m	Total £m
Cost				
At 1 January 2009	–	–	–	–
Acquisition through business combinations	41	7	2	50
Disposals	(3)	–	–	(3)
Revaluations	1	–	–	1
At 31 December 2009	39	7	2	48
Depreciation				
At 1 January 2009	–	–	–	–
Depreciation charge	–	1	–	1
At 31 December 2009	–	1	–	1
Carrying amounts at 31 December 2009	39	6	2	47

17. Investment properties

	2010 £m	2009 £m
At 1 January	**1,546**	–
Purchases	**67**	–
Acquisitions through business combinations	**2,292**	1,460
Disposals	**(859)**	(46)
Fair value adjustments	**143**	132
At 31 December	**3,189**	1,546

Of the total, £1,358 million (2009: £1,040 million) is held in with-profits funds and £1,831 million (2009: £506 million) in unit-linked funds.

18. Principal Group undertakings

Principal subsidiary undertakings of the Group as at 31 December 2010 are shown below.

Unless otherwise stated, they are undertakings incorporated in England and Wales or Scotland and have only one class of issued ordinary shares. The voting rights are equal to the percentage holdings unless otherwise stated. Other subsidiaries do not materially affect the results of the Group.

In March 2011 the new brand "Friends Life" was launched. As part of this rebranding the names of companies comprising the AXA UK Life Business were changed. The new names of the principal subsidiary undertakings are noted below.

Subsidiary undertaking	Activity	% held
Corporate		
Friends ASLH Limited(i)	Holding company	100
Friends Provident Group Limited	Holding company	100
Friends Provident Holdings (UK) plc(ii)	Holding company	100
Friends Provident Limited	Holding company	100
Resolution Holdco No 1 LP(iii)(iv)	Holding company	99.99
Resolution Holdings (Guernsey) Limited(v)	Holding company	100
UK life and pensions		
Friends Annuities Limited(vi)	Insurance	100
Friends Life Assurance Society Limited(vii)	Insurance	100
Friends Life Company Limited(viii)	Insurance	100
Friends Life Services Limited(ix)	Management services	100
Friends Provident Life Assurance Limited	Insurance	100
Friends Provident Life and Pensions Limited	Insurance	100
Friends Provident Management Services Limited	Management services	100
Friends Provident Pensions Limited	Insurance	100
Friends Provident Reinsurance Services Limited	Reinsurance	100
Friends Provident International Limited(x)	Insurance	100
Lombard International Assurance SA(xi)	Insurance	99.24
Sesame Bankhall Group Limited	IFA distribution business	100

(i) Formerly AXA Sun Life Holdings Limited
(ii) Formerly Friends Provident Holdings (UK) Ltd
(iii) Held directly by Resolution Limited (all other companies are held indirectly)
(iv) Guernsey limited partnership
(v) Incorporated in Guernsey
(vi) Formerly AXA Annuity Company Limited
(vii) Formerly Sun Life Assurance Society plc
(viii) Formerly AXA Sun Life plc
(ix) Formerly AXA Sun Life Services plc
(x) Incorporated in the Isle of Man
(xi) Incorporated in Luxembourg

19. Investments in associate and joint venture

a) Associate

	2010 £m	2009 £m
Carrying amount of investment	**27**	22

Investments in associated undertakings comprise the Group's investment in AmLife, a Malaysian based life assurance business. The Group's interest in the ordinary share capital of AmLife is 30%.

The total assets, liabilities, revenues and profits of AmLife are as follows:

	2010 £m	2009 £m
Current assets	**31**	62
Non-current assets	**235**	168
Current liabilities	**(49)**	(34)
Non-current liabilities	**(127)**	(122)
Net assets	**90**	74
Revenue	**136**	60
Profit before tax	**12**	19

b) Joint venture

	2010 £m	2009 £m
Carrying amount of investment	**5**	8

This investment is in Tenet Group Limited, an Independent Financial Advisor ("IFA") firm which comprises two IFA networks, and a compliance network and intermediary operating in the mortgage and general insurance sectors. The Group's interest in the ordinary share capital of Tenet Group Limited is 21.250% (2009: 21.023%) following an injection of capital of £1 million. The Group's share of assets, liabilities, revenue and profits is as follows:

	2010 £m	2009 £m
Current assets	**9**	9
Non-current assets	**–**	3
Current liabilities	**(2)**	(2)
Non-current liabilities	**(2)**	(2)
Net assets	**5**	8
Revenue	**15**	3
Profit before tax	**–**	–

20. Financial assets

The Group's financial assets are summarised by measurement category as follows:

	31 December 2010 £m	31 December 2009 £m
Fair value through the income statement	**98,768**	48,235
Loans at amortised cost	**677**	80
Total financial assets	**99,445**	48,315

20. Financial assets continued

a) Analysis of financial assets at fair value through the income statement

At 31 December 2010	With-profits £m	Unit-linked £m	Non-linked annuities £m	Non-linked other £m	Shareholder £m	31 December 2010 Total £m
Shares and other variable yield securities	**8,108**	**52,003**	**–**	**241**	**8**	**60,360**
Debt securities and other fixed income securities:						
– Government securities	**6,937**	**7,644**	**659**	**716**	**189**	**16,145**
– Corporate bonds	**8,885**	**5,445**	**5,634**	**922**	**569**	**21,455**
Derivative financial instruments	**393**	**24**	**39**	**5**	**(5)**	**456**
Deposits with credit institutions	**3**	**349**	**–**	**–**	**–**	**352**
Total financial assets	**24,326**	**65,465**	**6,332**	**1,884**	**761**	**98,768**

At 31 December 2009	With-profits £m	Unit-linked £m	Non-linked annuities £m	Non-linked other £m	Shareholder £m	31 December 2009 Total £m
Shares and other variable yield securities	2,568	27,693	–	103	8	30,372
Debt securities and other fixed income securities:						
– Government securities	3,654	1,803	424	256	173	6,310
– Corporate bonds	4,442	3,471	2,200	501	357	10,971
Derivative financial instruments	176	8	–	3	(6)	181
Deposits with credit institutions	–	375	–	24	2	401
Total financial assets	10,840	33,350	2,624	887	534	48,235

The above unit-linked column and with-profits column includes £964 million (2009: £584 million) of financial assets (£316 million of shares and £648 million of corporate bonds) relating to the minority interests in the OEICs that have been consolidated as the Group holding is 50% or more.

For unit-linked funds, the policyholders bear the investment risk and any change in asset values is matched by a broadly equivalent change in the liability.

The majority of financial assets held are readily realisable. However, included in the carrying amounts above, £87,707 million (2009: £44,852 million) is expected to be realised more than 12 months after the balance sheet date in line with the expected maturity of insurance/investment contract liabilities.

Asset backed securities (excluding those held by the linked funds) amount to £2,505 million (2009: £1,167 million) and 92% (2009: 89%) of these are at investment grade as set out in note 30(c).

20. Financial assets continued

b) Determination of fair value hierarchy

In accordance with the requirements of IFRS 7: *Financial Instruments: Disclosures*, financial assets at fair value have been classified into three categories as set out below. Financial assets at fair value include shares and other variable yield securities, government securities, corporate bonds (including ABS), derivative financial instruments and deposits with credit institutions.

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

Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (ie as prices) or indirectly (ie derived from prices). This category generally includes assets that are priced based on models using market observable inputs. Examples include certificates of deposit and derivatives.

Level 3 – inputs that are not based on observable market data. Assets with single-price feeds and/or limited trading activity are included in this category. Examples include unlisted equities and private equity investments.

The majority of the Group's assets held at fair value are valued based on quoted market information or market observable data. Approximately 4.5% (4% excluding unit-linked assets) are based on valuation techniques where significant observable market data are not available or the price is not observable from current market transactions. However, the fair value measurement objective of these assets remains the same, that is, an exit price from the perspective of the Group.

The requirements of IFRS 7 also require financial liabilities at fair value to be categorised into Level 1, 2 or 3 hierarchies. Financial liabilities at fair value include unit-linked contracts, amounts due to reinsurers, net asset value attributable to unit-holders (non-controlling interests in the OEICs that are consolidated) and derivative financial instruments. The classifications take into account the types of inputs used to determine the fair value measurements.

For unit-linked funds this has been undertaken on a fund by fund basis. For the net asset value attributable to unit holders, this has been analysed in the same proportion as the underlying consolidated investments categorisation.

The Group has financial liabilities which contain discretionary participation features of £9,123 million (2009: £3,974 million) that form part of its with-profits funds. Products giving rise to these liabilities are mainly investment or pension contracts with a unitised with-profits element. The Group is unable to measure the fair value of these financial liabilities reliably due to the lack of a robust basis to measure the supplemental discretionary returns arising on with-profits contracts and because there is not an active market for such instruments. These liabilities have therefore been excluded from the fair value analysis below.

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. The table shows both the total financial assets and liabilities and the total excluding unit-linked assets and liabilities, as shareholders have no direct exposure to profits or losses on unit-linked assets (other than through investment management fees).

20. Financial assets continued

	Including unit-linked				Excluding unit-linked			
At 31 December 2010	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets held at fair value								
Shares and other variable yield securities	48,119	8,892	3,349	60,360	7,103	271	983	8,357
Debt securities and other fixed income securities:								
– government securities	16,094	51	–	16,145	8,500	1	–	8,501
– corporate bonds (including ABS)	12,317	8,035	1,103	21,455	9,601	6,051	358	16,010
Derivative financial instruments	54	402	–	456	51	381	–	432
Deposits with credit institutions	351	1	–	352	3	–	–	3
Total financial assets held at fair value	76,935	17,381	4,452	98,768	25,258	6,704	1,341	33,303
Financial liabilities held at fair value								
Unit-linked investment contracts	–	62,492	–	62,492	–	–	–	–
Amounts due to reinsurers	–	1,666	–	1,666	–	1,666	–	1,666
Net asset value attributable to unit-holders	1,173	–	–	1,173	11	–	–	11
Derivative financial instruments	27	138	–	165	27	127	–	154
Total financial liabilities held at fair value	1,200	64,296	–	65,496	38	1,793	–	1,831

	Including unit-linked				Excluding unit-linked			
At 31 December 2009	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets held at fair value								
Shares and other variable yield securities	25,445	207	4,720	30,372	2,283	–	396	2,679
Debt securities and other fixed income securities:								
– government securities	6,297	13	–	6,310	4,507	–	–	4,507
– corporate bonds (including ABS)	5,996	4,287	688	10,971	5,195	2,215	90	7,500
Derivative financial instruments	–	181	–	181	–	173	–	173
Deposits with credit institutions	343	58	–	401	–	26	–	26
Total financial assets held at fair value	38,081	4,746	5,408	48,235	11,985	2,414	486	14,885
Financial liabilities held at fair value								
Unit-linked investment contracts	–	36,410	–	36,410	–	–	–	–
Amounts due to reinsurers	–	1,610	–	1,610	–	1,610	–	1,610
Net asset value attributable to unit-holders	–	668	–	668	–	–	–	–
Derivative financial instruments	–	54	–	54	–	54	–	54
Total financial liabilities held at fair value	–	38,742	–	38,742	–	1,664	–	1,664

20. Financial assets continued

c) Transfers between Level 1 and Level 2

In the period, the Group has refined the methodology for classifying certain assets under the IFRS hierarchy. In the prior period, corporate bonds were classified based on the existence of recent traded prices and if none existed, by reference to credit risk. The refined classification methodology takes into account a liquidity assessment of each bond rather than a credit assessment. The liquidity assessment is based on bid/offer spreads. The impact in the period is that £2,495 million of corporate bonds have been reclassified from Level 1 to Level 2.

In addition to the reclassification of corporate bonds above £958 million of shares and other variable yield securities were transferred from Level 1 to Level 2 and £735 million (2009: £181 million) of corporate bonds, shares and other variable yield securities were transferred from Level 2 to Level 1. These movements arose from changes in the availability of current quoted prices and market activity. There were no significant transfers between Level 1 and Level 2 for other financial assets.

d) Financial instruments

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

	At 1 January 2010 £m	Acquisition through business combinations £m	Total gains/ (losses) in income statement £m	Purchases £m	Sales £m	Net transfer to/from Level 1 and Level 2 £m	Foreign exchange adjustments	At 31 December 2010 £m	Total gains or losses for the period included in profit or loss for assets held at 31 December 2010 £m
Financial assets held at fair value									
Shares and other variable yield securities	**4,720**	**529**	**394**	**1,100**	**(889)**	**(2,477)**	**(28)**	**3,349**	**184**
Corporate bonds (including ABS)	**688**	**213**	**180**	**216**	**(99)**	**(58)**	**(37)**	**1,103**	**139**
Total financial assets held at fair value	**5,408**	**742**	**574**	**1,316**	**(988)**	**(2,535)**	**(65)**	**4,452**	**323**

Transfers out of Level 3 arise due to availability of prices in an active market and the refinement of methodology that took place during the year.

	At 1 January 2009 £m	Acquisition through business combinations £m	Total gains/ (losses) in income statement £m	Purchases £m	Sales £m	Net transfer to/from Level 1 and Level 2 £m	Foreign exchange adjustments	At 31 December 2009 £m	Total gains or losses for the period included in profit or loss for assets held at 31 December 2009 £m
Financial assets held at fair value									
Shares and other variable yield securities	–	5,096	(927)	325	(73)	299	–	4,720	(930)
Corporate bonds (including ABS)	–	687	(9)	11	(1)	–	–	688	(9)
Total financial assets held at fair value	–	5,783	(936)	336	(74)	299	–	5,408	(939)

Transfers into Level 3 arise due to prices no longer being readily available in an active market.

20. Financial assets continued

e) Level 3 sensitivity analysis

At 31 December	2010 Carrying amount £m	2010 Effect of reasonably possible alternative assumptions £m	2009 Carrying amount £m	2009 Effect of reasonably possible alternative assumptions £m
Unit-linked investments	**3,111**	**–**	4,922	–
Shares and other variable yield securities	**983**	**196**	396	79
Corporate bonds (including ABS)	**358**	**36**	90	9
Total Level 3 financial assets	**4,452**	**232**	5,408	88

For unit-linked investments, the policyholders bear the investment risk and any change in asset values is matched by a broadly equivalent change in the liability. Shareholder profits from annual management charges levied on such funds will, however, vary according to the change in asset values leading to some limited investment risk.

For shares and other variable yield securities, where there is no active market the price at year end could reasonably be expected to be higher or lower by approximately 20%.

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

f) Loans

At 31 December	2010 £m	2009 £m
Mortgage loans	**61**	3
Other loans	**616**	77
Total loans	**677**	80

Other loans include £600 million of loan assets held as a result of financial arrangements with Barclays Bank plc and Morgan Stanley. The loans which will be repaid in March 2011 are backed by collateral, which is routinely reviewed to ensure its valuation covers the loan value. As at 31 December 2010, the fair value of the collateral received from the counterparties was £645 million. No collateral received from the counterparties has been sold or re-pledged. The 2009 comparative includes £68 million due from the FPPS (see note 9) which was repaid in 2010. The fair value of loans is considered to be the same as their carrying value.

g) Unit-linked net assets

The amounts included in the statement of financial position in respect of net assets held within unit-linked funds are as follows:

At 31 December	2010 £m	2009 £m
Investment properties	**1,831**	506
Shares and other variable yield securities	**52,166**	27,341
Debt securities and other fixed-income securities	**11,893**	5,042
Derivative financial instruments	**24**	8
Deposits with credit institutions	**349**	375
Other receivables	**356**	120
Cash and cash equivalents	**4,879**	3,126
Total assets	**71,498**	36,518
Other payables	**(235)**	(141)
Total unit-linked net assets	**71,263**	36,377

The impact of consolidating OEICs in which the Group has a holding in excess of 50% has been excluded from the above analysis of unit-linked net assets. However, the underlying holdings in the OEICs are included within shares and other variable yield securities.

21. Deferred acquisition costs

	Insurance contracts £m	Investment contracts £m	Total £m
At 1 January 2010	**–**	**46**	**46**
Incurred and deferred in the period	**40**	**254**	**294**
Amortisation charge to the income statement	**(6)**	**(8)**	**(14)**
Other movements[i]	**–**	**32**	**32**
At 31 December 2010	**34**	**324**	**358**

(i) Other movements relate to foreign exchange movements and enhanced unit allocations.

Included in the carrying values above, £326 million (2009: £45 million) is expected to be recovered more than 12 months after the balance sheet date. Acquisition expenses that do not meet the criteria for deferral are expensed directly as incurred.

	Insurance contracts £m	Investment contracts £m	Total £m
At 1 January 2009	–	–	–
Incurred and deferred in the period	–	39	39
Amortisation charge to the income statement	–	(1)	(1)
Other movements	–	8	8
At 31 December 2009	–	46	46

22. Reinsurance assets

	2010 Total £m	2009 Total £m
At 1 January	**1,972**	–
Acquired through business combinations	**640**	1,995
Premiums	**241**	14
Claims	**(322)**	(11)
Other movements	**106**	(26)
At 31 December	**2,637**	1,972

No significant gain or loss arose on reinsurance contracts incepted in the period. The Group takes out reinsurance on its insurance contracts, but not its investment contracts.

Included in the carrying values above, £2,485 million (2009: £1,408 million) is expected to be recovered more than 12 months after the balance sheet date.

Reinsurance assets are valued using the same methods and bases as those used to value the underlying liabilities that are being reinsured.

23. Deferred tax assets and liabilities

a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	2010			2009 (restated)		
	Assets £m	Liabilities £m	Net £m	Assets	Liabilities	Net £m
Property and equipment	51	–	51	40	–	40
AVIF	–	(1,076)	(1,076)	–	(594)	(594)
Other intangible assets	–	(100)	(100)	–	(87)	(87)
Unrealised gains on investments	–	(339)	(339)	–	(12)	(12)
Employee benefits	16	–	16	1	–	1
Deferred acquisition costs	110	–	110	–	(1)	(1)
Tax value of recognised tax losses	289	–	289	142	–	142
Short-term temporary differences	–	(62)	(62)	–	(12)	(12)
Deferred tax assets/(liabilities)	466	(1,577)	(1,111)	183	(706)	(523)
Offset of deferred tax assets/liabilities	(462)	462	–	(171)	171	–
Net deferred tax assets/(liabilities)	4	(1,115)	(1,111)	12	(535)	(523)

Of the deferred tax assets above, £4 million (2009: £12 million) cannot be offset against deferred tax liabilities and is presented gross in the statement of financial position.

Comparatives have been restated for the change in the valuation of STICS, as set out in note 3.

b) Movement in temporary differences during the period

	At 1 January 2010 £m	Recognised in income £m	Recognised in other comprehensive income £m	Foreign exchange £m	Acquired in year £m	Disposals in year £m	At 31 December 2010 £m
Property and equipment	40	(2)	–	–	11	2	51
AVIF	(594)	89	–	7	(578)	–	(1,076)
Other intangible assets	(87)	15	–	–	(28)	–	(100)
Unrealised gains on investments	(12)	(196)	–	–	(131)	–	(339)
Employee benefits	1	(10)	25	–	–	–	16
Deferred acquisition costs	(1)	(33)	–	–	144	–	110
Tax value of recognised tax losses	142	11	–	–	135	1	289
Short-term temporary differences	(12)	(3)	–	–	(47)	–	(62)
Net deferred tax (liabilities)/assets	(523)	(129)	25	7	(494)	3	(1,111)

	At 1 January 2009 £m	Recognised in income £m	Recognised in other comprehensive income £m	Foreign exchange £m	Acquired in year £m	Disposals in year £m	At 31 December 2009 £m
Property and equipment	–	(2)	–	–	42	–	40
AVIF	–	11	–	–	(605)	–	(594)
Other intangible assets	–	3	–	–	(90)	–	(87)
Unrealised gains on investments	–	1	–	–	(13)	–	(12)
Employee benefits	–	(6)	5	–	2	–	1
Deferred acquisition costs	–	(1)	–	–	–	–	(1)
Tax value of recognised tax losses	–	5	–	–	137	–	142
Short-term temporary differences	–	2	–	–	(14)	–	(12)
Net deferred tax (liabilities)/assets	–	13	5	–	(541)	–	(523)

23. Deferred tax assets and liabilities continued

c) Unrecognised deferred tax assets and liabilities

Deferred tax assets of £47 million (2009: £101 million) in relation to tax losses carried forward have not been recognised as it is not probable that there will be sufficient suitable profits emerging in future periods against which to relieve them.

24. Insurance and other receivables

	2010 £m	Restated 2009 £m
Receivables arising out of direct insurance operations:		
– policyholders	**46**	24
– agents, brokers and intermediaries	**35**	39
Investment income receivables	**158**	56
Investments sold for subsequent settlement	**14**	39
Prepayments and accrued income	**536**	246
Other receivables	**187**	40
Total insurance and other receivables	**976**	444

£46 million of insurance and other receivables are expected to be recovered more than 12 months after the balance sheet date. The carrying value of each item approximates fair value.

25. Cash and cash equivalents

	2010 £m	2009 £m
Bank and cash balances	**3,252**	2,218
Short-term deposits	**6,036**	3,168
Total cash and cash equivalents	**9,288**	5,386

The Group holds the following balances of cash and cash equivalents that are not available for use by shareholders:

	2010 £m	2009 £m
OEICs	**150**	86
Long-term funds	**7,832**	4,554
	7,982	4,640

26. Terms and conditions of insurance and investment contracts

The main types of insurance and investment contracts that the Group currently has in force are:

a) Life

Protection business (other than whole life products) – these insurance contracts consist mainly of regular premium term assurance, critical illness and income protection products, which pay out a fixed amount (the sum assured) on ill health or death. The premium rate is usually guaranteed for the lifetime of the contract. For most policies this payout will be a single amount, whereas income protection products provide a regular income upon incapacity either for the length of illness or to the end of the contract if earlier, depending on the specific policyholder terms. Most contracts have no surrender value.

Endowments and whole-life products – these insurance contracts both provide benefits upon death or, in the case of endowments, at a preset maturity date if earlier. These policies usually have a surrender value. The amount payable on death is subject to a guaranteed minimum amount. The maturity value usually depends on the investment performance of the underlying assets. For with-profits business, it is underpinned by a minimum guarantee, which may be increased by the addition of bonuses.

Single premium bonds – these are unit-linked or unitised with-profits investment contracts that have no maturity date. On death, the amount paid is 100%–105% of the value of the units. On surrender the value of units is paid, sometimes in the first few years less a surrender penalty. For with-profits contracts a final bonus may be payable on death or surrender, or if markets are depressed a market value reduction may be applied to surrender values.

b) Pensions

Individual and group pensions – these contracts generally provide a cash sum at retirement. If death occurs before retirement, they generally return the value of the fund accumulated or in some cases premiums paid are returned. Contracts with guaranteed cash and annuity options (see below) are defined as insurance contracts but in the absence of these guarantees products are normally defined as investment contracts.

Annuities in payment – these insurance contracts are typically single premium products, which provide for a regular payment to the policyholder whilst they and/or their spouse are still alive. Payments are generally either fixed or increased each year at a specified rate or in line with the rate of inflation. Most contracts guarantee an income for a minimum period usually of five years, irrespective of death.

c) Guarantees and options

The main guarantees and options included within the Group's insurance contracts, the majority of which arise within the FPLP, FLC and FLAS with-profits funds, are as follows:

- Guaranteed cash and annuity options – most conventional deferred annuity contracts have benefit options expressed in terms of cash and annuity payments with a guaranteed conversion rate, allowing the policyholder the option of taking the more valuable of the two at retirement.
- Guarantees in respect of bonus additions – bonuses added to with-profits policies increase the guaranteed minimum benefit that policyholders are entitled to at maturity. These are set at a level that takes account of expected market fluctuations, such that the cost of the guarantee is generally met by the investment performance of the assets backing the policyholder liability. However in circumstances where there has been a significant fall in investment markets, the guaranteed maturity benefits may exceed asset shares and these guarantees become valuable to the policyholder. Also, for unitised with-profits policies it is guaranteed that the value of units will not fall, and for some older product classes, the value of units rises at a minimum guaranteed rate.
- Guaranteed surrender bases – certain older products have a guaranteed basis for calculating surrender values. In all these cases the basis includes an element of final bonus which can be reduced or taken away. The guaranteed basis typically applies over a period of 15 years but in most cases policies are approaching the end of this period. The effect of the guaranteed surrender basis is to extend the guarantee in respect of bonus additions so that they apply over an extended period and not just at the maturity date.
- Guaranteed minimum pensions – certain policies secured by transfer values from pension scheme provide a guarantee that the pension at retirement will not be less than the GMP accrued as a result of contracting out of the State Earnings Related Pension Scheme or State Second Pension.

27. Insurance contracts

a) Changes in insurance contracts liabilities

The following table shows the movements in insurance contracts liabilities in the year:

	2010 £m	2009 £m
At 1 January	**12,107**	–
Acquired through business combinations	**22,050**	12,265
Increase in liability from premiums	**1,209**	120
Release of liability due to recorded claims	**(2,050)**	(186)
Unwinding of discount	**320**	23
Change in assumptions:		
– Economic	**(241)**	(79)
– Non-economic	**42**	(4)
Other movements including net investment return	**1,644**	(32)
At 31 December	**35,081**	12,107

Included in the carrying amount above, £30,782 million (2009: £10,271 million) expected to be settled more than 12 months after the balance sheet date.

A liability adequacy test was carried out at policy level and resulted in no additional provision in 2010 (2009: £nil).

It should be noted that changes in the economic assumptions are typically largely offset by corresponding changes in the financial assets backing the liabilities. In addition, assumption changes on with-profits contracts will result in changes in the unallocated surplus, and not in retained earnings.

b) Method used for reserving for both insurance contracts and investment contracts with DPF

The liability for insurance contracts and investment contracts with DPF is calculated on the basis of recognised actuarial methods having due regard to actuarial principles and best practice. The methodology takes into account risks and uncertainties of the particular classes of long-term business written.

Calculations are generally made on an individual policy basis; however in addition there are some global provisions which are calculated using statistical or mathematical methods. The results are expected to be approximately the same as if the individual insurance/investment contract liability was calculated for each contract.

The methodology for the calculation of liabilities is set out in more detail in notes 1.2.19 and 1.2.20.

c) Process used for assumptions

i) Economic assumptions

Details regarding the economic assumptions used in the stochastic model for the valuation of with-profits policyholder liabilities are set out in note 28.

For other insurance liabilities and unitised with-profits contracts, economic assumptions are the same as those used for reporting to the FSA under the regulatory peak. Economic assumptions are adjusted from year to year by reference to changes in consistent economic indices or yields on the underlying portfolio. The principal assumption is the valuation interest rate, being the rate at which projected policy cash flows are discounted.

ii) Non-economic assumptions

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

27. Insurance contracts continued

Long-term estimates of future mortality and morbidity assumptions are based on standard tables wherever possible but adjusted to reflect the Group's own experience. Expense assumptions are based on recent experience for FPLP and FPLA. For FLC, FLAS and FAL the provision for future expenses covers the expected level of servicing fees payable to Friends Life Services Limited ("FLSL") under the Management Services Agreement, fees payable to investment managers and further amounts in respect of other expenses. Experience investigations for mortality, morbidity, persistency, guaranteed annuity option take-up rates and maintenance expenses are performed at least annually for major product classes. Where industry analysis indicates that changes in expected future mortality/morbidity or other assumptions factor patterns mean that claim costs are likely to rise in the future, then this is taken into account in the liability calculation. No benefit is taken in regulatory reserves where industry analysis indicates that future trends are likely to reduce claim costs in the future. For FLC and FLAS with-profits funds the benefit from a prudent view of expected future mortality improvements is taken on non-profit protection business in the realistic balance sheet. Improving mortality has been assumed when valuing annuities and deteriorating morbidity has been assumed when valuing some critical illness business. Assumptions, for policies other than with-profits, are generally intended to be a prudent estimate of future experience.

d) Valuation interest rates

As explained in note 28 with-profits business within FPLP, FPLA, FLC and FLAS is valued in accordance with the FSA's realistic reporting regime.

Valuation interest rates for other than conventional with-profits business are shown in the table below.

	Company	Class of Business	31 December 2010 %	31 December 2009 %
Life	FPLP/FPLA	Endowment and Whole Life in non-profit funds	**2.80**	3.00
		Protection	**2.80**	3.00
		Endowment and Whole Life in with-profit funds	**2.60**	2.80
	FLC	Over 50 Plan in NP Funds	**2.05**	–
		Over 50 Plan in WP Funds	**2.40**	–
		Additional Life Reserves	**2.65**	–
		Other conventional life in NP funds	**2.05**	–
		Other conventional life in WP funds	**2.40**	–
		Life annuities from FLAS	**3.00**	–
		Unit-Linked Life	**3.10**	–
	FLAS	Conventional Life	**2.90**	–
		Unit-Linked Life	**2.90**	–
Income Protection	FPLP/FPLA	Income Protection	**3.00**	3.30
	FLC	PHI	**4.40**	–
Pensions	FPLP/FPLA	Annuities in payment	**4.46–4.81**	4.33–5.21
		Protection	**3.50**	3.80
		Individual and Group Pensions in non-profit funds	**3.50**	3.80
		Individual and Group Pensions in with-profit funds	**3.30**	3.60
	FLC	Unit-Linked Pensions	**3.85**	–
		Conventional Pensions in NP funds	**2.55**	–
		Conventional Pensions in WP funds	**3.00**	–
		Additional Pensions Reserves	**3.30**	–
	FLAS	Conventional Pensions	**3.80**	–
		Unit-Linked Pensions	**3.65**	–
	FAL	FLC annuities reinsured December 2007	**4.25**	–
		FLAS annuities reinsured July 2009	**4.00**	–
		FLC index-linked annuities reinsured December 2007	**0.20**	–
		FLAS index-linked annuities reinsured July 2009	**0.60**	–

Within FPLP and FPLA certain products can have positive or negative reserves. The interest rate used for these products is 2.3% (2009: 2.5%) or 5% (2009: 5.4%) depending on which is more onerous.

27. Insurance contracts continued

e) Mortality, morbidity and lapse rates

Insurance contract liabilities allow for mortality and morbidity risk by making assumptions about the proportion of policyholders who die or become sick. Allowance for future mortality has been made using the following percentages of the standard published tables below:

		31 December 2010	31 December 2009
Term assurances – FPLP/FPLA	Smoker	**93% TMS00(5)**	93% TMS00(5)
		88% TFS00(5)	88% TFS00(5)
	Non-smoker	**93% TMN00(5)**	93% TMN00(5)
		86% TFN00(5)	86% TFN00(5)
Term assurances – FLC/FLAS	Smoker	**102% TMS00(5)**	
		114% TFS00(5)	
	Non-smoker	**96% TMN00(5)**	
		102% TFN00(5)	
Critical illness	FPLP/FPLA	**CIBT02**[(i)]	CIBT02[(i)]
Critical illness	FLC/FLAS	**CIBT02**[(ii)]	
Other life assurances	FPLP/FPLA	**120% AM/FC00ult**	120% AM/FC00ult
Other life assurances	FLC/FLAS	**140% AMC00**	
		125% AFC00	
Unitised policies	Life/Other – FPLP/FPLA	**130% AM/FC00ult**	130% AM/FC00ult
		110% AM/FC00ult	110% AM/FC00ult
Unitised policies	Life/Other – FLC/FLAS	**105% AMC00ult**	
		120% AFC00ult	
Pensions	FPLP/FPLA	**65% AM/FC00ult**	65% AM/FC00ult
		55% AM/FC00ult	55% AM/FC00ult
	FLC/FLAS	**90.91% A67/70ult-1**	
		90.91% AF80ult-1	
Individual income protection	FPLP/FPLA	**60% AM/F80ult**[(iii)]	60% AM/F80 ult[(iii)]
	FLC/FLAS	**100% AM/AF92**[(iv)]	
Annuities in payment	FPLP/FPLA individual annuities	**RM/FV00**[(v)]	RM/FV00[(vi)]
	FPLP/FPLA group annuities	**PCMA/PCFA00**[(v)]	PCMA/PCFA00[(vi)]
	FLC/FAL pension annuities	**93% PCMA00**[(vii)]	
		90.5% PCFA00[(vii)]	
	FLAS pension annuities	**90.5% PCMA00**[(vii)]	
		90.5% PCFA00[(vii)]	

(i) The percentages of the table used differ by sex and smoker status. Future deterioration in morbidity is allowed for by assuming claim rates increase by 1.25% per annum and 1.50% per annum for males and females respectively.
(ii) The percentages of the table used differ by sex, smoker status and sales group. Future deterioration in morbidity is allowed for by assuming claim rates increase by 0.75% per annum and 1.50% per annum for males and females respectively.
(iii) Individual income protection sickness and recovery rates are based on percentages of CMI 12 (male and female) published tables. Rates differentiate by smoker status, deferred period and occupational class.
(iv) Individual income protection sickness and recovery rates are based on percentages of CMIR 12 (male and female) published tables. Rates differentiate by smoker status, deferred period and occupational class.
(v) Age related percentages of the mortality tables are used. Future improvements in mortality are based on the following percentages of the average of CMI's Medium Cohort
   a) Males – 100% subject to a minimum improvement of 2.1% per annum
   b) Females – 75% subject to a minimum improvement of 1.8% per annum
(vi) Age related percentages of the mortality tables are used. Future improvements in mortality are based on the following percentages of the average of CMI's Medium Cohort and Long Cohort
   a) Males – 100% subject to a minimum improvement of 1.5% per annum
   b) Females – 75% subject to a minimum improvement of 1.25% per annum
(vii) Future improvements in mortality are based on the following percentages of the CMI's Medium Cohort
   a) Males – 100% subject to a minimum improvement of 2.1% (2009: 1.7%) per annum
   b) Females – 75% subject to a minimum improvement of 1.8% (2009: 1.5%) per annum

27. Insurance contracts continued

For protection business, lapse rates are based on recent experience with a prudent margin.

In determining liabilities for with-profits business, it is assumed that a proportion of policies is discontinued (surrendered, lapsed or converted paid-up) in each future year. The relevant rates vary by product and duration.

f) Apportionment of surplus between shareholders and with-profits policyholders

Shareholders are entitled to 100% of surplus emerging from companies within the Group, with the exception of surplus emerging in the with-profits funds.

The with-profits funds are run on a mutual basis and managed so that over time the working capital is sufficient to provide most of the risk capital but not exceed the risk capital margin.

Shareholders are entitled to one ninth of the cost of bonuses added to policies, except for:

a) Surplus arising on pre-demutualisation non-profit and unitised business (excluding the investment element) arises in the With-Profits Fund but assets of the With-Profits Fund equal to 60% of the surplus arising are transferred to shareholders.

b) Within the FPLP with-profits fund, post demutualisation policyholders are only entitled to surplus from the return on their investments; other sources of surplus are wholly owned by shareholders including policies written by FPLA and Friends Provident Pensions Limited ("FPP"), where the investment element is reinsured to the FPLP with-profits fund.

c) Within the FPLA closed fund, policyholders are entitled to all the surplus of that fund. In addition, FPLA has a closed unitised with-profits fund. Shareholders are entitled to all profits from the unitised with-profits fund other than investment profits, which are wholly owned by with-profits policyholders. The investment element of the contract is wholly reinsured to the FPLP with-profits fund.

The effect of the fund structure is that investment risk, in respect of assets backing with-profits policies, is largely borne by policyholders; shareholders bear 10% of the investment risk from conventional with-profits policies – other than within the FPLA closed fund.

Expense risk is borne by shareholders, other than within the FPLA closed fund. Prior to 2009, the FPLP with-profits fund was charged a fixed amount for managing policies, adjusted by an inflation index, irrespective of actual costs. The charges were reviewed at the end of 2009 to reflect market rates at that time.

Other forms of risk are shared between shareholders and policyholders as described above.

28. With-profits balance sheets

Of the five with-profits funds in the Group, all except FPLA are required to prepare realistic balance sheets as they are considered to be material under FSA rules. The realistic balance sheets for each major fund is shown below:

a) FPLP With-Profits Fund

	2010 £m	2009 £m
Total net assets	**12,066**	12,040
Less non-profit liabilities including long-term insurance capital requirements	**(2,456)**	(2,414)
Total regulatory assets	**9,610**	9,626
Additional assets arising on realistic basis	**192**	209
Total assets	**9,802**	9,835
Policyholder liabilities:		
– Asset shares	**8,123**	8,076
– Financial guarantees (net of charges)	**311**	386
– Options (guaranteed annuities)	**475**	427
Other liabilities	**747**	789
Total liabilities	**9,656**	9,678
Excess of assets over liabilities	**146**	157

28. With-profits balance sheets continued

At 31 December 2010, the surplus of assets over liabilities initially amounted to £403 million (2009: £560 million) with a Risk Capital Margin ("RCM") of £146 million (2009: £157 million). The surplus assets have subsequently been reduced by £257 million (2009: £403 million) by enhancing future payouts and, in 2009, reducing future policyholder guarantee charges. This leaves the working capital at £146 million (2009: £157 million) fully covering the RCM. After adding back the shareholders' share of future bonuses totalling £70 million (2009: £42 million) the excess in accordance with FRS 27 amounted to £216 million (2009: £199 million).

b) FLC New With-Profits Fund(i)

	2010 £m
Total net assets	**6,225**
Less non-profit liabilities including long-term insurance capital requirements	**(745)**
Total regulatory assets	**5,480**
Additional assets arising on realistic basis	**188**
Total with-profits assets	**5,668**
Policyholder liabilities:	
– asset shares	**4,574**
– financial guarantees (net of charges)	**246**
– options (guaranteed annuities)	**173**
Other liabilities	**383**
Total with-profits liabilities	**5,376**
Excess of assets over liabilities	**292**

(i) The fund was acquired during the year through the purchase of FASLH.

At 31 December 2010, the surplus of assets over liabilities amounted to £292 million with a RCM of £180 million. This leaves the working capital fully covering the RCM. Adding back the shareholders' share of future bonuses the excess in accordance with FRS 27 amounted to £454 million.

c) FLC Old With-Profits Fund(i)

	2010 £m
Total net assets	**1,496**
Less non-profit liabilities including long-term insurance capital requirements	**(108)**
Total regulatory assets	**1,388**
Additional assets arising on realistic basis	**26**
Total with-profits assets	**1,414**
Policyholder liabilities:	
– asset shares	**1,126**
– financial guarantees (net of charges)	**65**
– options (guaranteed annuities)	**47**
Other liabilities	**90**
Total with-profits liabilities	**1,328**
Excess of assets over liabilities	**86**

(i) The fund was acquired during the year through the purchase of FASLH.

At 31 December 2010, the surplus of assets over liabilities amounted to £86 million with a RCM of £46 million. This leaves the working capital fully covering the RCM. Adding back the shareholders' share of future bonuses the excess in accordance with FRS 27 amounted to £126 million.

28. With-profits balance sheets continued

d) FLAS With-Profits Fund[(i)]

	2010 £m
Total net assets	8,223
Less non-profit liabilities including long-term insurance capital requirements	(3,908)
Total regulatory assets	4,315
Additional assets arising on realistic basis	486
Total with-profits assets	4,801
Policyholder liabilities:	
– asset shares	4,126
– financial guarantees (net of charges)	291
– options (guaranteed annuities)	120
Other liabilities	264
Total with-profits liabilities	4,801
Excess of assets over liabilities	–

(i) The fund was acquired during the year through the purchase of FASLH.

At 31 December 2010, the surplus of assets over liabilities initially amounted to nil with a RCM of nil. Adding back the shareholders' share of future bonuses the excess in accordance with FRS 27 amounted to £228 million.

The main element of the liabilities within each fund is the asset shares of with-profits business. This represents the premiums received to date together with the investment return earned less expenses and charges. This is mainly calculated on an individual policy basis using historic information and in line with the companies PPFMs. Asset shares are closely matched since they move with the value of the underlying assets.

Policyholder liabilities (including options and guarantees) are then valued using a market consistent stochastic model. Other liabilities include current liabilities, creditors, tax provisions, and the value of future transfers to shareholders.

The realistic balance sheet also allowed for future profits of any non-profit business written in the with-profits fund to be included as an asset, in addition to the regulatory assets. In accordance with FRS 27, the value of future profits of non-profit business has been allowed for as a deduction from policyholder liabilities in the IFRS balance sheet.

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

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

28. With-profits balance sheets continued

		31 December 2010 £m	31 December 2009 £m
Maturity guarantees	FPLP With-Profits Fund	**311**	386
	FLC New With-Profits Fund	**246**	–
	FLC Old With-Profits Fund	**65**	–
	FLAS With-Profits Fund	**291**	–
Guaranteed annuity options	FPLP With-Profits Fund	**475**	427
	FLC New With-Profits Fund	**173**	–
	FLC Old With-Profits Fund	**47**	–
	FLAS With-Profits Fund	**120**	–

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

The cost of the with-profit guarantees is assessed using a market consistent stochastic model (using a Barrie & Hibbert model as the economic scenario generator) and is calculated using 2,000 simulations. In 2009 the cost of guarantees within the FPLP with-profits fund were assessed using The Smith Model as the scenario generator and calculated using 6,300 scenarios.

The model is calibrated using the gilt risk-free curve assuming interest rates of between 0.7% and 4.7% per annum and implied volatilities in the market as shown in the table below.

Swaption implied volatilities – FPLP

	31 December 2010 swap term			
Option term	10 years	15 years	20 years	25 years
UK Sterling				
10 years	**15%**	**15%**	**14%**	**14%**
15 years	**15%**	**14%**	**13%**	**13%**
20 years	**13%**	**13%**	**12%**	**12%**
25 years	**12%**	**12%**	**11%**	**11%**

	31 December 2009 swap term			
Option term	10 years	15 years	20 years	25 years
UK Sterling				
10 years	15%	15%	14%	14%
15 years	16%	15%	14%	14%
20 years	16%	15%	14%	13%
25 years	16%	14%	13%	12%

Swaption implied volatilities – FLC and FLAS

	31 December 2010 swap term			
Option term	10 years	15 years	20 years	25 years
UK Sterling				
10 years	**14%**	**14%**	**14%**	**14%**
15 years	**14%**	**14%**	**13%**	**13%**
20 years	**14%**	**13%**	**13%**	**13%**
25 years	**13%**	**13%**	**13%**	**13%**

28. With-profits balance sheets continued

For equity capital return and property total return implied volatilities are shown in the table below.

FPLP

	2010		2009	
Option term	Equities	Property	Equities	Property
5 years	27%	16%	25%	16%
10 years	28%	16%	27%	17%
15 years	28%	16%	29%	18%

FLC

	2010		2009	
Option term	Equities	Property	Equities	Property
5 years	28%	15%	–	–
10 years	29%	16%	–	–
15 years	31%	16%	–	–

FLAS

	2010		2009	
Option term	Equities	Property	Equities	Property
5 years	29%	15%	–	–
10 years	30%	16%	–	–
15 years	31%	16%	–	–

The cost of guarantees also depends on management actions that would be taken under various scenarios. The regular bonus rate is set each year such that, by maturity, guaranteed benefits are targeted as a prescribed fraction of the total asset share, leaving the remaining portion of the asset share to be paid as a final bonus. This management action is in line with the Company's PPFM and is programmed into the models.

The regular bonus rates are derived from the gross redemption yields on gilts with deductions for guaranteed interest rates, tax, expenses, shareholder transfers and a contingency margin. The remaining portion of the asset share is paid as a final bonus. The management action is in line with the Company's PPFM and is programmed into the models.

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

The guaranteed annuity options cost also depends upon other factors such as policy discontinuance and the take up rate for the options. The factors are based on recent experience adjusted to reflect industry benchmarks and to anticipate trends in policyholder behaviour. A summary of the key assumptions is as follows:

Policy discontinuances: lapse, early retirement and paid-up rates vary by policy type and period and have been based on recent experience.

28. With-profits balance sheets continued

Policy lapses and paid-up rates are generally in the ranges shown below:

	2010 % p.a.	2009 % p.a.
FPLP With-Profits Fund		
Pensions – lapses	**1% to 5%**	1% to 4.5%
Life – lapses	**3% to 15%**	3% to 10%
Mortgage endowments – lapses	**14%**	14%
With-profits bonds – lapses	**20%**	20%
Pensions – paid-up	**4% to 17%**	4% to 17%
Life – paid-up	**0.5% to 2%**	0.5% to 2%
FLC New With-Profits Fund		
Pensions – lapses	**2% to 6.5%**	–
Life – lapses	**2.5% to 13%**	–
Mortgage endowments – lapses	**6% to 13%**	–
With-profits bonds – lapses	**10%**	–
Pensions – paid-up	**5%**	–
Life – paid-up	**1%**	–
FLAS Old With-Profits Fund		
Pensions – lapses	**2% to 6.5%**	–
Life – lapses	**2.5% to 13%**	–
Mortgage endowments – lapses	**6% to 13%**	–
With-profits bonds – lapses	**10%**	–
Pensions – paid-up	**5%**	–
Life – paid-up	**1%**	–
FLAS With-Profits Fund		
Pensions – lapses	**1.5% to 8%**	–
Life – lapses	**2.5% to 11%**	–
Mortgage endowments – lapses	**3% to 11%**	–
With-profits bonds – lapses	**10%**	–
Pensions – paid-up	**5%**	–
Life – paid-up	**1%**	–

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

Tax free cash option: where a guaranteed annuity option is more valuable than the cash equivalent it is assumed that 18% to 27% of the benefit of the option is taken tax-free depending on the type of business. This is based on recent experience.

There are also guarantees and options in respect of some of the other life assurance business within the Group, but these are not considered to be material to the Group's future cash flows. In addition, they have largely been matched with suitable assets and there is no material exposure to market or interest rate changes. Provisions have been established using deterministic scenarios based on prudent assumptions.

29. Capital

a) Overview

The Group complies with all regulatory capital requirements; these include the IGCA and individual company regulatory requirements.

IGCA looks at capital from a Group shareholder perspective and is a prudent measure in that surplus capital not immediately available to shareholders, such as surplus capital in the long-term funds, is excluded from the calculation.

The Group's life and pensions business manages its capital on both economic capital and regulatory bases.

The economic capital model helps in setting the Group's financial risk appetite and in actively managing financial risk. The economic capital model compares total available capital resources, calculated on a realistic basis, with the risk capital required to cover unexpected losses.

The life and pensions capital statement, drawn up in accordance with FRS 27, illustrates the financial strength of the life and pensions business and is set out in section (b) below. Total available capital resources are calculated on a realistic basis for the with-profits funds and on a regulatory basis for all other funds.

A reconciliation of IFRS equity, life and pensions capital resources per the capital statement and FPH capital on an IGCA basis is set out below.

31 December 2010	Capital resources £m	Capital requirements £m	Surplus £m
IFRS			
Equity attributable to the equity holders of the parent	6,227	–	6,227
Entity resources excluded from capital statement[(i)]	51	–	51
Internal STICS and preference shares[(ii)]	811	–	811
Subordinated debt[(iii)]	7	–	7
Unallocated surplus	1,098	–	1,098
Regulatory prudence: inadmissible assets and valuation differences[(iv)]	(4,619)	–	(4,619)
Life and pensions capital requirements	–	1,240	(1,240)
Life and pensions capital statement	3,575	1,240	2,335
With-profits funds resources calculated on a regulatory basis[(v)]	3,961	3,436	525
Long-term fund surplus and other restricted assets[(vi)]	(875)	–	(875)
Internal STICS and preference shares	(811)	–	(811)
External STICS	488	–	488
External subordinated debt[(vii)]	862	–	862
Entities excluded from capital statement[(i)]	(386)	24	(410)
Other[(viii)]	201	(2)	203
Estimated FPH IGCA surplus[(ix)]	7,015	4,698	2,317

(i) FPH corporate centre, IFA distribution businesses and Resolution holding companies.
(ii) Proceeds of the £300 million 2003 STICS and £500 million 2005 STICS were injected into the Friends Life group and have not been restructured following the restructure of external STICS in 2009.
(iii) Lombard subordinated debt (£5 million relates to internal capital with FPH holding companies).
(iv) Largely goodwill, intangible assets and DAC less actuarial funding (for which credit cannot be taken on an IFRS basis).
(v) With-profits fund resources are calculated on a realistic basis under IFRS and a regulatory basis under the IGCA.
(vi) Long-term fund surplus capital over and above capital requirements is excluded from capital resources on an IGCA basis.
(vii) Includes £700 million of debt issued by FPH to Resolution Holdings (Guernsey) Limited, which is included as capital for IGCA purposes.
(viii) Valuation differences between local basis used in the capital statement and valuation rules applied in IGCA, including £198 million of assets in excess of counterparty limits.
(ix) FPH is the top EEA company in the Group.

29. Capital continued

31 December 2009(i)	Capital resources £m	Capital requirements £m	Surplus £m
IFRS			
Equity attributable to equity holders of the parent	3,655	–	3,655
Entity resources excluded from capital statement(ii)	(609)	–	(609)
Internal STICS and preference shares(iii)	811	–	811
Subordinated debt(iv)	11	–	11
Unallocated surplus	273	–	273
Regulatory prudence: inadmissible assets and valuation differences(v)	(2,209)	–	(2,209)
Life and pensions capital requirements	–	681	(681)
Life and pensions capital statement	1,932	681	1,251
With-profits fund resources calculated on a regulatory basis(vi)	1,136	818	318
Long-term fund surplus(vii)	(436)	–	(436)
Internal STICS and preference shares	(811)	–	(811)
External STICS	488	–	488
External subordinated debt	162	–	162
Entities excluded from capital statement(ii)	53	16	37
Other(viii)	12	(2)	14
Estimated FPH IGCA surplus(ix)	2,536	1,513	1,023

(i) The 2009 reconciliation has been expanded to provide a clearer presentation consistent with 2010.
(ii) FPH corporate centre, IFA distribution businesses and Resolution holding companies.
(iii) Proceeds of the £300 million 2003 STICS and £500 million 2005 STICS were injected into the Friends Life group and have not been restructured following the restructure of external STICS in 2009.
(iv) Lombard subordinated debt (£5 million relates to internal capital with FPH holding companies).
(v) Largely goodwill, intangible assets and DAC less actuarial funding (for which credit cannot be taken on an IFRS basis).
(vi) With-profits fund resources are calculated on a realistic basis under IFRS and a regulatory basis under the IGCA.
(vii) Long-term fund surplus capital over and above capital requirements is excluded from capital resources on an IGCA basis.
(viii) Valuation differences between local basis used in the capital statement and valuation rules applied in IGCA.
(ix) FPH is the top EEA company in the Group.

29. Capital continued

b) Capital statement

The capital statement in respect of the Group's life and pensions business is set out below. This statement shows an analysis of the available capital resources calculated on a realistic basis for the FPLP, FLC and FLAS with-profits funds and calculated on a regulatory basis for all other funds. It also shows the regulatory capital requirements and, in total, the overall surplus capital over regulatory requirements. In addition, the statement provides an analysis of policyholders' liabilities.

At 31 December 2010	Total UK with-profits funds[ii] £m	UK non-participating funds £m	Overseas life and pensions funds £m	Life and pensions shareholders' funds £m	Total life and pensions business £m
Equity holders' funds[i]					
Outside long-term fund	–	–	–	2,177	2,177
Inside long-term fund	–	2,173	158	–	2,331
	–	2,173	158	2,177	4,508
Other qualifying capital					
Subordinated debt	–	–	7	–	7
Preference shares	–	–	–	300	300
Unallocated surplus	1,098	–	–	–	1,098
	1,098	2,173	165	2,477	5,913
Regulatory adjustments					
Assets	(520)	(2,144)	(802)	(211)	(3,677)
Liabilities	508	560	759	–	1,827
Shareholders' share of future bonuses	(488)	–	–	–	(488)
Available capital resources	598	589	122	2,266	3,575
Capital requirement					
UK realistic basis	372	–	–	–	372
Other regulatory bases	24	760	84	–	868
	396	760	84	–	1,240
Overall surplus capital over regulatory requirements					2,335
Analysis of policyholders' liabilities					
With-profits	20,312	–	–	–	20,312
Unit-linked	25	48,877	23,286	–	72,188
Non-participating	6,156	8,762	74	–	14,992
Total	26,493	57,639	23,360	–	107,492

(i) AXA UK Life business shareholder equity is based on the UK GAAP accounting basis. All other businesses are based on IFRS.
(ii) UK with-profits funds are analysed in the following table.

29. Capital continued

UK with-profits funds

At 31 December 2010	FPLP £m	FPLA £m	FLC NWPF £m	FLC OWPF £m	FLAS £m	Total £m
Equity holders' funds						
Outside long-term fund	–	–	–	–	–	–
Inside long-term fund	–	–	–	–	–	–
	–	–	–	–	–	–
Other qualifying capital						
Subordinated debt	–	–	–	–	–	–
Preference shares	–	–	–	–	–	–
Unallocated surplus	216	74	454	126	228	1,098
	216	74	454	126	228	1,098
Regulatory adjustments						
Assets	(3)	–	(161)	(22)	(334)	(520)
Liabilities	3	–	159	9	337	508
Shareholders' share of future bonuses	(70)	–	(160)	(27)	(231)	(488)
Available capital resources	146	74	292	86	–	598
Capital requirement						
UK realistic basis	146	–	180	46	–	372
Other regulatory bases	–	24	–	–	–	24
	146	24	180	46	–	396
Overall surplus capital over regulatory requirements						202
Analysis of policyholders' liabilities						
With-profits	9,147	176	5,049	1,239	4,701	20,312
Unit-linked	–	–	–	–	25	25
Non-participating	2,318	54	528	77	3,179	6,156
Total	11,465	230	5,577	1,316	7,905	26,493

29. Capital continued

At 31 December 2009	FPLP £m	FPLA £m	UK non-participating funds £m	Overseas life and pensions funds £m	Life and pensions shareholders' funds £m	Total life and pensions business £m
Equity holders' funds						
Outside long-term fund	–	–	–	–	877	877
Inside long-term fund	–	–	994	125	–	1,119
	–	–	994	125	877	1,996
Other qualifying capital						
Subordinated debt	–	–	–	11	–	11
Preference shares	–	–	–	–	300	300
Unallocated surplus	199	74	–	–	–	273
	199	74	994	136	1,177	2,580
Regulatory adjustments						
Assets	–	–	(497)	(732)	(13)	(1,242)
Liabilities	–	–	(16)	675	(23)	636
Shareholders' share of future bonuses	(42)	–	–	–	–	(42)
Available capital resources	157	74	481	79	1,141	1,932
Capital requirement						
UK realistic basis	157	–	–	–	–	157
Other regulatory bases	–	32	417	75	–	524
	157	32	417	75	–	681
Overall surplus capital over regulatory requirements						1,251
Analysis of policyholders' liabilities						
With-profits	9,139	181	–	–	–	9,320
Unit-linked	–	–	17,606	19,689	–	37,295
Non-participating	2,289	48	3,645	5	–	5,987
Total	11,428	229	21,251	19,694	–	52,602

i) Summary

The total available capital resources of the Group's life and pensions business amounts to £3,575 million (2009: £1,932 million) and its regulatory capital requirements amount to £1,240 million (2009: £681 million) resulting in a surplus of available capital resources over regulatory capital of £2,335 million (2009: £1,251 million).

Set out below are details of how the available capital resources have been calculated, the restrictions that are in existence over the available capital resources, the basis of calculating the regulatory capital requirements and an explanation for the change in the available capital.

ii) Basis of calculating available capital resources in life and pensions business

Capital resources available to meet UK regulatory capital requirements are calculated using FSA valuation rules. Those in respect of overseas businesses are calculated according to local regulatory requirements.

In terms of UK with-profits funds, in the case of FPLP, FLC and FLAS, available capital has been calculated on the basis of the FSA realistic balance sheet regulations, with the smaller closed with-profits fund of FPLA being calculated using the FSA regulatory basis. The majority of the Group's life and pensions options and guarantees are within the with-profits funds and details are set out in note 28; typically these are valued on a market-consistent stochastic basis. In accordance with FRS 27, the realistic liabilities only represent amounts due to policyholders and do not include the shareholders' share of future bonuses. However, the shareholders' share is treated as a deduction from capital that is available to meet regulatory requirements and shown as a separate adjustment in the capital statement.

29. Capital continued

A number of adjustments are made to reconcile the assets and liabilities on an accounting basis to the available capital on a regulatory basis. These include adjustments to remove intangible assets, and the associated deferred tax liability, together with a number of liability differences such as the allowance for deferred front-end fees.

iii) Restrictions on available capital resources in life and pensions business

The available capital is subject to certain restrictions as to its availability to meet capital requirements elsewhere in the Group. The UK with-profits funds of the following companies are subject to certain additional constraints:

- FPLP: Shareholders are entitled to one-ninth of the amount distributed to conventional with-profits policyholders in the form of bonuses. In addition, shareholders are entitled to 60% of the surplus arising in respect of the pre demutualisation non-profit and unitised business written in the fund (excluding the investment element). In addition, post demutualisation policyholders are only entitled to surplus from the return on their investments; other sources of surplus are wholly-owned by shareholders, including policies written by FPLA and FPP, where the investment element is reinsured to the FPLP with-profits fund.
- FPLA: The surplus in the closed with-profits fund may only be distributed to policyholders.
- FLC and FLAS: Shareholders are entitled to one-ninth of the amount distributed to policyholders in the form of bonuses.

For non-participating business, surplus can generally be distributed to shareholders subject to meeting regulatory requirements and other capital management objectives of the business and subject to restrictions set out in the Scheme governing the FLC Inherited Estate (refer to section c below).

iv) Intra-group capital arrangements

The FPLP non-profit fund provided a contingent loan of £62 million (2009: £62 million) inclusive of accrued interest (with a facility for a further £38 million (2009: £38 million)) to the FPLP with-profits fund which is repayable out of future surpluses in the with-profits fund, subject to certain restrictions.

There is a financing arrangement in the form of reinsurance of certain business written by FLAS which was transferred into FLC from Friends SLPM Limited ("FSLPM") through a Part VII Scheme in 2007. The net amount of financing outstanding at December 2010 was £61 million.

In December 2007, FLC issued £300 million of contingent loan notes to FASLH. Repayment is contingent on surplus arising on the business transferred in to FLC from Friends SLUA Limited, FSLPM and PPPLC. FLC repaid £119 million of capital during the year leaving a remaining loan balance of £87 million at 31 December 2010.

It remains the intention of management to ensure that there is adequate capital to cover regulatory requirements of the Group's life and pensions businesses, to meet any net new business strain and to support the Group's overall credit ratings. FPLP has guaranteed the STICS originally issued by FPG but now transferred to FPH. FPLP has also guaranteed the £162 million subordinated debt issued by FPG in May 2009 but now transferred to FPH.

FLC with-profits support is discussed in detail in section c below.

v) Basis of calculating capital requirements for life and pensions business

For UK companies, regulatory capital requirements are calculated using FSA valuation rules. Those in respect of overseas businesses are calculated according to local regulatory requirements.

For the UK with-profits funds, in the case of FPLP, FLC and FLAS, capital requirements are calculated on the basis of the FSA realistic balance sheet regulations, also known as the "twin peaks test". The WPICC which adjusts the regulatory peak surplus to the realistic peak surplus, is then reduced by the value of future transfers to shareholders. These are liabilities of the with-profits fund in the realistic peak, but are not admissible assets of the shareholder funds to which they are payable.

The capital requirements of the smaller closed with-profits fund of FPLA are calculated using the FSA regulatory basis.

29. Capital continued

FPLP

	Realistic 2010 £m		Regulatory 2010 £m
Available capital	**146**	Surplus	**1,601**
Risk capital margin	**(146)**	Long-term insurance capital requirements	**(350)**
Realistic peak	**–**	Regulatory peak surplus	**1,251**
		With-profits insurance capital component	**(934)**
		Regulatory excess capital[i]	**317**

	Realistic 2009 £m		Regulatory 2009 £m
Available capital	157	Surplus	1,293
Risk capital margin	(157)	Long-term insurance capital requirements	(362)
Realistic peak	–	Regulatory peak surplus	931
		With-profits insurance capital component	(613)
		Regulatory excess capital[i]	318

FLC New With-Profits Fund

	Realistic 2010 £m		Regulatory 2010 £m
Available capital	**292**	Surplus	**1,299**
Risk capital margin	**(180)**	Long-term insurance capital requirements	**(187)**
Realistic peak	**112**	Regulatory peak surplus	**1,112**
		With-profits insurance capital component	**(934)**
		Regulatory excess capital	**178**

FLC Old With-Profits Fund

	Realistic 2010 £m		Regulatory 2010 £m
Available capital	**86**	Surplus	**367**
Risk capital margin	**(46)**	Long-term insurance capital requirements	**(42)**
Realistic peak	**40**	Regulatory peak surplus	**325**
		With-profits insurance capital component	**(275)**
		Regulatory excess capital	**50**

FLAS With-Profits Fund

	Realistic 2010 £m		Regulatory 2010 £m
Available capital	**–**	Surplus	**1,218**
Risk capital margin	**–**	Long-term insurance capital requirements	**(339)**
Realistic peak	**–**	Regulatory peak surplus	**879**
		With-profits insurance capital component	**(747)**
		Regulatory excess capital[i]	**132**

(i) Represented by value of future internal transfers.

29. Capital continued

vi) Movement in available capital

At 31 December 2010, total available life and pensions capital resources had increased during the period by £1,643 million to £3,575 million, as shown below.

	Total with-profits funds £m	UK non-participating funds £m	Overseas life and pensions funds £m	Life and pensions shareholders' funds £m	Total life and pensions business £m
At 1 January 2010	231	481	79	1,141	1,932
Acquired through business combinations	550	1,134	–	424	2,108
New business strain	–	(152)	(86)	–	(238)
Surplus in the period(i)	(133)	317	129	50	363
Transfers	(50)	(1,191)	–	1,151	(90)
Dividend and STICS interest	–	–	–	(500)	(500)
At 31 December 2010	598	589	122	2,266	3,575

Analysis of with-profits funds

	FPLP £m	FPLA £m	FLC NWPF £m	FLC OWPF £m	FLAS £m	Total with-profits funds £m
At 1 January 2010	157	74	–	–	–	231
Acquired through business combinations	–	–	277	273	–	550
New business strain	–	–	–	–	–	–
Surplus in the period(i)	17	–	17	(170)	3	(133)
Transfers	(28)	–	(2)	(17)	(3)	(50)
At 31 December 2010	146	74	292	86	–	598

	UK with-profits (FPLP) £m	UK with-profits (FPLA) £m	UK non-participating funds £m	Overseas life and pensions funds £m	Life and pensions share holders' funds £m	Total life and pensions business £m
At 1 January 2009	–	–	–	–	–	–
Acquired through business combinations	157	62	737	75	942	1,973
New business strain	–	–	(27)	13	–	(14)
Surplus in the period(i)	8	12	(18)	(9)	5	(2)
Transfers	(8)	–	(211)	–	219	–
Dividend and STICS interest	–	–	–	–	(7)	(7)
Acquisitions	–	–	–	–	(18)	(18)
At 31 December 2009	157	74	481	79	1,141	1,932

(i) All tax items are included within surplus in the period.

c) The Friends Life Company inherited estate

The acquired AXA UK Life Business included a RIE which was transferred to the FLC non-profit funds ("NPFs") as part of the re-attribution of the Friends AELLAS Limited ("FAELLAS") inherited estate. The re-attribution was implemented as part of an intra group Part VII scheme (the "Scheme") transferring business into FLC. The Scheme took effect on 1 April 2001 and was amended as part of a subsequent transfer of mainly unit-linked business into FLC on 1 January 2007 (the "2006 Scheme").

With-profits policies which had been elected to take part in the re-attribution were transferred to the FLC New WPF. With-profits policies which were not so elected were transferred to the FLC Old WPF with a proportionate share of the FAELLAS inherited estate.

29. Capital continued

Transfers out of the FLC inherited estate

There are conditions applicable to future transfers to shareholders from the RIE in the FLC NPFs. The amount of, and conditions permitting, transfers from the NPFs to shareholders' funds are set out in the Scheme, as altered by the 2006 Scheme to exclude surplus on business transferred into the NPFs by the 2006 scheme. Similarly, there are conditions applicable to the use of the inherited estate within the Old WPFs to declare special bonuses on Old WPFs with-profits policies.

Transfers of the RIE to the FLC shareholders' fund can only take place following the completion of stochastic modelling of FLC and the application of certain other tests in relation to the financial strength of FLC. No such transfer can be made without the approval of the FLC board and until 30 days after the FSA has been notified of the proposed transfer. These tests must be undertaken every five years and the latest tests were undertaken based on the company's financial position as at 31 December 2010.

The results of the testing are highly dependent on a number of factors including:

- the size of the RIE relative to the size of the FLC New WPF;
- the financial strength of FLC; and
- the volume of new with-profits business expected to be written by FLC in the future.

The results of the release testing required to be undertaken in relation to the RIE will determine the maximum amounts which can be paid as special bonuses in the Old WPF or transferred to the FLC shareholders' fund from the FLC NPFs. The extent to which any RIE transferred to the FLC shareholders' fund can then be dividended out of that company will be dependent on the need to retain sufficient capital within FLC to ensure it can meet its target capital ratios on a Pillar 1 and Pillar 2 basis and can finance future new business as required.

Distribution of the FLC re-attributed inherited estate

As at 31 December 2010, the FLC RIE was £2,437 million increased from an estimated £2,200 million at 31 December 2009.

The Scheme rules governing the operation of FLC require that a test be undertaken every five years to determine whether it is possible to transfer any of the RIE from the FLC NPFs to the FLC shareholders' fund or to distribute any of the inherited estate retained in the Old WPF in the form of Special Bonuses (and associated transfer to the shareholders' fund). The latest five yearly test was undertaken as at 31 December 2010.

The results of the testing showed that just under £2.0 billion of the RIE could be available to transfer to the FLC shareholders' fund in the five year period commencing 31 December 2010. However such transfers are subject to FLC being able to continue to satisfy certain tests of financial strength after any such transfer. This has restricted the amount available to be transferred to the FLC shareholders' fund at the end of 2010. Following the results of the five year testing, the FLC board determined that as at 31 December 2010 it should make:

(a) a transfer of £1,010 million of RIE from the NPFs to the shareholders' fund; and

(b) a distribution of £157 million of the inherited estate in the Old WPF, which will be split 90% to with-profits policies allocated to or reinsured to the Old WPF in the form of a Special Bonus and 10% to the FLC shareholders' fund.

The transfer of RIE to the FLC shareholders' fund is an after tax amount, and consists of £843 million of cash and £167 million of receivables which would otherwise have had to be repaid by holding companies. Of the cash component of the RIE transferred to the FLC shareholders' fund, it is necessary to retain approximately £400 million within the company in order to support the capital requirements of the FLC NPFs and to support the New WPF and the Old WPF in accordance with the Scheme. Following completion of the 2010 year end valuation, FLC has declared a dividend of £390 million to its parent company, FPLP, consisting of £300 million of the cash transferred from the RIE, the £16 million shareholders' share of the Special Bonus declared in the Old WPF, and £74 million derived from business as usual activities.

The remaining RIE in the FLC NPFs is predominantly in the form of the VIF of non-profits business written within those funds. To the extent that this VIF emerges into cash during the five year period commencing 31 December 2010, the cash may be available to be transferred to the FLC shareholders' fund subject to passing the relevant financial strength tests (including those specified in the Scheme), providing 30 days' notification of such transfers to the FSA, and subject to an overall cap on such further transfers, and associated tax cost, of £928 million prior to the next five year testing as at 31 December 2015.

29. Capital continued

Support arrangements for FLC With-Profits Funds

The Scheme requires that to the extent that the RIE is required to be retained in the FLC NPFs, it should be available to provide financial support, by way of a temporary or permanent transfer into the relevant with-profits fund, for both the New WPF (into which the policies of those who accepted the reattribution proposals were transferred) and the Old WPF.

In the case of a temporary transfer, the transferred assets and the investment return earned on them remain attributable to the shareholder as they will be transferred to the FLC NPFs when the amount of temporary transfer is no longer required to support the capital requirements of the relevant with-profits funds, and is returned to the NPFs in accordance with the Scheme. If all or part of the assets transferred into a with-profits fund under the support arrangements set out in the Scheme are believed to be unlikely to be returned in the foreseeable future (taking into consideration the duration of the in force with-profits policies), then the relevant part of the transfer would be designated permanent, resulting in a loss of value from the NPFs. As at 31 December 2010, there were no outstanding amounts which had been transferred to either the New WPF or the Old WPF. Under the rules of the Scheme a test ("the Test") must be performed at least once in a 12 month period and may result in a transfer being made to either the New WPF or the Old WPF. The next Test will be carried out as at 1 January 2011 and is not expected to result in a transfer being required to either the New WPF or the Old WPF.

The results of the 31 December 2010 five year testing required that part of the RIE be retained in the FLC NPFs until the next five year testing takes place as at 31 December 2015. However, following the transfer of RIE to the FLC shareholders' fund, the majority of the remaining RIE in the FLC NPFs will be in the form of the value of in-force business rather than tangible net assets. As tangible assets are required to provide financial support to the with-profit funds in accordance with the Scheme, FLC will retain some of the RIE transferred to the FLC shareholders' fund within the shareholders' funds to provide such support until such time as the RIE required to be retained in the NPFs until 2015 is in the form of tangible assets which can provide support to the New WPF and the Old WPF in accordance with the Scheme.

30. Risk management objectives and policies for mitigating risks

Overview

The Group, in the course of doing business, is exposed to the following categories of risk:

- financial risk including market risk, credit risk, insurance risk and liquidity risk;
- strategic risks including risks arising from the Group's business model and including risks associated with mergers and acquisitions and the Group's capital structure; and
- operational risks arising from inadequate or failed internal processes, or from people, systems or external events. Operational risks include regulatory, financial crime, people, legal, information technology and business protection risks.

This note presents information about the Group's exposure to each of the above risks and the Group's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board has overall responsibility for the Group's risk management framework and for setting its risk appetite and risk policies. To support it in this role, a governance framework is in place comprising formal committees and risk functions that oversee implementation of the risk management policies and co-ordinate the risk assessment and reporting processes.

The Board has defined its approach to risk management through the establishment of a Group Risk Policy. Similarly it has articulated its risk appetite through a series of appetite statements. Taken together the Policy and the appetite statements outline the Group's risk management standards and principles to be applied within its subsidiary businesses. Subsidiary boards are required to establish and maintain appropriately robust risk management policies, processes and procedures that are aligned to these principles and to adopt risk appetite statements and risk limits consistent with the Board's risk appetite. These appetites and limits and policies, processes and procedures will cover financial, strategic and operational risks.

The Audit and Risk Committee as a board committee is charged with assisting the Board in:

- making decisions on the Group's risk appetite;
- reviewing the Group's risk management systems to assess the effectiveness of those systems (this includes at least annual reviews of Group Policies to ensure they remain relevant to the changing demands of the business and regulatory environment); and
- overseeing the monitoring and control of risks relative to the Group's risk appetite.

30. Risk management objectives and policies for mitigating risks continued

ROL, subject to the oversight of the Board, is responsible for recommending appropriate risk appetite statements to the Audit and Risk Committee, updating the Group's Risk Policy, maintaining the Group's overall risk management framework and production of risk reports and other such reports as required.

In the oversight of the Friends Life group, the Audit and Risk Committee places significant reliance on the board and committees of FPH. FPH is the immediate parent company for all the businesses acquired as part of the Group's UK Life Project. It has itself established a BRCC to oversee the Friends Life group's risk framework and its risk management policies, and to endorse the risk frameworks of the operating business units, including coverage of local statutory obligations; it receives quarterly reports summarising Friends Life group's key risks and the actions in place to control them. The BRCC also provides oversight to the activities of the Financial Risk Committee ("FRC") and the Operational Risk Committee ("ORC").

The FRC and ORC are composed of executive directors and other relevant senior managers of the Friends Life group. The FRC oversees the management of financial risks of the Friends Life group including the recommendation of strategies for managing financial risks to the business, while ORC oversees the management of operational risks. FPIL, Lombard and Sesame Bankhall have risk committees comprising executive directors and other relevant senior managers that oversee their risk management processes for all risks and report into their respective boards as well as reporting into the FRC and ORC as appropriate.

The AC oversees the effectiveness of the implementation of the Friends Life group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the group. The AC is supported in its oversight role by Group Internal Audit, which undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the AC. FPIL and Sesame Bankhall have their own audit committees and Lombard has an audit and risk committee. The audit responsibilities of these committees are overseen by the AC.

a) Quantitative risk exposure

The Group's quantitative exposure to a range of financial, insurance and other risks is illustrated in the MCEV sensitivity analysis opposite, where the impacts of reasonably possible changes in risk variables are disclosed. The basis of preparation and limitations of the MCEV methodology are provided in the MCEV supplementary information.

Life and pensions

The table below shows the sensitivity of the embedded value for covered business and the contribution from new business to changes in assumptions at year end 2010, split by UK and International. The sensitivities shown reflect movements in life and pensions MCEV only.

For each sensitivity other future experience assumptions remain unchanged, except where changes in economic conditions directly affect them. The assumptions underlying the statutory reserving calculations remain unchanged in all sensitivities.

Sensitivities shown in a single direction have broadly symmetrical impacts.

30. Risk management objectives and policies for mitigating risks continued

2010 Sensitivities	Change in MCEV (net of tax) UK & Corporate £m	Change in MCEV (net of tax) Lombard & Int £m	Change in MCEV (net of tax) Total £m	Change in VNB (gross of tax) UK £m	Change in VNB (gross of tax) Lombard & Int £m	Change in VNB (gross of tax) Total £m
Base MCEV and VNB (per note 11 of the supplementary information)	5,336	1,134	6,470	19	126	145
Market and credit risk						
100bps increase in reference rates	(115)	(13)	(128)	(7)	2	(5)
100bps reduction in reference rates	122	5	127	2	(3)	(1)
Removal of illiquidity premium for immediate annuities	(425)	–	(425)	(20)	–	(20)
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield(i)	(192)	(66)	(258)	n/a	n/a	n/a
25% increase in equity and property volatility	(22)	–	(22)	n/a	n/a	n/a
25% increase in swaption implied volatility	(4)	–	(4)	n/a	n/a	n/a
100bps increase in corporate bond spreads(ii)	(283)	(16)	(299)	(9)	–	(9)
100bps decrease in corporate bond spreads(ii)	298	16	314	8	–	8
10% reduction in Sterling/overseas exchange rate(iii)	(34)	(62)	(96)	n/a	n/a	n/a
Insurance and other risk						
Reduction to EU minimum capital or equivalent(iv)	79	3	82	3	–	3
10% reduction in maintenance expenses	162	31	193	8	6	14
10% reduction in lapses	85	57	142	7	9	16
10% reduction in paid-up rates	13	4	17	4	2	6
5% reduction in mortality and morbidity (excluding annuities):						
Before reinsurance	227	6	233	8	–	8
After reinsurance	62	2	64	2	–	2
5% reduction in annuitant mortality/morbidity:						
Before reinsurance	(6)	–	(6)	(2)	–	(2)
After reinsurance	(49)	–	(49)	(2)	–	(2)

(i) The movement in embedded value from a reduction in market values comprises a £3 million (2009: £3 million) fall in the value of shareholders' net worth and a £189 million (2009: £93 million) reduction in the value of in-force covered business.
(ii) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 30bps for in-force business and 40bps for the value of new business.
(iii) Currency risk is expressed in terms of total overseas exposure; the Group's principal currency exposures other than Sterling are the Euro and US Dollar.
(iv) Required capital is set at the greater of regulatory capital and requirements arising from internal capital management policies. In aggregate, the required capital is higher than the regulatory requirement by £1,093 million (2009: £350 million). This sensitivity shows the impact on embedded value and value of new business of using the lower regulatory capital requirement.

30. Risk management objectives and policies for mitigating risks continued

b) Market risk

Market risk is the risk of loss arising from a change in the values of, or the income from, assets or in interest or exchange rates. A risk of loss also arises from volatility in asset prices, interest rates or exchange rates. Market risk includes the following four elements:

- equity risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in equity prices or income;
- foreign exchange risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in exchange rates;
- interest rate risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in interest rates; and
- property risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in real estate values or income.

Market risk arises on guarantees and options offered on certain of the Group's products. As described within the section on policyholder liabilities (see note 28), the Group is exposed to guarantees on bonus additions that become more valuable as investment values fall and where the cost of hedging (measured by implied volatility) increases. In addition, the Group is exposed to guaranteed cash and annuity options on certain pension policies that become more valuable as interest rates fall and where the cost of hedging increases.

The Group manages market risk attaching to assets backing specific policyholder liabilities and to assets held to deliver income and gains for the shareholder. Within the unit-linked funds and with-profits funds, the Group manages market risk so as to provide a return in line with the expectations of policyholders. The principal objective for shareholder assets is to manage them so that they meet the capital requirements of the Group, and support its future strategic and operational objectives.

The FPH board sets appetite for market risk for each of the different asset classes taking account of the risk appetite set by the Resolution Board. Consideration is given to the objectives of the asset pools to which they relate and the nature of the liabilities backed by those assets. The FRC, in consultation with the management and the risk function of the Friends Life group and the BRCC, recommends appropriate risk appetite statements to the FPH board and reviews risk appetite on a regular basis.

For assets backing non-linked policyholder liabilities, market risk is managed by matching, where possible, the realistic duration and profile of assets to the policyholder liabilities they are backing. This helps manage market risk to the extent that changes in the values of assets are matched by a corresponding movement in the values of liabilities.

Shareholders' earnings are further exposed to market risk to the extent that the income from policyholder funds is based on the value of financial assets held within those unit-linked or with-profits funds.

The following summarises the key actions undertaken by the Group to manage market risk:

The FPH Investment Oversight Committee, which is a sub-committee of the FPH board oversees investment policy and strategy, which the Group controls primarily through the use of investment fund mandates. Day-to-day implementation of investment policy and strategy is managed predominantly by F&C in respect of Friends Provident and by AXA Investment Management UK Limited ("AXA IM") in respect of the AXA UK Life Business in line with these approved mandates.

Mandates are set for each fund within each of the insurance legal entities within the Group taking account of the relevant factors outlined above. Unit-linked funds are managed in line with their underlying objectives as set out in policy holder contracts. The mandates seek to limit exposure to market risk by using some or all of the following mechanisms:

- restrictions on the asset classes held;
- restrictions on the maximum exposure to any one issuer; and
- defined sector, country or regional limits.

F&C and AXA IM managed funds may hold equity derivatives to facilitate efficient portfolio management where their use is provided for in the relevant fund mandates. Currency forwards and other derivatives may also be held to manage currency risk, but only if permitted by individual fund mandates. The Group may seek to reduce investment risk by holding derivatives (without disproportionately increasing other types of risk).

Non-F&C and AXA IM managed unit-linked funds may use derivatives for the purposes of efficient portfolio management and risk reduction in accordance with policyholder contracts and marketing literature relevant to the funds.

30. Risk management objectives and policies for mitigating risks continued

In addition to the mandates, the Group undertakes a programme of asset/liability management. For example, in order to manage the impact of interest changes on profit, corporate bonds and gilts are held to match the duration, profile and cash flows of annuity and permanent health insurance policies.

In order to manage the exposure arising from guarantees and options, the Group has purchased a number of derivatives, including interest rate swaps, equity put options, currency forwards, inflation swaps, interest rate swaptions, and equity futures to manage exposures to movements in equity prices or interest rates. Hedge accounting has not been applied to these derivatives, as movements in the fair value of these instruments will be offset by the movement in the valuation of the liability. As noted, the majority of these guarantees arise within the Group's with-profits funds and so any net fair value movement will be reflected in the unallocated surplus rather than within shareholders' funds.

The following provides additional information on the exposure to equity and property risk, foreign exchange risk and interest rate risk:

i) Equity and property risk

Equity and property risk, as defined above, are accepted in accordance with agreed risk appetite in order to achieve the desired level of return from policyholder assets.

Asset allocation within the with-profits funds is actively managed. During 2010 steady improvement in the investment return of the FPLP with-profits fund has facilitated reductions in the few remaining MVRs. At 31 December 2009 the proportion of equities and property backing asset shares in the FPLP with-profits fund was close to 26%. Following credit derisking of the FPLP with-profits fund and market recovery the EBR has been increased and was 49% at 31 December 2010. These actions reflect work to define more clearly the risk appetite of the with-profits fund and are in line with the Group's commitment to fair treatment of all its customers and the published Principles and Practices of Financial Management underlying the fund. The proportion of equity and property backing asset shares in the AXA UK Life Business with-profits funds is managed on a basis which targets a stable proportion over time.

For with-profits and unit-linked policies, the policyholders bear the majority of the investment risk and any change in asset values is matched by a broadly equivalent change in the realistic liability. However, charges that are expressed as a percentage of fund values are impacted by movements in equity and property prices and therefore falling values still have an adverse effect on shareholders and in very adverse circumstances shareholders may be obliged to provide additional support to the with-profits funds. Throughout 2010 there has been no exposure to equity risk within the Friends Provident shareholders' funds. The AXA UK Life Business' funds are in principle exposed to equity risk, however hedges (using equity put options) have been put in place to protect shareholder value.

The management of equity investments for the Friends Provident and AXA UK Life Business in the UK is largely undertaken by F&C and AXA IM respectively. The interaction between the Group and F&C and AXA IM is governed by investment management agreements, service level agreements and investment mandates. In their decision making on equity investments, F&C and AXA IM will assess the extent of equity risk required or allowed by the fund as set out in the fund objectives and relative to defined performance benchmarks. The management of equity investments by non-F&C and AXA IM fund managers will be performed in accordance with the objectives of the fund as set out in policy contracts and marketing literature.

ii) Foreign exchange risk

The Group is exposed to foreign exchange risk through its investment in foreign operations, fee income derived from financial instruments denominated in currencies other than its measurement currency (pounds Sterling), and revenues receivable in foreign currency. The net exposure to foreign exchange risk through investment in overseas equities is currently small, and exposure through debt securities is limited due to restrictions through limits placed by investment mandates. Consequently, the Group is exposed to the risk that the exchange rate of its measurement currency relative to other currencies may change in a manner that has an adverse effect on the value of the Group's financial assets and liabilities. This risk is accepted, in accordance with the agreed risk appetite, as being consequential upon the Group following its agreed investment strategy.

For unit-linked contracts and with-profits policies (to the extent that currency risk on overseas equities held by the with-profits funds are only partially hedged), currency risk is borne by the policyholder. As noted above, the shareholders are subject to currency risk only to the extent that income from policyholder funds is based on the value of the financial assets held in those funds. The liability for non-linked insurance contracts in currencies other than Sterling is immaterial.

30. Risk management objectives and policies for mitigating risks continued

iii) Interest rate risk

The Group is exposed to fair value interest rate risk where changes to interest rates result in changes to fair values rather than cash flows, for example fixed interest rate loans and assets. Conversely, floating rate loans expose the Group to cash flow interest rate risk. The Group makes use of derivatives to manage interest rate risk. In the case of swaps the Group holds both:

- receiver interest rate swaps (where fixed payments are received in return for floating payments being paid) – increases to interest rates increase cash flows payable and reduce fair value; and
- payer interest rate swaps (where floating payments are received in return for fixed payments being paid) – reductions to interest rates reduce cash flows receivable and reduce fair value.

However, both types of swaps are held in order to reduce the net asset-liability rate risk which would otherwise arise.

Bond-related performance benchmarks within fund mandates are generally set so that asset profiles broadly match liability profiles and hence the interest rate risk is minimised. However in FAL assets have been invested deliberately in bonds with a shorter duration than the company's liabilities. An interest rate swap has then been put in place to reduce the reinvestment risk which would otherwise arise.

Day-to-day investment decisions around the management of interest rate risk and its impact on the value of FPLP's investments are largely undertaken on behalf of FPLP by F&C, within the boundaries set by fund mandates. In its decision making on gilt and corporate bond investments, F&C will assess the extent of interest rate risk allowed by the fund as set out in the fund objectives and relative to the defined performance benchmarks.

Management of interest rate risk for the investments managed by AXA IM is largely undertaken by the Asset and Liability Management ("ALM") function.

The ALM function is responsible for monitoring and managing net asset-liability interest rate risk across all of the Friends Life group's businesses.

The Group may also be exposed to interest rate risk on its strategic investments, and on any debt issuance. As part of any proposal for strategic investment or debt capital raising, the interest rate risk to which the Group is exposed will be given careful consideration as one of the factors impacting on the final recommendation. Ultimate approval for any strategic investments or debt raising rests with the Board.

c) Credit risk

Credit risk includes the following seven elements:

- investment credit risk – financial loss arising from a change in the value of an investment due to a rating downgrade, default, or widening of credit spread. Changes in credit spreads are also affected by the liquidity of the stock and market expectations in respect of whether any option embedded within it will be exercised, but since the liquidity and effects related to embedded options are usually closely related to credit risk, these risks are managed as credit risk;
- derivative counterparty risk – financial loss arising from a derivative counterparty's default, or the deterioration of the derivative counterparty's financial position;
- reinsurance counterparty risk – financial loss arising from a reinsurer's default, or the deterioration of the reinsurer's financial position;
- deposit risk – financial loss arising from a deposit institution's default, or the deterioration of the deposit institution's financial position;
- loan risk – financial loss arising from a debtor's inability to repay all, or part, of its loan obligations or the deterioration of the debtor's financial position;
- country risk – financial loss arising from economic agents in a sovereign foreign country, including its government, being unable or unwilling to fulfil their international obligations due to a shortage of foreign exchange or another common reason such as currency inconvertibility; and
- settlement risk – financial loss arising from the failure or substantial delay of an expected settlement in a transfer system to take place, due to a party other than the Group defaulting/not delivering on its settlement obligations.

The life and pensions business will take on investment credit risk and loan risk when it is deemed financially beneficial to do so in support of financial objectives.

The Group is exposed to investment credit risk on its investment portfolio, primarily from investments in corporate bonds and from holdings of credit default swaps within the AXA UK Life Business. Creditworthiness assessment for new and existing investments is largely undertaken on behalf of the Group by F&C and AXA IM. In their decision-making, F&C or AXA IM (as appropriate) will assess the extent of investment credit risk allowed by each fund as set out in the fund mandates and relative to defined performance benchmarks.

30. Risk management objectives and policies for mitigating risks continued

The majority of the Group's corporate bond portfolio is highly rated (see table on page 166).

Derivatives purchased over the counter have the potential to expose the Group to substantial credit risk but this risk is significantly reduced through collateral arrangements with counterparties. The ALM function is responsible for recommending derivative strategies to the FPH board, and assisting other finance teams to put in place the appropriate internal management processes. The Group endeavours only to transact over the counter derivatives with highly rated counterparties.

The Group is exposed to reinsurance counterparty risk of three different types:

- as a result of debts arising from claims made but not yet paid by the reinsurer;
- from reinsurance premium payments made to the reinsurer in advance; and
- as a result of reserves held by the reinsurer which would have to be met by the Group in the event of default.

In addition, there is potential for the Group's credit risk exposure to increase significantly under adverse insurance risk events, e.g. if one of the insurance companies within the Group received a large number of claims for which it needed to recover amounts from its reinsurers. In order to mitigate reinsurance counterparty risk, the Group gives consideration to the credit quality of a reinsurer before incepting a reinsurance treaty. To facilitate this process, a list of acceptable reinsurers is maintained.

The Group is exposed to credit risk on the balances deposited with banks in the form of cash, certificates of deposit and money market instruments. Money market instruments issued by parties other than banks such as commercial paper are also covered under this heading. The primary risk is borrower quality; this is mitigated by limiting the holding in any one issuer.

In certain, limited circumstances, Lombard is exposed to deposit risk:

- of custodian banks relating to unit-linked policyholder cash positions; and
- for cash amounts held on behalf of unit-linked policyholders for premium proceeds with respect to policies not yet issued, and withdrawal/surrenders/death claim proceeds not yet paid to beneficiaries.

Insurance companies in the Group are exposed to loan risk in several different areas, the most material of which are:

- loans to IFAs as part of strategic investments;
- other strategic loans;
- loans to appointed representatives;
- loans to brokers;
- agency debt (including debt arising as a result of clawback of commission);
- policyholder debt; and
- rental income due.

In general, these quantitative credit exposures are relatively low but they can bear relatively high likelihoods of default.

The Group is exposed to country risk in a number of key areas, the most significant of which is bonds issued by foreign governments in non-domestic currency. The mandates that govern all F&C and AXA IM managed funds restrict the purchase of foreign government bonds to only those that exceed a minimum level of creditworthiness.

The management of country risk on the creditworthiness of the investments is largely undertaken on behalf of the Group by F&C and AXA IM.

Settlement risk is a form of credit risk that arises at the settlement of a transaction, as a result of a counterparty failing to perform its obligations. The Group is exposed to settlement risk in the following key areas:

- bank transfers, including foreign exchange transactions;
- the purchase or sale of investments;
- the purchase or sale of property;
- the purchase, sale or expiry of exchange-traded derivatives or the transfer of periodic payments under these contracts; and
- the settlement of derivative contracts.

30. Risk management objectives and policies for mitigating risks continued

Objectives in managing credit risk

To mitigate credit risk:

- investment mandates for many funds will have a prescribed minimum credit rating of bonds that may be held and will generally prohibit investment in bonds of below specified minimum ratings subject to some discretion where assets are downgraded. Investing in a diverse portfolio reduces the impact from individual companies defaulting;
- counterparty limits are set for investments, cash deposits, foreign exchange trade exposure and stock lending;
- all over the counter derivative transactions are covered by collateral, with minor exceptions;
- the Group regularly reviews the financial security of its reinsurers; and
- in some cases, derivatives are held to protect against the risk of credit default.

The exposure to individual counterparties is limited to specific percentages of total non-linked assets in the long-term fund, based on regulatory categorisation of counterparties.

Concentrations of credit risk might exist where the Group has significant exposure to a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions.

Lombard deposits cash amounts with custodian banks. The deposit risk is managed by diversification across a number of custodian banks, holdings via diversified monetary collective funds, longer term balances being held in highly-rated and/or state-backed custodian banks and via in some cases clients acceptance of the risk in general policy conditions.

An indication of the Group's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The Group is most exposed to credit risk on debt and other fixed-income securities, derivative financial instruments, deposits with credit institutions, reinsurance arrangements and cash and cash equivalents. Debt and other fixed-income securities mainly comprise government bonds and corporate bonds. Given the nature of the Group's investments in government bonds the credit risk associated with these is considered small and the Group therefore focuses on monitoring the quality of its corporate bonds.

The following table gives an indication of the level of creditworthiness of those categories of assets which are neither past due nor impaired and are most exposed to credit risk using principally ratings prescribed by Standard & Poor's and Moody's. Assets held within unit-linked funds have been excluded from the tables below as the credit risk on these assets is borne by the policyholders rather than the shareholders. The carrying amount of assets included in the statement of financial position represents the maximum credit exposure.

At 31 December 2010	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Corporate bonds	2,876	3,196	4,147	2,645	315	57	269	13,505
Asset-backed securities	560	825	622	289	110	2	97	2,505
Derivative financial instruments	46	141	245	–	–	–	–	432
Reinsurance assets	–	2,349	287	–	–	–	1	2,637
Deposits with credit institutions	–	3	–	–	–	–	–	3
Cash and cash equivalents	2,004	988	1,225	36	–	–	6	4,259
Insurance and other receivables	–	–	–	–	–	–	976	976
Total	5,486	7,502	6,526	2,970	425	59	1,349	24,317
%	23%	31%	27%	12%	2%	0%	5%	100%

At 31 December 2009	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Corporate bonds	1,247	2,256	1,774	450	84	249	273	6,333
Asset-backed securities	501	254	198	85	6	42	81	1,167
Derivative financial instruments	–	(5)	178	–	–	–	–	173
Reinsurance assets	–	1,972	–	–	–	–	–	1,972
Deposits with credit institutions	4	13	9	–	–	–	–	26
Cash and cash equivalents	1,132	49	541	–	–	–	70	1,792
Insurance and other receivables	–	–	–	–	–	–	443	443
Total	2,884	4,539	2,700	535	90	291	867	11,906
%	24%	38%	23%	5%	1%	2%	7%	100%

30. Risk management objectives and policies for mitigating risks continued

The exposure of the Group to the debt of the governments and companies of Greece, Ireland, Italy, Portugal and Spain in shareholder and annuity funds is set out in the table below (to the nearest £million). The aggregate exposure to the more vulnerable economies of Ireland and Portugal is relatively immaterial and there is no exposure to Greece. Where the Group holds securities issued by financial companies, it has considered the company's financial strength and the ability of the domicile government to provide financial support in the event of stress.

	Govt. debt £m	Corporate debt £m	Total £m
Greece	–	–	–
Ireland	–	42	42
Portugal	–	14	14
Italy	7	221	228
Spain	–	128	128
Total	7	405	412

The following tables show the amounts of insurance receivables and loans that were impaired and the amounts of insurance receivables and loans that were not impaired but either past due or not at the end of the year. No other financial assets were either past due or impaired at the end of the year. However, some issuers of subordinated bonds in which the Group has holdings have suspended or announced that they intend to suspend the payment of coupons. Assets held in unit-linked funds have been excluded from the tables.

	2010		2009	
31 December 2010	**Insurance receivables**	**Loans**	Insurance receivables	Loans
Financial assets that are neither past due nor impaired	**93.34%**	**100%**	85.70%	100%
Financial assets that are past due:				
0 – 3 months past due	**0.53%**		6.40%	
3 – 6 months past due	**0.13%**		0.30%	
6 – 12 months past due	**0.13%**		0.30%	
Impaired financial assets for which provision is made	**5.87%**		7.30%	
Total before provision for impairment (£m)	**751**	**677**	342	80

For the majority of over the counter derivative transactions undertaken by the Group, collateral is received from the counterparty if the sum of all contracts held with the counterparty is in-the-money (i.e. it is being valued as an asset). The Group has a legal right to this collateral if the counterparty does not meet its obligations but has no economic benefit from holding the assets and the counterparty may substitute at any time the collateral delivered for another asset of the same value and quality. It is repayable if the contract terminates or the contract's fair value falls. Contractual agreements between the Group and each counterparty exist to protect the interests of each party, taking into consideration minimum threshold, asset class of collateral pledged and the frequency of valuation. At 31 December 2010, the fair value of such collateral held was £290 million (2009: £177 million). No collateral received from any counterparty has been sold or repledged.

Reinsurance assets include an amount of £1,666 million (2009: £1,715 million) which relates to a reinsurance agreement with Swiss Re, as set out in note 33. The asset is secured by a collateral arrangement with HSBC offering protection should any counterparty supporting the reinsurance agreement default. An Investment Management Agreement is in place between FPLP and Swiss Re to govern the suitability of collateral assets. As at 31 December 2010, the value of such collateral was £1,674 million (2009: £1,614 million).

The value of the reinsurance and underlying collateral are reviewed annually to ensure that the future payments received from the loan note continue to match the best estimate liability cash flows. The review process is ongoing but current expectation is that there will be no need for a payment by the reinsurer to increase the value of the loan note and collateral (2009: £40 million). Should a payment be necessary it is expected that this would take place in April 2011.

30. Risk management objectives and policies for mitigating risks continued

d) Liquidity risk

Liquidity risk is the risk that an entity, although solvent, either does not have sufficient financial resources available to it in order to meet its obligations when they fall due, or can secure them only at excessive cost.

The Group faces two key types of liquidity risk:

- shareholder liquidity risk (liquidity within funds managed for the benefit of shareholders, including shareholders' interests in long-term funds); and
- policyholder liquidity risk (liquidity within funds managed for the benefit of policyholders).

The overall objective of shareholder liquidity risk management is to ensure there are sufficient funds available to meet the cash flow needs of the business. The overall objective of policyholder liquidity risk management is to ensure that sufficient liquid funds are available to meet cash flow requirements under all but the most extreme scenarios (the exception being the property funds where a six-month notice period may be required for switches and withdrawals).

The Group will meet shareholder liquidity needs arising in a number of key areas. For example:

- the ability to support the liquidity requirements arising from new business;
- the capacity to maintain dividend payments/loan repayments and interest etc;
- the ability to deal with the liquidity implications of strategic initiatives, such as merger and acquisition activity;
- the capacity to provide financial support across the Group; and
- the ability to fund its day-to-day cash flow requirements.

The overall objective of shareholder liquidity risk management is to ensure that there is sufficient liquidity over short (up to one year) and medium time horizons to meet the needs of the business.

For policyholder funds, liquidity needs arise from a number of potential areas, including:

- a short-term mismatch between cash flows arising from assets and cash flow requirements of liabilities;
- having to realise assets to meet liabilities during stressed market conditions;
- investments in illiquid assets such as property and private placement debt;
- higher than expected levels of lapses/surrenders caused by economic shock, adverse reputational issues or other events;
- higher than expected payments of claims on insurance contracts; and
- the implementation of temporary restrictions for the withdrawal of funds, as recently applied by extending the notice periods of switches and withdrawals from property funds.

Exposure to policyholder liquidity risk can be split between non-linked and linked funds. As a general rule, the Group is more likely to be significantly impacted by policyholder liquidity risk on non-linked funds, as opposed to linked funds where policyholder benefits are expressed directly as units held in an underlying fund, though this may not always be the case.

The overall objective of policyholder liquidity risk management is to ensure that sufficient liquid funds are available to meet cash flow requirements under all but the most extreme scenarios.

Liquidity risk is managed in the following way:

- in connection with potential future acquisitions the Group may fund such transactions by the issuance of new shares, rights issues, debt funding, use of existing internal resources or a combination thereof;
- forecasts are prepared regularly to predict required liquidity levels over both the short and medium term;
- a credit facility with a syndicate of banks exists to enable cash to be raised in a relatively short time-span;
- credit risk of cash deposits is managed by applying counterparty limits and imposing restrictions over the credit ratings of third parties with whom cash is deposited;
- assets of a suitable maturity and marketability are held to meet policyholder liabilities as they fall due; and
- limits are set on the level of investment in securities that are not readily realisable. These are typically restricted to 5% of non-linked assets.

30. Risk management objectives and policies for mitigating risks continued

The Group benefits from a £500 million (2009: £300 million) multi-currency revolving credit facility with Barclays Bank plc, Royal Bank of Canada, HSBC Bank Plc and The Royal Bank of Scotland Plc, with Barclays Bank plc as agent, entered into on 24 June 2010. If a third party, who does not presently have control of the Group, acquires such control, the Group must notify the agent immediately. In this circumstance, the lenders are not obliged to fund utilisation and may notify the agent to cancel their commitments under the facility. This would have the effect of rendering all of their loans repayable within 10 business days from the date of notice. As at the date of this report, the facility remains undrawn.

Where contracts have a surrender value (i.e. the policy is theoretically payable on demand) the following table shows the current surrender value in the within one year or payable on demand column. Otherwise it indicates the undiscounted expected contractual net cash flows in respect of financial and insurance liabilities.

		Contractual undiscounted cash flows		
Year ended 31 December 2010	Carrying value £m	Within 1 year or payable on demand £m	1–5 years £m	More than 5 years £m
Non-derivative financial liabilities				
Insurance contracts	**35,081**	**20,465**	**2,786**	**16,719**
Investment contracts	**72,411**	**72,411**	**–**	**–**
Loans and borrowings:				
principal	**1,212**	**186**	**653**	**373**
interest	**–**	**87**	**348**	**401**
Due to reinsurers	**1,666**	**119**	**464**	**2,009**
Net asset value attributable to unitholders	**1,173**	**1,173**	**–**	**–**
Insurance payables and other payables	**710**	**657**	**23**	**30**
Derivative financial liabilities				
Interest rate swaps	**75**	**–**	**18**	**57**
Cross-currency swaps	**23**	**23**	**–**	**–**
Credit default swaps	**4**	**–**	**1**	**3**
Contractual undiscounted cash flows – cross-currency swaps	**46**	**–**	**10**	**36**
Futures – fixed-interest	**2**	**2**	**–**	**–**
Forward currency contracts	**15**	**15**	**–**	**–**

		Contractual undiscounted cash flows		
Year ended 31 December 2009	Carrying value £m	Within 1 year or payable on demand £m	1–5 years £m	More than 5 years £m
Non-derivative financial liabilities				
Insurance contracts	12,107	6,828	1,062	5,673
Investment contracts	40,495	40,575	–	–
Loans and borrowings:				
principal	590	164	30	396
interest	–	48	127	132
Due to reinsurers	1,610	120	470	2,052
Net asset value attributable to unitholders	668	668	–	–
Insurance payables and other payables	393	393	–	–
Derivative financial liabilities				
Interest rate swaps	19	–	–	19
Inflation rate swaps	3	1	2	–
Futures backing equities	22	22	–	–
Forward currency contracts	11	11	–	–

Amounts expected to be settled from the unallocated surplus are excluded from the analysis above as there is no contractual obligation to settle the liability. Of the carrying amount on the balance sheet in respect of the unallocated surplus, £1,051 million (2009: £253 million) is expected to be settled more than 12 months after the balance sheet date.

30. Risk management objectives and policies for mitigating risks continued

(e) Policy cash flow risk (including insurance risk)

Policy cash flow risk consists of the following four main areas:

Insurance risks:

- mortality risk – risk of loss arising due to policyholder deaths experience being different from expectations; or for annuities, risk of annuitants living longer than expected (called annuity longevity risk); and
- morbidity risk – risk of loss arising due to policyholder health experience being different from expectations.

Other risks:

- policyholder decision risk – risk of loss arising from experience of actual policyholder behaviour (e.g. lapses, option take-up) being different from expectations; and
- expense risk – risk of loss due to expense experience being different from expectations.

The life and pensions business actively pursues mortality risk (other than annuitant mortality risk) and morbidity risk in those areas where it believes it has a competitive advantage in managing these risks to generate shareholder value (without compromising the interests of policyholders, and the need to treat customers fairly). Annuitant mortality risk, policyholder decision risk and expense risk are taken on when it is deemed financially beneficial for the organisation to do so, or where the taking of these risks is in support of the Group's strategic objectives.

Underpinning the Group's management of policy cash flow risk is:

- adherence to an approved underwriting policy that takes into account the level of risk that the Group is prepared to accept;
- controls around the development of products and their pricing; and
- regular analysis of actual mortality, morbidity and lapse experience which feeds into the development of products and policies. If the analysis changes expectations of future liability cash flows, periodic adjustments are made to asset cash flows to maintain the asset liability match.

Risks in excess of agreed underwriting limits may be reinsured. The Group's objective is to purchase reinsurance in the most cost-effective manner from reinsurers whose creditworthiness is deemed appropriate.

Substantially all insurance contracts, and the majority of the combined insurance and investment contract portfolio, are written in the UK and so results are sensitive to changes in the UK insurance market and tax regime. Otherwise the Group sells a diverse range of products to a diverse group of people.

Note 27 describes the main insurance contracts written by the Group and the basis of setting assumptions in measuring insurance liabilities which will take into account the risks above. The following sections describe how policy cash flow risks are managed.

i) Mortality and morbidity risk

Life assurance
Most insurance policies other than annuities and deferred annuity policies include life assurance. When pricing policies, an assumption is made as to the likelihood of death during the policy term and this assumption is reviewed as part of the annual valuation of policies. To the extent that actual mortality experience is worse than that anticipated in pricing (and subsequently in the insurance liability valuation) a loss will be made. The risk is greater for those policies such as term assurance where the maturity or surrender benefit is small in relation to the death benefit. Other policies which have a savings element, such as endowment assurance, have significant liabilities relating to the maturity benefit, particularly as the policy approaches maturity. Contractual terms for unit-linked and unitised with-profits products include provision for increases in mortality charges.

Critical illness
The Group writes a number of critical illness policies that pay out in the event of a policyholder's ill-health. As for life assurance, the amount payable on ill-health can be significantly higher than the amount payable if the policy is surrendered.

30. Risk management objectives and policies for mitigating risks continued

Income protection
The two main risks related to income protection are an increase in the frequency of claims (the inception rate) and an increase in the average length of the claim (a reduction in recovery rate). Most income protection policies are regular premium with the premium and cover fixed at inception. Some group policies allow premiums to be reviewed but the premium rates are usually guaranteed for three years.

Annuities
If annuitants live longer than expected on average, profits will reduce. In most cases there is an initial guarantee period in which, in the event of death, annuity payments continue to be made to dependants or the policyholder's estate and many policies are written so that when the first life dies the benefit continues, often at a reduced level. These features tend to reduce the volatility of results to random fluctuations in experience but not the impact of a general increase in longevity.

Deferred annuities are subject to a similar risk from the impact of longevity, the only difference being that the risk of adverse impact is greater given that the annuity is payable further into the future. However, most of these policies are with-profits and the impact would be offset by a reduction in the unallocated surplus, with relatively little resulting impact on shareholder profits.

The annuity risk of the Friends Life group was significantly reduced through a reinsurance agreement with Swiss Re put in place in April 2007. The agreement covers annuity contracts written between July 2001 and December 2006 within FPP. The Swiss Re agreement covers annuity contracts valued at £1,666 million (2009: £1,610 million) at 31 December 2010.

Longevity risk within FAL and the FLAS with-profits fund was reduced by a three stage project during 2009 and 2010 to reinsure the annuity business with RGA, RBC and Partner Re. The agreement reinsures 95% of the longevity risk in respect of £3.7bn of annuity liabilities in FAL and a further £2bn of annuity liabilities in FLAS at 31 December 2010.

ii) Policyholder decision risk

Persistency experience varies over time as well as from one type of contract to another. Factors that will cause lapse rates to vary over time include changes in investment performance of the assets underlying the contract where appropriate, regulatory changes that make alternative products more attractive, customer perceptions of the insurance industry in general and the Group in particular, and the general economic environment.

The reattribution scheme in respect of FLC includes a requirement for a "5 Year Test" of the surplus in the company's reattributed with-profits funds at the end of 2010. The result, if it shows a significant surplus, may lead to a special bonus distribution to those policyholders that elected not to accept the reattribution offer. It is possible that the lapse rate amongst policyholders whose policies receive a special bonus will increase as a result of policyholders having held off surrendering their policy in anticipation of a payment or having received a payment believing that further special bonuses are unlikely.

The valuation of the Group's guarantees and options is described in note 28. As stated in that note, the cost of guaranteed annuity options is dependent on decisions made by policyholders such as policy discontinuance and tax-free cash take-up. These assumptions are set by reference to recent experience.

iii) Expense risk

Although under IFRS 4 expense risk is not a component of insurance risk, it is an important policy cash flow risk in the context of insurance and investment contracts.

The whole of the impact of changes in expense levels is borne by shareholders with the following exceptions:

- In 2009 the charges made to the FPLP with-profits fund for managing policies were reviewed to reflect market rates at the time. Pre-demutualisation with-profits policyholders will bear the impact of any resulting changes to charges;
- FPLA closed fund with-profits policyholders bear the full expense risk for the fund; and
- FLC and FLAS with-profits funds have a fee agreement with FLSL, under which increased expenses may be passed on to the funds provided independent review of the proposed expenses shows they are in line with market rates.

Contractual terms for unit-linked and unitised with-profits products include provision for increases in charges. Certain expenses (such as fees and commissions) are fixed at the time a contract is written.

31. Investment contracts

Movement in investment contracts liabilities

	2010 £m	2009 £m
At 1 January	**40,495**	–
Acquired through business combinations	**25,031**	37,669
Premiums	**6,253**	2,383
Claims	**(4,527)**	(600)
Investment return, annual management charges and other expenses	**5,648**	1,153
Foreign exchange adjustments	**(489)**	(110)
At 31 December	**72,411**	40,495
Analysed as follows:		
Unit-linked contracts	**62,492**	36,398
Policies with DPF	**9,123**	3,974
Other	**796**	123
Total investments contract liabilities	**72,411**	40,495

None of the movement in liabilities is attributable to changes in credit risk of the liabilities. Fair value movements of £5,863 million (2009: £1,189 million) are included within the income statement arising from movements in investment contract liabilities held at fair value.

Included in the carrying amount above, £66,973 million (2009: £36,028 million) is expected to be settled more than 12 months after the balance sheet date.

Unit-linked liabilities are based on the fair value of the underlying assets. Liabilities relating to policies with DPF are determined using methods and principles consistent with insurance contracts as set out in note 27. There is no significant difference between carrying values and maturity values of investment contract liabilities.

32. Loans and borrowings

The Group's loans and borrowings are as follows:

	Coupon %	2010 £m	2009 £m
Subordinated liabilities:			
Lombard undated subordinated loans	Various	**3**	4
£162m Friends Provident Holdings (UK) plc subordinated debt due 2021(i)	12.00	**186**	–
£162m Friends Provident Group Limited subordinated debt due 2021(i)	12.00	**–**	189
Deferred consideration notes(ii)			
Series A deferred consideration notes	6.00	**300**	–
Series B deferred consideration notes	7.25–6.50	**200**	–
Debenture loans:			
Box Hill Life Finance plc securitisation notes – class A-1 due 2016(iii)	3m LIBOR +0.20	**–**	15
Box Hill Life Finance plc securitisation notes – class A-2 due 2019(iii)	3m LIBOR +0.23	**–**	100
F&C Commercial Property Trust secured bonds due 2017(iv)	5.23	**–**	219
Reinsurance:			
Lombard financial reinsurance treaty	Various	**15**	27
Friends Provident financial reinsurance treaty	3m EURIBOR +1.75	**–**	4
Friends Provident financial reinsurance treaty(v)	3m EURIBOR +3.60	**29**	–
Other:			
Acquisition finance facility(vi)	Various	**400**	–
Amounts owed to credit institutions (overdrafts)		**79**	32
Total loans and borrowings		**1,212**	590

(i) On 21 May 2009, Friends Provident exchanged £322 million of its STICS for £162 million 12% Sterling Denominated Fixed Rate Subordinated Guaranteed Notes due 2021. These notes are irrevocably guaranteed on a subordinated basis by FPLP. The subordinated debt is carried at amortised cost based on the fair value of the debt on acquisition of FPG. The carrying value of £186 million is based on £162 million principal, less capitalised issue costs of £2 million, plus the fair value adjustment arising on acquisition (less amortisation) of £26 million (£2009: £29 million). On 15 December 2010, the subordinated debt was transferred to FPH in connection with a simplification of group debt capital structure, and FPH has been substituted for FPG as the principal obligor (see note 39).

(ii) On 10 September 2010 the Company issued fixed rate, unsecured loan notes with an agreed principal amount of £500 million to AXA UK in connection with the acquisition of the AXA UK Life Business. The deferred consideration notes constitute senior, unsecured and unsubordinated obligations of the Company. The Series A notes will be redeemed by payment of £60 million on each anniversary from issue for five years. The Series B notes will be redeemed by payment of £2.5 million on each of the first five anniversaries from issue, followed by payments of £62.5 million on each of the three anniversaries to 2018. The Series A coupon rate remains at 6% throughout the loan period. The Series B coupon rate commenced at 7.25% and reduces in incremental amounts annually to a rate of 6.66% at 29 September 2015. The rate reduces to 6.50% for the three years to 30 September 2018. The Company may at any time redeem the loan notes in full or in part. The Company has a mandatory requirement to redeem the loan notes in full or in part on occurrence of certain specified events.

(iii) On 16 December 2004 FPLP raised £380 million of core regulatory capital in the form of floating rate secured notes through a securitisation of the cash flows expected to emerge from a book of life insurance policies. Sufficient surplus emerging at 31 December 2009 allowed the notes to be repaid in full on 15 April 2010.

(iv) Following the reduction in the Group's investment in the F&C CPT on 23 April 2010 the entity is no longer consolidated by the Group (see note 39). The retained holding is accounted for as a financial investment at fair value through the income statement.

(v) On 30 June 2010, FPLP entered into a financial reinsurance agreement with Munich Reinsurance Company UK Life Branch (Munich Re) which has advanced £29 million to finance new German unit-linked pension business written since 1 January 2010.

(vi) On 24 June 2010, Resolution Holdings (Guernsey) Limited and the Company entered into an acquisition finance term loan facility agreement with Barclays Bank plc and Royal Bank of Canada to fund part of the consideration payable for the AXA UK Life Business. The acquisition finance facility was issued on 13 September 2010 and has a maturity date that can be extended to 30 June 2012. The coupon rate is variable and consists of LIBOR plus a margin. The margin commenced at 2.50% and rises incrementally to 7.00% at 30 June 2012. Duration fees apply on a quarterly basis if the facility is still in force.

(vii) In addition to the loans and borrowings described above, the Group has a £500 million (2009: £300 million) multi-currency revolving credit facility with Barclays Bank plc, Royal Bank of Canada, HSBC Bank Plc and The Royal Bank of Scotland Plc, with Barclays Bank plc as agent, entered into on 24 June 2010. If a third party, who does not presently have control of the Group, acquires such control, the Group must notify the agent immediately. In this circumstance, the lenders are not obliged to fund utilisation and may notify the agent to cancel their commitments under the facility. This would have the effect of rendering all of their loans repayable within ten business days from the date of notice. As at the date of this report, the facility remains undrawn.

32. Loans and borrowings continued

Total interest-bearing loans and borrowings are repayable as follows:

	2010 £m	2009 £m
Within one year or on demand	**586**	166
Between one and two years	**63**	10
Between two and three years	**63**	8
Between three and four years	**63**	7
Between four and five years	**63**	3
In more than five years	**374**	396
Total loans and borrowings	**1,212**	590

Included in the carrying amount above, £626 million (2009: £435 million) is expected to be settled more than 12 months after the balance sheet date.

Total interest expense for financial liabilities not measured at fair value through the income statement, which arises solely from interest-bearing loans and borrowings, is £59 million (2009: £6 million).

33. Amounts due to reinsurers

During April 2007, FPP entered into a reinsurance treaty with Windsor Life Assurance Company Limited, a subsidiary of Swiss Re. The agreement, which took effect from 1 January 2007, reinsures the mortality and investment risk, but not expense risk, of 100% of FPP's in-force post demutualisation annuity books as at 31 December 2006. Business written after 31 December 2006 is not reinsured under the treaty. The liability due to Swiss Re represents future reassurance premiums payable and is accounted for as a financial liability at fair value through the income statement, thereby avoiding a mismatch with the assets backing the liability. Reassurance premium payments are funded from the fixed return on an investment in a collateralised HSBC Amortising Note, purchased with a transfer of the assets previously backing the annuity policies.

Included in the carrying amount of £1,666 million (2009: £1,610 million) is £1,548 million (2009: £1,489 million) that is expected to be settled more than 12 months after the balance sheet date.

34. Net asset value attributable to unit-holders

The movements in the value of third-party interests in open-ended investment companies and unit trusts that are consolidated by the Group are as follows:

	2010 £m	2009 £m
At 1 January	**668**	–
Acquired through business combinations	**377**	624
Share of total return in the period	**139**	31
Share of distributions in the period	**(20)**	(3)
Amount paid on issue of shares	**474**	79
Disposals	**(29)**	–
Amount received on cancellation of shares	**(436)**	(63)
At 31 December	**1,173**	668

The carrying value of net asset value attributable to unit-holders approximates fair value.

35. Provisions

	Review of mortgage endowment sales £m	Separation and integration costs £m	Other £m	Total £m
At 1 January 2010	**14**	**–**	**58**	**72**
Acquired through business combinations	**–**	**–**	**155**	**155**
Charged in the period	**6**	**14**	**29**	**49**
Released in the period	**(1)**	**–**	**(7)**	**(8)**
Utilised in the period	**(10)**	**–**	**(37)**	**(47)**
At 31 December 2010	**9**	**14**	**198**	**221**

	Review of mortgage endowment sales £m	Other £m	Total £m
At 1 January 2009	–	–	–
Acquired through business combinations	12	72	84
Charged in the period	4	4	8
Released in the period	(1)	(3)	(4)
Utilised in the period	(1)	(15)	(16)
At 31 December 2009	14	58	72

Included in the carrying amount above, £172 million (2009: £28 million) is expected to be settled more than 12 months after the balance sheet date.

a) Review of mortgage endowment sales

Provision has been established for the estimated likely cost of redress, including administrative costs, arising from the review of the suitability of mortgage endowment policies. In addition to the accounting provision of £9 million (2009: £14 million), an actuarial reserve of £2 million (2009: £4 million) was held in the insurance contracts provision of FPLP's with-profits fund in respect of estimated further complaints. In addition, an actuarial reserve of £3 million was held by the AXA UK Life Business at the end of the year.

b) Separation and integration costs

As part of the purchase agreement of the AXA UK Life Business, the Group will incur various costs to separate the business purchased from AXA UK plc and to integrate the businesses within the Group. At the year end, the Group has provided £10 million for separation costs where the Group has an onerous commitment to separation activities and the separation plans are sufficiently progressed. In addition, £4 million has been provided against reorganisation activities where the FPH board has approved the plans.

c) Other

Other provisions reflect the addition of £155 million arising directly from the acquisition of the AXA UK Life Business. The balance of £198 million includes lapse provisions within Sesame Bankhall of £19 million, provisions for vacant property of £16 million and £144 million in respect of costs to be incurred by the AXA UK Life businesses. These include provisions for policyholder compensation in the normal course of business other than in respect of pension and endowment sales, bad debts, and commission clawbacks. Also included is a provision related to certain aspects of the administration by the acquired AXA UK Life Business of defined benefit pension schemes.

36. Insurance payables, other payables and deferred income

	2010 £m	2009 £m
Creditors arising out of direct insurance operations	**94**	74
Creditors arising out of reinsurance operations	**64**	20
Accruals and deferred income	**171**	89
Investments purchased for subsequent settlement	**138**	58
Deferred front-end fees	**28**	8
Derivative contracts	**165**	55
Other payables	**243**	152
Total insurance payables, other payables and deferred income	**903**	456

Included in the carrying amount above, £85 million (2009: £22 million) is expected to be settled more than 12 months after the balance sheet date. The carrying value of each item approximates fair value.

37. Share capital

The authorised share capital of the Company is represented by an unlimited number of ordinary shares of no par value.

	2010		2009	
Issued and fully paid	Number of shares (million)	£m	Number of shares (million)	£m
Shares of no par value fully paid	**1,452.6**	**4,413**	2,412.5	2,359
Transaction costs, net of income tax	**–**	**(76)**	–	(10)
Treasury shares	**(8.6)**	**(20)**	–	–
Total at 31 December	**1,444.0**	**4,317**	2,412.5	2,349

Changes to share capital during 2010

	31 December 2010	
Issued and fully paid	Number of shares (million)	Share capital £m
At beginning of period	**2,412,451,145**	**2,349**
Shares in respect of scrip dividend (final 2009)	**5,753,268**	**5**
Share consolidation 1 for 30	**80,606,814**	**2,354**
Rights issue 17 for 1	**1,370,315,835**	**2,055**
Shares issued in respect of scrip dividend (interim 2010)	**1,641,722**	**4**
Transaction costs, net of income tax	**–**	**(76)**
Treasury shares[(i)]	**(8,579,292)**	**(20)**
At end of period	**1,443,985,079**	**4,317**

(i) Treasury shares are shares held by subsidiary undertakings of the Company. These shares will be disposed of in 2011.

On 4 November 2009, 1,752.5 million ordinary shares of £1 each were issued by the Company at 97 pence per share in connection with the acquisition of FPG, as set out in note 41. The total value of the shares issued was £1,700 million.

On 5 August 2010 a fully underwritten rights issue of £2,055 million (gross) was successfully completed with the new ordinary shares issued by the Company commencing trading on the London Stock Exchange on the following day. The Company undertook a share consolidation on 20 July 2010. The share consolidation was undertaken on the basis that shareholders would receive one consolidated ordinary share for every 30 existing ordinary shares held by them at the share consolidation record date. In October 2010 a scrip dividend of 1,641,722 shares was made in respect of the 2010 interim dividend. On 31 December 2010 following the share consolidation, the rights issue, the scrip dividend and the deduction of treasury shares, the issued share capital of the Company is 1,443,985,079 ordinary shares of nil par value.

All ordinary shares in issue in the Company rank parri passu and carry the same voting rights and rights to receive dividends and other distributions declared or paid by the Company.

38. Other reserves

Other reserves included in equity attributable to equity holders of the parent are as follows:

Year ended 31 December 2010	Capital reserve £m	Retained earnings £m	Foreign currency translation reserve £m	Total £m
At 31 December 2009 as previously reported	**1**	**1,191**	**(5)**	**1,187**
Prior year adjustment[(i)]	**–**	**119**	**–**	**119**
1 January 2010, as restated	**1**	**1,310**	**(5)**	**1,306**
Profit for the period	**–**	**765**	**–**	**765**
Actuarial loss on defined benefit schemes (net of tax)	**–**	**(21)**	**–**	**(21)**
Tax relief on STICS interest	**–**	**9**	**–**	**9**
Foreign exchange adjustments (net of tax) and other items	**–**	**–**	**(9)**	**(9)**
Share based payments	**–**	**4**	**–**	**4**
Dividends	**–**	**(144)**	**–**	**(144)**
At 31 December 2010	**1**	**1,923**	**(14)**	**1,910**

(i) Prior year restatement of STICS increasing the gain arising on the acquisition of Friends Provident as set out in note 3.

Year ended 31 December 2009	Capital reserve £m	Retained earnings £m	Foreign currency translation reserve £m	Total £m
At 1 January 2009	1	(1)	–	–
Profit for the period	–	1,161	–	1,161
Actuarial gain on defined benefit schemes	–	30	–	30
Tax relief on STICS interest	–	1	–	1
Foreign exchange adjustments	–	–	(5)	(5)
At 31 December 2009	1	1,191	(5)	1,187

39. Non-controlling interests

31 December 2010	2010 £m	As restated 2009 £m
Step-up tier 1 insurance capital securities	**318**	318
F&C Commercial Property Trust	**–**	293
Other	**4**	4
Total non-controlling interests	**322**	615

The STICS are carried at their fair value at the date of acquisition.

a) Step-up tier 1 insurance capital securities

	2003 STICS £m	2005 STICS £m	Total £m
At 1 January 2010	**135**	**183**	**318**
Interest payable in the period	**14**	**17**	**31**
Interest paid in the period	**(14)**	**(17)**	**(31)**
At 31 December 2010	**135**	**183**	**318**

39. Non-controlling interests continued

	2003 STICS £m	2005 STICS £m	As restated Total £m
At 1 January 2009	–	–	–
Acquired through business combinations	141	179	320
Interest payable in the period	1	4	5
Interest paid in the period	(7)	–	(7)
At 31 December 2009	135	183	318

As a result of the acquisition of Friends Provident, the Group has two STICS which at the date of acquisition were an obligation of a subsidiary undertaking. These securities are described as the 2003 STICS and the 2005 STICS, respectively, reflecting the year in which they were issued.

A summary of the principal terms of the STICS is set out in the following paragraphs.

2003 STICS

On 21 November 2003, FPG issued £300 million of STICS of which £210 million were outstanding at the date of acquisition, as noted below. If they pay out, they bear interest from November 2003 to November 2019 at a rate of 6.875% with interest payable in equal instalments in arrears on 21 May and 21 November of each year. The remaining STICS have no maturity date but will be redeemable at the option of FPH (as successor to Friends Provident plc) on 21 November 2019, thereafter on the coupon payment date falling on or nearest successive fifth anniversaries of this date. The STICS are perpetual securities and are not redeemable at the option of the holders at any time. The STICS are irrevocably guaranteed on a subordinated basis by FPLP. The guarantee is intended to provide holders with rights against FPLP in respect of the guaranteed payments which are as near as possible equivalent to those they would have had if the STICS had been directly issued preference shares of FPLP. For each coupon period after 20 November 2019, the STICS will bear interest that is reset every five years. The STICS are carried at their fair value at the date of acquisition.

2005 STICS

On 27 June 2005, FPG issued £500 million of STICS of which £268 million were outstanding at the date of acquisition, as noted below. They bear interest, if they pay out, from 30 June 2005 to 30 June 2015 at a rate of 6.292% with interest payable in arrears on 30 June of each year. The remaining STICS have no maturity date but will be redeemable in whole or part at the option of FPG on 1 July 2015, thereafter on every fifth anniversary of this date. The STICS are perpetual securities and are not redeemable at the option of the holders at any time. The STICS are guaranteed on a limited and subordinated basis by FPLP. For each coupon period after 1 July 2015, the STICS will bear interest that is reset every five years. The STICS are carried at their fair value at the date of acquisition.

Financial restructuring

On 21 May 2009, FPG carried out a financial restructuring by exchanging £90 million of the 2003 STICS and £232 million of the 2005 STICS for £162 million 12% Sterling denominated fixed-rate subordinated guaranteed notes due 2021, irrevocably guaranteed on a subordinated basis by FPLP. The subordinated debt was valued at fair value at the date that Friends Provident was acquired by the Company and is subsequently measured at amortised cost using the effective interest method.

On 15 December 2010, in connection with a simplification of group debt capital structure, FPH has been substituted for FPG as the principal obligor. The STICS and 12% Sterling denominated fixed rate subordinated guaranteed notes continue to be guaranteed by FPLP on the same terms and subject to the same conditions as prior to the substitution, and continue to be admitted to listing on the Official List of the UK Listing Authority and to trading on the regulated market of the London Stock Exchange.

Under IFRS, the STICS are accounted for as equity as there is no requirement to settle the obligation in cash or another financial asset. Consistent with this equity classification, interest on these instruments is not treated as an expense but as an appropriation of profit. However, given the operating nature of the interest payments on these securities, the Group has deducted the interest on the securities in computing the operating profit for the Group. No ordinary dividend can be paid if the STICS dividend is not paid. The STICS are presented in the financial statements as a non-controlling interest.

In May 2010 the IASB issued "Improvements to IFRS" which amended IFRS 3 (revised) Business Combinations. The amendment to the standard requires that the STICS should be recorded at fair value with effect from the date that IFRS 3 (revised) has been adopted. In 2009, the STICS were stated at nominal value less cost and interest adjustments as permitted by the previous standard. The 2009 figures have been restated in accordance with the amendment to the standard. This reduces the value of the STICS by £165 million (See note 3).

39. Non-controlling interests continued

b) F&C Commercial Property Trust

As detailed in Note 41, during the year the Group reduced its holding in F&C CPT from 50.3% to 34.16%. F&C CPT is a company which holds a diversified portfolio of freehold and predominantly long leasehold UK commercial properties. It invests principally in three commercial property sectors: office, retail and industrial.

c) Other

Other non-controlling interest mainly relates to £3 million of investments made by the senior managers of Lombard in that company. The investments comprise holdings in Class B, C and D ordinary shares which generally do not have rights to receive a share of the annual profits of Lombard. In addition, RCAP Guernsey LP (a Guernsey Limited partnership) holds a 0.01% capital interest in Resolution Holdco No 1 LP.

40. Contingent liabilities and commitments

a) Contingent liabilities

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

b) Commitments

Operating leases where the Group is lessee

The Group leases a number of properties under operating leases. These leases typically run for a period of 50 years, with an option of renewal at the end of the lease. Lease terms include annual escalation clauses to reflect current market conditions.

The future minimum rentals payable under non-cancellable leases are as follows:

	2010			2009		
	Land and buildings £m	**Other £m**	**Total £m**	Land and buildings £m	Other £m	Total £m
Within one year	**7**	**1**	**8**	3	1	4
Between one and five years	**17**	**1**	**18**	12	1	13
In more than five years	**26**	**–**	**26**	10	–	10
Total operating lease payables	**50**	**2**	**52**	25	2	27

Other commitments

The Group has investment property commitments of £24 million (2009: £nil) relating to ongoing construction, renovation costs and costs of acquiring existing properties.

The Group has potential commitments of £517 million (2009: £217 million) to venture capital vehicles (partnerships and similar vehicles) that allow exposure to private equity investments in UK, US and European markets. All investments are held under agreements between the private equity managers and the Group which have committed the Group to providing an agreed maximum level of funding.

The Group has entered into a number of outsourcing arrangements which have resulted in financial commitments amounting to £510 million as at 31 December 2010 (2009: £nil). The average weighted years remaining on these outsourcing contracts is 15 years as at 31 December 2010 (2009: nil years).

41. Business combinations

a) Acquisition of AXA UK Life Business

In September 2010, the Group through its subsidiary, FPH, acquired the AXA UK Life Business, a UK life and pensions business, by acquiring all of the shares and voting interests of FASLH. The Group is deemed to have obtained control of the AXA UK Life Business on 3 September 2010 following satisfaction of the last of the substantive conditions to legal completion.

The share capital of WLUK was not acquired at the acquisition date. Under an option agreement between FPH and a subsidiary of AXA UK ("the subsidiary"), subject to certain conditions, FPH has the right to require the subsidiary to sell, and the subsidiary has the right to require FPH to acquire, the shares of WLUK. However, some of the assets and liabilities currently held by WLUK and its subsidiaries do not form part of the acquisition and will therefore need to be transferred to the AXA group before WLUK can be transferred to the Group. These transfers are proposed to be effected under Part VII of the Financial Services and Markets Act 2000. Consequently, the WLUK acquisition is not expected to be completed until towards the end of 2011 and will not be consolidated into Group accounts until this has occurred. Two other portfolios of business, GOF and TIP, are currently owned by the Group, but under the terms of the AXA acquisition, will be transferred to AXA during 2011. This is described in note 42.

Under the framework agreement the net amount payable to AXA in respect of the misplaced portfolios of business is £26 million plus interest. The amount payable is subject to an adjustment to reflect the actual value of shareholder net worth in the misplaced portfolios of business at the transfer date, if it is different from the value set out in the framework agreement.

In the period from the acquisition to 31 December 2010, the AXA UK Life Business contributed revenue of £3,339 million and a profit after tax of £1 million. If the acquisition had occurred on 1 January 2010, consolidated revenue is estimated to be £6,670 million and consolidated profit after tax for the year £109 million. In determining these amounts, it has been assumed that the fair value adjustments which arose on the date of acquisition would have been the same if the acquisition had occurred on 1 January 2010.

The fair value of the consideration, calculated as the sum of the fair values transferred, and liabilities incurred at acquisition is shown in the table below:

	£m
Cash paid	**2,224**
Deferred consideration notes	**500**
Fair value of consideration excluding acquisition expenses incurred at acquisition	**2,724**
Fair value of net assets acquired	**3,607**
Excess of the interest in the fair value of assets acquired over cost	**883**

The acquisition was financed by:

- a fully underwritten rights issue of £2,055 million (before transaction costs) which successfully completed on 5 August 2010;
- a certain funds acquisition finance facility of £400 million; and
- £500 million deferred consideration notes representing senior, unsecured and unsubordinated obligations of the Company issued in connection with the acquisition.

The consolidated income statement includes within administrative and other expenses £28 million of costs related to the transaction and a further £76 million has been charged against equity as it relates to the costs of raising that equity.

41. Business combinations continued

Identifiable assets acquired and liabilities assumed

	Recognised values on acquisition £m
Intangible assets:	
– acquired value of in-force business	2,192
– distribution and customer relationships	122
– computer software	28
Property and equipment	2
Investment properties	2,292
Financial assets	43,191
Reinsurance assets	640
Current tax assets	37
Insurance and other receivables(i)	939
Cash and cash equivalents	3,193
Assets of operations classified as held for sale(ii)	1,122
Total identifiable assets	**53,758**
Insurance contracts	22,050
Unallocated surplus	823
Financial liabilities:	
– investment contracts	25,031
– loans and borrowings	23
– amounts due to reinsurers	25
Net asset value attributable to unit-holders	377
Provisions	155
Deferred tax liabilities	494
Insurance payables, other payables and deferred income	332
Liabilities of operations classified as held for sale(ii)	841
Total identifiable liabilities	**50,151**
Net identifiable assets acquired and liabilities assumed	**3,607**
Attributable to equity holders of the parent	**3,607**

(i) The gross contractual amount in respect of the receivables acquired was £971 million of which £32 million is expected to be uncollectable.
(ii) The GOF/TIP business is presented on a held for sale basis with assets and liabilities having a net fair value of £281 million.

The values of assets acquired and liabilities assumed, recognised on acquisition, are their estimated fair values.

In determining the fair value of the acquired value of in-force business, the Group applied a pre-tax discount rate to the associated cash flows for each principal CGU of 8%.

In determining the fair value of other intangibles acquired, the Group applied a pre-tax discount rate of 10% to the associated projected cash inflows for each principal CGU.

The gain of £883 million recognised as a result of the acquisition is attributable to the purchase price being at a discount to the fair value of the net assets acquired (based on the market consistent embedded value) of the AXA UK Life Business. This gain is shown in other income in the consolidated income statement.

41. Business combinations continued

b) Acquisition of Friends Provident in prior year

On 4 November 2009, the Group through its subsidiary, FPH, acquired Friends Provident, a UK-listed life and pensions business, by acquiring all of the shares and voting interests of FPG.

In the period from the acquisition to 31 December 2009, Friends Provident contributed revenue of £1,507 million and profit after tax of £18 million. If the acquisition had occurred on 1 January 2009, consolidated revenue would have been £6,551 million, and consolidated profit after tax for the year would have been £148 million. In determining these amounts, management has assumed that the fair value adjustments which arose on the date of acquisition would have been the same if the acquisition had occurred on 1 January 2009.

The following summarises the major classes of consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date:

	As restated £m
Issue of 1,752,451,145 ordinary shares (note 37)	1,700
Cash paid	312
Fair value of purchase consideration	2,012
Acquisition costs incurred	16
Fair value of net assets acquired (restated)	3,333
Excess of the interest in the fair value of assets acquired over cost	1,305

The fair value of the ordinary shares issued was based on the listed share price of the Company at close of business on 3 November 2009 of 97 pence per share.

c) Disposals of subsidiaries

Disposal of Pantheon Financial Limited

On 19 March 2010 the Group disposed of its entire holding in 100% of the share capital of Pantheon which formed part of the UK operating segment.

Details of the transaction are as follows:

	£m
Assets and liabilities on disposal:	
– cash and cash equivalents	**3**
– other net assets and liabilities	**(3)**
	–
Gain included in profit from continuing operations	**–**
Consideration received	**–**
Cash and cash equivalents in disposal	**(3)**
Cash flow from disposal of subsidiary, net of cash disposed	**(3)**

41. Business combinations continued

Reduction in holding in F&C Commercial Property Trust plc ("F&C CPT")

On 23 April 2010 the Group reduced its holding in F&C CPT from 50.3% to 34.16%. The retained holding has been recognised as a financial asset at fair value through the income statement. As at 31 December 2010, F&C CPT is not treated as an associate as the Group does not have significant influence over this trust. Until 23 April 2010, the F&C CPT was treated as a subsidiary and all its assets and liabilities were consolidated on a line-by-line basis. Loss of control arose when the holding was reduced resulting in de-recognition of assets and liabilities. The carrying amounts de-recognised are set out in the table below.

	£m
Assets and liabilities on disposal:	
– investment properties	767
– financial assets	6
– cash and cash equivalents	97
– insurance and other receivables	(4)
– interest-bearing loans and borrowings	(219)
– insurance payables, other payables and deferred income	(23)
Net assets on disposal	624
Non-controlling interest in assets and liabilities on disposal	(310)
Fair value of investment retained	(214)
Gain included in profit from continuing operations	–
Consideration received (all cash)	100
Cash and cash equivalents on disposal	(97)
Cash flow from disposal of subsidiary, net of cash disposed	3

42. Disposal group classified as held for sale

Two portfolios of business, GOF and TIP, are currently owned by the Group but under the terms of the AXA acquisition, will be transferred to AXA under Part VII of the Financial Services and Markets Act 2000 and are therefore classified as held for sale assets. The transfer is expected to take place during 2011.

The major classes of assets and liabilities of the GOF and TIP business as at 31 December 2010 are disclosed in the table below:

	£m
Intangible assets – AVIF	269
Deferred tax assets	20
Financial assets	904
Cash and cash equivalents	13
Assets of operations classified as held for sale	1,206
Insurance contracts	21
Investment contracts	904
Liabilities of operations classified as held for sale	925
Net assets of operations classified as held for sale	281

42. Disposal group classified as held for sale continued

The income statement impact is consolidated on a line-by-line basis in the core financial statements. The table below shows the income statement of the held for sale business:

	£m
Gross earned premiums	**29**
Gross claims and benefits paid	**(5)**
Changes in insurance contract liabilities	**7**
Acquisition expenses	**(19)**
Administrative and other expenses	**(15)**
Profit before tax from continuing operations	**(3)**

The disposal group is included in the UK segment for the purposes of segmental reporting.

43. Related parties

In the ordinary course of business, the Group and its subsidiary undertakings carry out transactions with related parties, as defined by IAS 24: *Related party disclosures*. Material transactions for the year (period from acquisition in respect of transactions related to AXA) are set out below.

The principal subsidiary undertakings of the Group and its interest in associates and joint venture are shown in notes 18 and 19 respectively.

a) Key management personnel compensation

Key management personnel consists of directors of Resolution Limited and ROL.

In aggregate the compensation paid to key management is as set out below:

	2010 Number	**2010 £m**	2009 Number	2009 £m
Short-term employee benefits	**11**	**1**	7	1
Post-employment benefits (excluding defined benefit scheme)	**–**	**–**	–	–
Share-based payments	**–**	**–**	–	–
Total key management personnel compensation charged to the income statement	**11**	**1**	7	1
Post-employment benefits: defined benefit schemes	**–**	**–**	–	–
Total key management personnel compensation	**11**	**1**	7	1

The compensation paid to ROL is disclosed in note 43 b) below.

43. Related parties continued

b) Other related parties

Details of the Group's pension schemes are provided in note 9.

Transactions made between the Group and related parties were made in the normal course of business. Loans from related parties are made on normal arm's length commercial terms.

As explained in note 9, a Group company made a loan of £160 million to FPPS in 2008, of which £nil (2009: £68 million) is outstanding at 31 December 2010.

The Company has entered into certain contracts with related parties as described below:

- An operating agreement with ROL, as a result of which the Company has outsourced most of its operating functions to ROL. This agreement has, subject to certain conditions, a minimum term of five years. Under this agreement, the Company will pay an annual fee based on the value of the Company (subject to a minimum payment of £10 million) to ROL. An amount of £13 million has been included in administrative expenses and an amount of £1 million is included in trade creditors and other payables in the financial statements in respect of amounts due to ROL;
- RCAP Guernsey LP, a partnership in which the members of ROL are limited partners, acquired shares in the Company for a consideration of £20 million in the initial public offering. The Company has entered into a lock-up deed with RCAP GP Limited, acting in its capacity as general partner of RCAP Guernsey LP, restricting the sale of the shares held by RCAP Guernsey LP for a period of three years. Following the Company's acquisition of the AXA UK Life Business, a further £8 million was invested by RCAP Guernsey LP as part of the rights issue. The sale of these shares will not be restricted by the lock-up deed;
- As shown in note 18, the Company has a 99.99% interest in, and is the general partner in, Resolution Holdco No 1 LP, a Guernsey limited partnership. The limited partners in this partnership are RCAP Guernsey LP and RCAP Investments SARL. The Company has entered into the partnership agreement with these parties for the purpose of making acquisitions of financial services businesses;
- A trade mark licence agreement with Resolution (Brands) Limited, a company wholly owned by Clive Cowdery, a partner in ROL, under which the Group has paid a fee of £100,000 in respect of each of the years commencing 4 December 2009 and 4 December 2010, with the fee increasing annually in line with the retail price index; and
- ROL was involved in the provision of certain capital raising services to the Company in connection with the financing of the AXA UK Life Business acquisition. In consideration for these services the Group has paid ROL a fee of £3.75 million with a further £0.75 million payment expected in 2011. Lazard provided financial advice to the Board in connection with the terms of the appointment of ROL in respect of the financing of the acquisition and provided confirmation to the UKLA that it considered that the terms of such appointment were fair and reasonable as far as shareholders are concerned.

44. Post balance sheet events

a) Acquisition of Bupa Health Assurance Limited

FPLP completed the acquisition of BHA on 31 January 2011. The purchase price was £168 million compared to an announced price in October 2010 of £165 million. The increase in price reflects an additional £3 million of capital injected into BHA in December 2010 by British United Provident Association Limited.

The work on the acquisition balance sheet is continuing and the figures set out below should therefore be regarded as provisional.

The MCEV as at 31 January 2011 is estimated to be approximately £226 million, of which the acquired value of in-force business is £123 million.

On an IFRS basis for the acquisition balance sheet the net assets acquired are estimated at £236 million, which would give a gain on acquisition of £68 million.

44. Post balance sheet events continued

The draft IFRS acquisition balance sheet is summarised as follows:

	£m
Acquired value of in-force (£123.4 million, net of deferred tax)	172
Other intangible assets (£6.6 million, net of tax)	8
Investments and cash	173
Current assets	30
Total assets	**383**
Insurance liabilities	67
Other liabilities	80
Total liabilities	**147**
Net assets	**236**

b) Reorganisation

The Group recently completed a reorganisation of its operating and service companies with all life companies now being direct subsidiaries of the shareholder fund of FPLP, a subsidiary of FPL, and both the Friends Provident and acquired AXA service companies becoming fellow subsidiaries of FPL.

Prior to the year end the listed obligations of FPG, the STICS and subordinated debt, as set out in notes 32 and 39, were novated from FPG, the parent company of FPL, to FPH, its parent company.

The reorganisation has enabled the Group to simplify its internal financing structure. This will ensure that existing holders of the Group's listed debt obligations are supported by all of the operating company cash flows.

c) EU Gender Directive

On 1 March 2011 the European Court of Justice ("ECJ") announced that it had upheld the ruling on gender discrimination that results in insurers not being able to use gender related information to calculate insurance premiums and benefits. The ECJ has declared that the adoption of unisex premiums and benefits will apply with effect from 21 December 2012.

A transitional period has been granted to allow insurance companies sufficient time to adjust to the new legal framework and adapt its products and pricing policies accordingly. The Group is currently assessing the impact of this recent judgment which may have a significant impact on the way that future business is underwritten.

d) Changes in rates of corporation tax

A gradual reduction in the UK corporation tax rate from 28% to 24% over four years was announced in the Emergency Budget of 22 June 2010. The Finance (No. 2) Act 2010 enacted the first of the 1% rate reductions with effect from April 2011. Subsequent reductions will be dealt with by future legislation. The benefit to the Group's net assets from the reduction in the rate is estimated as approximately £84 million in total and will be recognised as the legislation is substantively enacted.

In the budget on 23 March 2011 the Chancellor announced a reduction of a further 1% to the corporation tax rate in April 2011 (to 26%) in addition to the 1% already substantively enacted. The final corporation tax rate following all planned changes will now be 23%. Given the timing of the announcement relative to the date of approval of these financial statements it has not been possible to quantify the impact on the Group's financial statements.

e) Future tax regime applicable to life insurance companies

The Chancellor's Budget which took place on 23 March contained significant announcements in relation to the tax regime applicable to life insurance companies following the consultation, issued in March 2010, on the effect of Solvency II on the tax regime. The announcements will be followed by a further period of consultation and detailed rules will not be available until late 2011. Given the timing of the announcement and the detail which is not as yet available, it is premature to assess the impact on the deferred tax assets and liabilities recognised in the balance sheet.

MCEV financial statements

Statement of directors' responsibilities in respect of the market consistent embedded value (MCEV) basis

The directors of Resolution Limited have chosen to prepare supplementary information in accordance with European Insurance CFO Forum (MCEV Principles), issued in October 2009. When compliance with the MCEV Principles is stated, those principles require the directors to prepare supplementary information in accordance with the methodology contained in the MCEV Principles and to disclose and explain any non-compliance in the guidance included in the MCEV Principles.

In preparing the MCEV supplementary information, the directors have:

- done so in accordance with the MCEV Principles and fully complied with the guidance included therein;
- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent; and
- described the basis on which business that is non-covered has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group condensed consolidated IFRS financial statements.

By order of the Board

Fergus Dunlop
Director

23 March 2011

Independent Auditor's Report to the Directors of Resolution Limited on the Consolidated Market Consistent Embedded Value (MCEV) Financial Statements

We have audited the consolidated MCEV financial statements of Resolution Limited for the year ended 31 December 2010 which comprise the Consolidated income statement – MCEV basis, the Earnings per share – MCEV basis, the Consolidated statement of comprehensive income – MCEV basis, the consolidated statement of changes in equity – MCEV basis, the Consolidated statement of financial position – MCEV basis, the Group MCEV analysis of earnings and the related notes 1 to 13. The consolidated MCEV financial statements have been prepared in accordance with the Market Consistent Embedded Value Principles issued in October 2009 by the CFO Forum ("the MCEV Principles") and the basis of preparation set out on pages 196 to 199.

We have reported separately on the statutory Group financial statements of Resolution Limited for the year ended 31 December 2010. The information contained in the consolidated MCEV financial statements should be read in conjunction with the financial statements prepared on an IFRS basis.

This report is made solely to the Company in accordance with our engagement letter dated 26 November 2010. Our audit work has been undertaken so that we might state to the Company those matters we are required to state to them in an auditors' 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 Company for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the consolidated MCEV financial statements in accordance with the MCEV Principles.

Our responsibilities, as independent auditor, in relation to the MCEV financial statements are set out in our engagement letter dated 26 November 2010. We report to you our opinion as to whether the consolidated MCEV financial statements have been properly prepared in all material respects in accordance with the MCEV Principles and the basis of preparation set out on pages 196 to 199. We also report to you if we have not received all the information and explanations we require for our audit of the consolidated MCEV financial statements.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the consolidated MCEV financial statements.

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 consolidated MCEV financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the consolidated MCEV financial statements, and of whether the accounting policies are appropriate to the Group'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 consolidated MCEV financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the consolidated MCEV financial statements.

Opinion

In our opinion the consolidated MCEV financial statements for the year ended 31 December 2010 have been properly prepared, in all material respects, in accordance with the MCEV Principles and the basis of preparation set out on pages 196 to 199.

Ernst & Young LLP

Ernst & Young LLP
London

23 March 2011

Consolidated income statement – MCEV basis

For the year ended 31 December 2010

	Notes	Resolution Limited Year ended 31 December 2010 £m	Resolution Limited Year ended 31 December 2009 £m	FPH Year ended 31 December 2010 £m	FPH 5 November to 31 December 2009 £m
Life and pensions					
Value of new business	6	**145**	52	145	52
Expected existing business contribution		**247**	28	247	28
Operating experience variances		**32**	(25)	32	(25)
Operating assumption changes		**(23)**	1	(23)	1
Other operating variances		**65**	–	65	–
Development costs	10	**(28)**	(5)	(28)	(5)
Life and pensions covered business operating profit before tax	3	**438**	51	438	51
Other income and charges		**(11)**	3	(11)	3
Life and pensions operating profit before tax		**427**	54	427	54
Corporate income and charges		**(15)**	(13)	–	–
Operating profit before tax		**412**	41	427	54
Economic variances	3	**229**	40	229	40
Amortisation and impairment of non-covered business acquired intangible assets	3	**(3)**	(1)	(3)	(1)
Non-recurring items and non-operating variances	3	**(22)**	5	(8)	5
Profit from continuing operations before tax		**616**	85	645	98
Tax on operating profit		**(96)**	(15)	(96)	(15)
Tax on other activities		**(60)**	1	(60)	1
Profit for the period[(i)]		**460**	71	489	84

(i) Profit for the period is attributable to equity holders of the parent.

Earnings per share – MCEV basis

For the year ended 31 December 2010

	Notes	Resolution Limited Year ended 31 December 2010 pence	Resolution Limited Year ended 31 December 2009 pence
Earnings per share:			
Operating earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**33.50**	11.18
– Diluted		**33.24**	11.16
Earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**48.77**	30.54
– Diluted	4	**48.39**	30.49
Earnings per share prior to restatement for 21 July 2010 share consolidation:			
Operating earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**n/a**	2.78
– Diluted		**n/a**	2.78
Earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**n/a**	7.60
– Diluted	4	**n/a**	7.59

MCEV operating profit is from continuing operations and is based on expected investment return and excludes: (i) amortisation and impairment of non-covered business acquired intangible assets; (ii) effect of economic variances (including the impact of economic assumption changes); and (iii) significant non-recurring items. Operating profit is considered to be a better measure of the performance of the Group and this measure of profit is used internally to monitor the Group's MCEV results.

Consolidated statement of comprehensive income – MCEV basis

For the year ended 31 December 2010

	Resolution Limited	Resolution Limited	FPH	FPH
	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Year ended 31 December 2010 £m	5 November to 31 December 2009 £m
Profit for the period	**460**	71	489	84
Actuarial gains/(losses) on defined benefit pension schemes, net of tax	**(22)**	29	(22)	29
Foreign exchange adjustments	**(11)**	(3)	(11)	(3)
Other comprehensive income/(loss) for the period, net of tax	**(33)**	26	(33)	26
Total comprehensive income for the period[i]	**427**	97	456	110

(i) Total comprehensive income for the period is attributable to equity holders of the parent.

Consolidated statement of changes in equity – MCEV basis

For the year ended 31 December 2010

	Resolution Limited Year ended 31 December 2010 £m	Resolution Limited Year ended 31 December 2009 £m	FPH Year ended 31 December 2010 £m	FPH 5 November to 31 December 2009 £m
Opening ordinary shareholders' equity	**3,488**	650	3,181	–
Acquired value of Friends Provident as at 4 November 2009	**–**	3,070	–	3,070
Cost of acquisition of Friends Provident	**–**	(2,012)	–	–
Acquired value of AXA UK Life Business as at 3 September 2010	**3,498**	–	3,498	–
Cost of acquisition of AXA UK Life Business	**(2,724)**	–	(2,724)	–
Transaction costs(i)	**–**	(16)	–	–
Total comprehensive income/(expense) for the period	**427**	97	456	110
Issue of share capital (net of capitalised expenses and treasury shares)	**1,967**	1,699	2,165	–
Dividends on equity shares	**(144)**	–	(65)	1
Share-based payments (impact on MCEV reserves)	**3**	–	3	–
Increase in MCEV reserves for the period	**3,027**	2,838	3,333	3,181
Closing ordinary shareholders' equity	**6,515**	3,488	6,514	3,181

(i) Transaction costs are included in other non-operating expenses in 2010 (£28 million in total in Resolution Limited, of which £14 million is included in FPH).

Consolidated statement of financial position – MCEV basis

At 31 December 2010

	Resolution Limited 2010 £m	Restated Resolution Limited 2009 £m	FPH 2010 £m	Restated FPH 2009 £m
Assets				
Pension scheme surplus	**22**	38	22	38
VIF (covered business excluding assets of operations classified as held for sale)	**3,966**	1,873	3,966	1,873
Intangible assets	**29**	29	29	29
Property and equipment	**46**	47	46	47
Investment properties	**3,189**	1,546	3,189	1,546
Investment in associates and joint venture	**27**	22	27	22
Deferred tax assets	**–**	12	–	12
Financial assets	**99,445**	48,315	99,465	48,315
Deferred acquisition costs	**119**	128	119	128
Reinsurance assets	**2,637**	1,972	2,637	1,972
Current tax assets	**22**	4	22	4
Insurance and other receivables	**1,024**	444	1,023	464
Cash and cash equivalents	**9,288**	5,386	9,057	5,073
Assets of operations classified as held for sale				
– value of in-force covered business	**236**	–	236	–
– other assets	**970**	–	970	–
Total assets	**121,020**	59,816	120,808	59,523
Liabilities				
Insurance contracts	**35,142**	12,108	35,142	12,108
Unallocated surplus	**1,090**	295	1,090	295
Financial liabilities				
– Investment contracts	**71,535**	39,868	71,535	39,868
– Loans and borrowings	**1,599**	908	1,399	908
– Amounts due to reinsurers	**1,666**	1,610	1,666	1,610
Net asset value attributable to unit-holders	**1,173**	668	1,173	668
Provisions	**221**	72	221	72
Deferred tax liabilities	**270**	37	270	23
Current tax liabilities	**11**	15	11	15
Insurance payables, other payables and deferred income	**869**	450	858	478
Liabilities of operations classified as held for sale	**925**	–	925	–
Total liabilities	**114,501**	56,031	114,290	56,045
Equity attributable to:				
– Equity holders of the parent	**6,515**	3,488	6,514	3,181
– Non-controlling interests	**4**	297	4	297
Total equity	**6,519**	3,785	6,518	3,478
Total equity and liabilities	**121,020**	59,816	120,808	59,523

Group MCEV analysis of earnings

For the year ended 31 December 2010

	FPH			Resolution Limited (ex. FPH)[i]	Resolution Limited	Resolution Limited	FPH
	Year ended 31 December 2010			Year ended 31 December 2010	Year ended 31 December 2010	Year ended 31 December 2009	5 November to 31 December 2009
	Covered business £m	Non-covered business £m	Total £m	Non-covered business £m	Total business £m	Total business £m	Total £m
Opening Group MCEV[ii]	3,047	134	3,181	307	3,488	650	–
Opening adjustments:							
capital and dividend flows	–	2,165	2,165	(186)	1,979	–	–
acquired/divested businesses:							
– acquired value of Friends Provident	–	–	–	–	–	3,070	3,070
– cost of acquisition of Friends Provident	–	–	–	–	–	(2,012)	–
– acquired value of AXA UK Life Business	3,343	155	3,498	–	3,498	–	–
– cost of acquisition of AXA UK Life Business	–	(2,724)	(2,724)	–	(2,724)	–	–
– transaction costs[iii]	–	–	–	–	–	(16)	–
Adjusted opening Group MCEV	6,390	(270)	6,120	121	6,241	1,692	3,070
Operating MCEV earnings	341	(10)	331	(15)	316	26	39
Non-operating MCEV earnings	126	32	158	(14)	144	45	45
Total MCEV earnings	467	22	489	(29)	460	71	84
Other movements in IFRS net equity	–	(22)	(22)	(20)	(42)	29	29
Closing adjustments:							
capital and dividend flows	(376)	314	(62)	(71)	(133)	1,699	1
foreign exchange variances	(11)	–	(11)	–	(11)	(3)	(3)
Closing Group MCEV	6,470	44	6,514	1	6,515	3,488	3,181

(i) Resolution Limited (ex. FPH) refers to the Group excluding the acquired assets of Friends Provident and the AXA UK Life Business.
(ii) The opening Group MCEV split between covered and non-covered business has been revised. See note 12.
(iii) Transaction costs are included in non-operating MCEV earnings in 2010 (£28 million in Resolution Limited, of which £14 million is included in FPH).

1. Basis of preparation

Introduction

Resolution Limited is presenting the results and financial position for its life and pensions business on the MCEV basis and for its other businesses on the IFRS basis. The MCEV basis is in compliance with the European Insurance CFO Forum MCEV Principles[1] ("MCEV Principles"), issued in June 2008, and re-issued in amended form in October 2009.

On 3 September 2010, the Company acquired all of the share capital of FASLH, a life insurance business which at that date was owned by AXA UK. The consolidated income statement therefore includes the result of this business from that date subject to the following exceptions. Under the terms of the AXA UK Life Business acquisition certain portfolios of business will be purchased that are currently still legally owned by AXA UK and similarly certain portfolios of business legally owned by the Group as a result of the acquisition are to be transferred back to AXA UK.

In particular, it is intended that the assets and liabilities of the GOF and TIP businesses will be transferred under the provisions of Part VII of the Financial Services and Markets Act 2000 back to AXA UK and they are therefore classified as held for sale assets and liabilities.

WLUK is still legally owned by AXA UK and control is expected to pass to the Company in 2011. This is contingent upon a transfer under Part VII of the Financial Services and Markets Act 2000 of AXA retained business out of WLUK and FSA approval for change of control being received. The results and net assets of WLUK have therefore not been included in these financial statements.

The acquisition of BHA at a cost of £168 million completed on 31 January 2011. No contribution from BHA is included in the MCEV results for Resolution Limited at 31 December 2010.

This MCEV supplementary information presents results for Resolution Limited and FPH, including the results for Friends Provident and the AXA UK Life Business from the dates of the respective acquisitions.

The comparative MCEV results for the period ended 31 December 2009 include:

- results for Resolution holding companies for the full year to 31 December 2009; and
- results for the acquired Friends Provident businesses for the post acquisition period from 5 November 2009 to 31 December 2009.

The MCEV results were approved by the Board of directors on 23 March 2011.

Segmental analysis and definitions

Following the acquisition of the AXA UK Life Business and in line with IFRS 8: *Operating segments*, the Group has reviewed its segmental analysis under IFRS and MCEV reporting bases. This review resulted in certain changes to the segmental analysis that are set out in note 12.

Following a review of definitions, and in order to assist with comparisons of disclosures such as cash and shareholder resources, a number of changes to the presentation of the split of MCEV between free surplus, required capital and value of in-force ("VIF") have been made. These changes have not affected the previously reported overall MCEV, the Operating MCEV Earnings or Total MCEV Earnings. The detailed changes are discussed in note 12.

Comparative figures for 2009 have been restated to reflect the revised segmentation and definitions.

MCEV methodology

Overview

The MCEV basis of reporting is designed to recognise profit as it is earned over the term of a life insurance policy. The total profit recognised over the lifetime of the policy is the same as that recognised under the IFRS basis of reporting, but the timing of recognition is different.

Covered business

Covered business comprises the following:

- all life and pensions business written by Friends Provident's UK and overseas life insurance subsidiaries;
- all life and pensions business written by the AXA UK Life Business;
- Friends Provident's 30% share in AmLife, a Malaysian based life insurance business.

These businesses are collectively referred to as "life and pensions covered business".

The STICS and external lower tier 2 subordinated debt are formally allocated to covered business on the basis that all obligations to make payments in respect of this debt are guaranteed by FPLP. The STICS and external lower tier 2 subordinated debt are included within the MCEV at market value, based on listed bid price.

1 Copyright© Stichting CFO Forum Foundation 2008.

1. Basis of preparation continued

Non-covered business

The Group's non-covered business includes the IFA distribution businesses, the management services businesses and the net pension asset of FPPS on an IAS 19 basis. FPH corporate net assets, Resolution Limited corporate net assets, the Deferred Consideration Notes issued by Resolution Limited, the acquisition finance facility of the Resolution holding companies and the lower tier 2 subordinated debt issued by FPH to Resolution holding companies are all non-covered business.

Whilst the management services businesses are classified as non-covered, the expenses and cash flows of those businesses are linked to the life and pensions businesses via service agreements. The cash flows of the companies are calculated on the "look-through" principle and are allowed for when setting appropriate expense and tax assumptions.

Segmental reporting under MCEV

The covered business within Friends Life group has been split into the following segments in line with IFRS reporting:

- UK, which includes the life and pensions businesses within the UK from Friends Provident and the AXA UK Life Business;
- International, which includes FPIL, the overseas life assurance business within the Friends Provident life and pensions subsidiaries and Friends Provident's share in AmLife; and
- Lombard.

Corporate functions are not strictly an operating segment, but are reported to management, and are provided to reconcile the Group's reportable segments to total profit. FPH corporate includes the STICS and external lower tier 2 subordinated debt and the cost of holding any required capital in excess of the operating segment capital policy.

Comparative figures for 2009 have been amended to reflect the revised segmentation as set out in note 12.

New business

New business within the life and pensions covered business includes:

- premiums from the sale of new policies;
- payments on recurring single premium policies, including Department for Work and Pensions rebate premiums, except existing stakeholder-style pensions business where, if a regular pattern in the receipt of premiums for individuals has been established, the regular payment is treated as a renewal of an existing policy and not new business;
- non-contractual increments on existing policies; and
- new entrants to existing schemes in the group pensions business.

The MCEV new business definition is consistent with the quarterly new business disclosures.

Calculation of embedded value

The MCEV provides an estimate of the value of shareholders' interest in the covered business, excluding any value that may be generated from future new business. The MCEV comprises the sum of the shareholders' net worth of the life and pensions covered business and the value of in-force covered business. The shareholders' net worth of the life and pensions covered business includes the listed debt of the STICS and external lower tier 2 subordinated debt at market value, based on listed bid price.

The MCEV is calculated on a post-tax basis. Where gross results are presented, these have been calculated by grossing up the post-tax results at the appropriate rate of corporation tax for each segment.

The reported Group MCEV provides an estimate of the total consolidated MCEV of the Group and comprises the MCEV in respect of the life and pensions covered business, plus the IFRS net assets in respect of the non-covered business, excluding intangible assets relating to future new business.

a) Shareholders' net worth

The shareholders' net worth of the life and pensions covered business consists of free surplus and required capital.

Free surplus is the market value of any assets allocated, but not required, to support the in-force covered business at the valuation date. Required capital is the market value of assets, attributed to the covered business over and above that required to back liabilities for covered business, whose distribution to shareholders is restricted. The Group's required capital is set at the greater of local regulatory capital requirements and those requirements arising from internal capital management policies, which include economic risk capital objectives. The economic risk capital is determined from internal models, based on the Group's risk appetite. The level of required capital is shown in note 10.

b) Value of in-force covered business

The value of in-force covered business consists of:

- present value of future profits; less
- time value of financial options and guarantees;
- frictional costs of required capital; and
- cost of residual non-hedgeable risks.

Present value of future profits ("PVFP")
The value of existing business is the present value of the future distributable profits available to shareholders from the in-force covered business. Future profits are projected using best estimate non-economic assumptions and market consistent economic assumptions.

1. Basis of preparation continued

The non-economic assumptions include: the behaviour of customers (eg persistency), mortality, the level of expenses required to maintain the book of business, tax and the regulatory environment. The assumptions are a reflection of best estimates of the likely behaviours, outcomes, or circumstances in the future. The estimates are made, typically, on an annual basis following experience investigations based on the data available at the time both from the book of business and externally sourced information.

The aim is to set assumptions at a level that reflects recent or current experience.

The PVFP includes the capitalised value of profits and losses arising in subsidiary companies providing administration and other services to the extent that they relate to covered business. This is referred to as the "look through" into service company expenses. In addition expenses arising in holding companies that relate directly to acquiring or maintaining covered business have been allowed for.

In valuing shareholders' cash flows, allowance is made in the cash flow projections for taxes in the relevant jurisdiction affecting the covered business. Tax assumptions are based on best estimate assumptions, applying local corporate tax legislation and practice together with known future changes and taking credit for any deferred tax assets.

The economic assumptions are market consistent whereby, in principle, each cash flow is valued in line with the price of similar cash flows that are traded in the capital markets. For example, an equity cash flow is valued using an equity risk discount rate, and a bond cash flow is valued using a bond risk discount rate. If a higher return is assumed for equities, the equity cash flow is discounted at this higher rate.

In practice, for liabilities where the payouts are either independent or move linearly with market movements, a method known as the "certainty equivalent approach" has been applied whereby all assumed assets earn the reference rate and all cash flows are discounted using the reference rate. This gives the same result as applying the method in the previous paragraph.

Time value of financial options and guarantees ("TVOG")
The PVFP is based on a single deterministic projection of future economic assumptions. However, a single projection does not fully reflect the potential for extreme events and the resulting impact of options and guarantees on the shareholder cash flows. While the PVFP allows for the intrinsic value of an option or guarantee under a single set of economic assumptions, it does not reflect the potential range of future economic scenarios on the shareholder cash flows. Stochastic modelling techniques are used to assess the impact of potential future economic scenarios on an option or guarantee and to determine the average value of shareholder cash flows under a number of market consistent scenarios.

The TVOG is calculated as the difference between the average value of shareholder cash flows under a number of market consistent scenarios, and the intrinsic value under a single projection within the PVFP.

The material financial options and guarantees are those in the with-profits funds of the subsidiary life companies of FPH, in the form of the benefits guaranteed to policyholders and the guaranteed annuity rates associated with certain policies. The risk to shareholders is that the assets of the with-profits funds are insufficient to meet these guarantees. While shareholders are entitled to only a small share of profits in the with-profits funds (via one-ninth of the cost of bonus), they can potentially be exposed to the full cost of fund assets being insufficient to meet policyholder guarantees. The TVOG has been assessed using a stochastic model derived from the current Realistic Balance Sheet ("RBS") model. This model has been calibrated to market conditions at the valuation date. Allowance has been made under the different scenarios for management actions, such as altered investment strategy, consistent with the RBS model. The TVOG would be markedly higher without the hedging activities and management actions currently undertaken.

Only modest amounts of new with-profits business are written and the guarantee levels offered are lower, hence there is no material impact in respect of the TVOG on the value of new business.

Frictional costs of required capital
The value of in-force covered business includes a deduction for the additional costs to an investor of holding the assets backing required capital through investment in a life company, rather than investing in the asset directly. These additional frictional costs comprise taxation and investment expenses on the assets backing the required capital.

The frictional costs of required capital are calculated as the difference between the market value of assets backing required capital and the present value of future releases of that capital allowing for future investment return (net of frictional costs) on that capital. The calculation allows for the run-off of the required capital over time using projections of the run-off of the underlying risks and regulatory requirements.

Details of the level of required capital are set out in note 10.

Cost of residual non-hedgeable risks ("CNHR")
The main area of non-hedgeable risk relates to non-financial risks, such as insurance and operational risks, where no deep, liquid market exists to fully mitigate the risk. Allowance for non-financial risk is made directly within:

- the PVFP via an appropriate choice of best estimate assumptions and with the impact of variability of the risk on the level, and hence cost, of required capital; and
- the TVOG for the impact of variations of non-financial risks on the possibility of shareholders needing to meet the guarantees within the with-profits funds of the subsidiary life companies of FPH.

1. Basis of preparation continued

The CNHR covers those non-hedgeable risks not already allowed for fully in the PVFP or in the TVOG. The most significant of these risks are those for which the impact of fluctuations in experience is asymmetric; where adverse experience has a higher impact on shareholder value than favourable experience and the best estimate assumptions do not reflect this asymmetry. The areas identified as having the potential for material asymmetry are operational risk, persistency risk and reinsurance counterparty default risk.

The CNHR has been calculated by considering the financial cost to shareholders of the impact of asymmetric risks and with regard to the results of risk-based capital modelling. The risk-based capital is calculated using internal models, consistent with those used in the Group's Individual Capital Assessment, with:

- a 99.5% confidence level over one year;
- allowance for diversification between non-hedgeable risks;
- no allowance for diversification between non-hedgeable and hedgeable risks; and
- no allowance for diversification between covered and non-covered business.

The CNHR impacts both the value of existing business and new business.

Participating business
Future regular bonuses on participating business are projected in a manner consistent with current bonus rates and expected future market consistent returns on assets deemed to back the policies.

Future terminal bonuses are assumed to be set at a level to exhaust all the assets deemed to back the policies over the future lifetime of the in-force with-profit policies.

The PVFP includes the shareholders' share of future profits from the with-profits funds, based on the assumed bonus rates.

There may be some extreme future economic scenarios in which total assets in each of the with-profits funds are not sufficient to pay all policyholder claims and the resulting shortfall would be met by shareholders. Stochastic modelling techniques are used to assess the impact of future economic scenarios on the with-profits funds' ability to pay all policyholder claims and to determine the average additional cost to shareholders arising from future projected shortfalls. This cost to shareholders has been included in the TVOG.

Consolidation adjustments

The effect of transactions and reinsurance arrangements between life insurance subsidiary companies has been included in the results split by segment in a consistent manner. No elimination is required on consolidation.

Goodwill and intangibles

Goodwill and intangibles relating to the non-covered business are included on an IFRS basis. Intangible assets recognised under IFRS relating to the value of future new business, such as distribution relationships and brand value, have been excluded from the Group MCEV.

Exchange rates

The results and cash flows of overseas subsidiaries and joint ventures have been translated at the average exchange rates for the period and the assets and liabilities have been translated at the period end rates. Translation differences are shown as foreign exchange adjustments in the consolidated statement of comprehensive income. Exchange rate driven movements in MCEV earnings are reported within economic variances.

Details of the exchange rates used are shown in note 10.

2. Analysis of MCEV earnings

The following tables show the movement in the MCEV of Resolution Limited including the results for Friends Provident and the AXA UK Life Business from the dates of their acquisitions (5 November 2009 and 3 September 2010 respectively).

All of the Group's covered business is wholly contained within the Friends Life group.

The analysis is shown separately for free surplus, required capital and the value of the in-force covered business. All figures are shown net of tax.

For the year ended 31 December 2010

	FPH						Resolution Limited	
	Covered business							
Net of tax	Free surplus £m	Required capital £m	VIF £m	MCEV £m	Non-covered business £m	Total £m	Non-covered business £m	Total £m
Opening MCEV[i]	812	362	1,873	3,047	134	3,181	307	3,488
Opening adjustments:								
– capital and dividend flows	–	–	–	–	2,165	2,165	(186)	1,979
– acquired/divested businesses	30	1,409	1,904	3,343	155	3,498	–	3,498
– cost of acquisition	–	–	–	–	(2,724)	(2,724)	–	(2,724)
Adjusted opening MCEV	842	1,771	3,777	6,390	(270)	6,120	121	6,241
Value of new business	(245)	31	331	117	–	117	–	117
Expected existing business contribution:								
– expected existing business contribution (reference rate)	13	(3)	30	40	–	40	–	40
– expected existing business contribution (in excess of reference rate)	5	(8)	162	159	–	159	–	159
Transfers from VIF and required capital to free surplus	386	(32)	(354)	–	–	–	–	–
Experience variances	4	(38)	30	(4)	–	(4)	–	(4)
Operating assumption changes	(42)	5	20	(17)	–	(17)	–	(17)
Other operating items	36	(3)	13	46	(10)	36	(15)	21
Operating MCEV earnings	157	(48)	232	341	(10)	331	(15)	316
Economic variances	104	(61)	131	174	(2)	172	–	172
Other non-operating items	288	(406)	70	(48)	34	(14)	(14)	(28)
Total MCEV earnings	549	(515)	433	467	22	489	(29)	460
Other movements in IFRS net equity	–	–	–	–	(22)	(22)	(20)	(42)
Closing adjustments:								
– capital and dividend flows	(416)	37	3	(376)	314	(62)	(71)	(133)
– foreign exchange variances	2	(2)	(11)	(11)	–	(11)	–	(11)
Closing MCEV	977	1,291	4,202	6,470	44	6,514	1	6,515

(i) The opening MCEV split between free surplus, required capital and VIF has changed. See note 12.

For the year ended 31 December 2010, Resolution holding companies contributed operating MCEV earnings of £(15) million and non-operating MCEV earnings of £(14) million.

2. Analysis of MCEV earnings continued

For the year ended 31 December 2009

Net of tax	FPH (restated) 5 November to 31 December 2009 Covered business Free surplus £m	Required capital £m	VIF £m	MCEV £m	Non-covered business £m	Total £m	Resolution Limited Year ended 31 December 2009 Non-covered business £m	Total £m
Opening MCEV[i]	–	–	–	–	–	–	650	650
Opening adjustments:								
– acquired/divested businesses	860	354	1,769	2,983	87	3,070	(2,028)	1,042
Adjusted opening MCEV	860	354	1,769	2,983	87	3,070	(1,378)	1,692
Value of new business	(20)	7	51	38	–	38	–	38
Expected existing business contribution:								
– expected existing business contribution (reference rate)	4	(2)	9	11	–	11	–	11
– expected existing business contribution (in excess of reference rate)	1	(3)	12	10	–	10	–	10
Transfers from VIF and required capital to free surplus	39	(1)	(38)	–	–	–	–	–
Experience variances	(10)	–	(13)	(23)	–	(23)	–	(23)
Operating assumption changes	4	–	(3)	1	–	1	–	1
Other operating variances	–	–	–	–	2	2	(13)	(11)
Operating MCEV earnings	18	1	18	37	2	39	(13)	26
Economic variances	7	5	15	27	15	42	–	42
Other non-operating items	5	–	–	5	(2)	3	–	3
Total MCEV earnings	30	6	33	69	15	84	(13)	71
Other movements in IFRS net equity	–	–	–	–	29	29	–	29
Closing adjustments:								
– capital and dividend flows	(78)	2	74	(2)	3	1	1,698	1,699
– foreign exchange variances	–	–	(3)	(3)	–	(3)	–	(3)
Closing MCEV	812	362	1,873	3,047	134	3,181	307	3,488

(i) The opening and closing MCEV split between free surplus, required capital and VIF has changed. See note 12.

Further details of the calculation and analysis of the value of new business are set out in note 6.

The expected existing business contribution is the sum of two components:

- the expected earnings over the period assuming the opening assets earn the beginning of period reference rate; and
- the additional expected earnings (in excess of the beginning of period reference rate) consistent with management's expectation for the business.

The reference rate is based on the one-year swap return plus, for UK immediate annuity business only, an illiquidity premium.

The additional earnings are the excess over the reference rate and reflect management's long-term expectation of asset returns, based on assumed asset mix.

Detailed business commentary relating to the analysis of MCEV earnings is shown in note 3. Note 3 shows the analysis of MCEV earnings by business segment and on a gross of tax basis, with attributed tax shown separately.

3. Segmental analysis of MCEV earnings

The table below shows a further breakdown of the MCEV earnings. All of the Group's covered business is wholly contained within FPH.

All earnings are shown on a gross of tax basis with attributed tax shown separately.

For the year ended 31 December 2010

	FPH						Resolution Limited	
	Covered business							
Gross of tax	UK £m	Int'l £m	Lombard £m	FPH corporate £m	Non-covered business £m	Total £m	Resolution (ex. FPH) Non-covered business £m	Total £m
Value of new business	19	43	83	–	–	145	–	145
Expected existing business contribution	210	29	38	(30)	–	247	–	247
Operating experience variances	37	12	(17)	–	–	32	–	32
Operating assumption changes	(41)	(2)	20	–	–	(23)	–	(23)
Other operating variances	96	(7)	39	(63)	–	65	–	65
Development costs	(21)	(6)	(1)	–	–	(28)	–	(28)
Life and pensions covered business operating profit/(loss) before tax	300	69	162	(93)	–	438	–	438
Other income and charges	–	–	–	–	(11)	(11)	–	(11)
Life and pensions operating profit/(loss) before tax	300	69	162	(93)	(11)	427	–	427
Corporate income and charges	–	–	–	–	–	–	(15)	(15)
Operating profit/(loss) before tax	300	69	162	(93)	(11)	427	(15)	412
Economic variances	276	25	33	(103)	(2)	229	–	229
Other non-operating items	(48)	(1)	1	(20)	57	(11)	(14)	(25)
Profit/(loss) before tax	528	93	196	(216)	44	645	(29)	616
Attributed tax on operating profits	(81)	(4)	(39)	27	1	(96)	–	(96)
Attributed tax on other activities	(59)	(1)	(7)	30	(23)	(60)	–	(60)
Profit/(loss) after tax	388	88	150	(159)	22	489	(29)	460

3. Segmental analysis of MCEV earnings continued

For the year ended 31 December 2009

	Restated FPH[i]						Resolution Limited	
	Covered business							
Gross of tax	UK £m	Int'l £m	Lombard £m	FPH corporate £m	Non-covered business £m	Total £m	Resolution (ex. FPH) Non-covered business £m	Total £m
Value of new business	–	9	43	–	–	52	–	52
Expected existing business contribution	26	5	4	(7)	–	28	–	28
Operating experience variances	(12)	(6)	(7)	–	–	(25)	–	(25)
Operating assumption changes	1	–	–	–	–	1	–	1
Other operating variances	–	–	–	–	–	–	–	–
Development costs	(3)	(2)	–	–	–	(5)	–	(5)
Life and pensions covered business operating profit/(loss) before tax	12	6	40	(7)	–	51	–	51
Other income and charges	–	–	–	–	3	3	–	3
Life and pensions operating profit/(loss) before tax	12	6	40	(7)	3	54	–	54
Corporate income and charges	–	–	–	–	–	–	(13)	(13)
Operating profit/(loss) before tax	12	6	40	(7)	3	54	(13)	41
Economic variances	3	10	14	7	6	40	–	40
Other non-operating items	6	–	–	–	(2)	4	–	4
Profit/(loss) before tax	21	16	54	–	7	98	(13)	85
Attributed tax on operating profits	(4)	(1)	(11)	2	(1)	(15)	–	(15)
Attributed tax on other activities	(3)	–	(4)	(1)	9	1	–	1
Profit/(loss) after tax	14	15	39	1	15	84	(13)	71

(i) 5 November 2009 to 31 December 2009.

UK covered

The life and pensions covered business operating profit before tax for the UK segment is £300 million in 2010.

VNB

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The reference rate is based on the one-year swap return plus, for UK immediate annuity business only, an illiquidity premium equivalent to 75 bps at the beginning of the year.

The additional earnings are the excess over the reference rate and reflect management's long-term expectation of asset returns, based on an assumed asset mix.

The total expected contribution of £210 million comprises £177 million from applying expected rates of return to the value of in-force at the start of the period and £33 million of expected return on shareholders' net assets.

The expected contribution from the value of in-force of £177 million reflects the expected rates of return applied to the opening value of in-force of £1,091 million at 31 December 2009 and the value of in-force from the AXA UK Life Business of £1,904 million at 3 September 2010.

The UK expected contribution on shareholders' net worth of £33 million includes offsetting items for the expected income on shareholder investments, including the use of a one-year return on bonds rather than a long-term average yield, and interest payable on debt instruments which is recharged to the life companies and is fixed in amount.

3. Segmental analysis of MCEV earnings continued

Operating experience variances

Operating experience variances relate to variances between actual experience and that anticipated in the projection assumptions. Operating experience variances totalled £37 million and comprise the following elements:

- a £12 million benefit from tax variances, notably £14 million in respect of a prior year's tax provision;
- a £11 million benefit from lower than assumed mortality on life protection business;
- a £16 million benefit from better than assumed morbidity experience on income protection business;
- a £7 million benefit from an accumulation of small operational and processing variances;
- a £4 million benefit from actual expenses being lower than long-term expense assumptions;
- a £(9) million charge from an increase in the vacant property charge provision, primarily relating to the relocation of the London head office of FPH;
- a £(5) million charge in respect of worse than expected persistency experience on the AXA UK Life Business. Persistency levels for Friends Provident business have been in line with expectations of a period of higher lapses compared with long-term assumptions given the challenging economic environment. At 31 December 2009 a provision of £64 million (gross of tax) was set up to cover short-term adverse persistency. At 31 December 2010, £27 million of this provision has been used to meet the adverse variance over 2010; the remaining provision is £37 million; and
- other minor variances totalling £1 million.

Operating assumption changes

The effect of operating assumption changes totalled £(41) million.

The Company reviewed the annuitant mortality assumptions of both Friends Provident and the AXA UK Life Businesses. This review has led to a strengthening of the assumptions and the resulting basis across the UK is now harmonised. This contributed £(47) million to operating assumption changes in 2010.

Other changes of £6 million include £3 million in relation to changes in persistency assumptions for some minor product lines, and £3 million of changes to operational assumptions underlying the TVOG.

Other operating variances

Other operating variances of £96 million include the effects of a number of items:

- £21 million following an increase in the value of tax assets within the AXA UK Life Business;
- £26 million from a change in the timing of modelled tax relief on group pensions business;
- £13 million relating to on-going reviews of systems and processes;
- £12 million from changes to the presentation by segment of frictional costs of capital. In previous years the cost of capital in respect of FPH corporate has been shown under the UK segment. There is an offsetting adjustment within the FPH corporate category;
- £9 million relating to the allowance for variable charging structures in the modelling of group pensions business;
- £12 million of other minor operating variancies;
- £3 million from changes to the operational risk profile that reduced the cost of non-hedgeable risk.

Development costs

Development costs of £21 million relate to costs that are expected to enhance current propositions and generate future profits which are not captured in the MCEV. These costs relate principally to the development of the corporate investment platform and the development costs associated with tied distribution arrangements.

3. Segmental analysis of MCEV earnings continued

International covered

The life and pensions operating profit for International is £69 million in 2010.

VNB

Further details of the calculation and analysis of the VNB are discussed in note 6.

Existing business contribution

The expected contribution of £29 million comprises £27 million of expected return on the opening value of in-force of £398 million, and £2 million from the expected return on shareholders' net assets.

Operating experience variances

Operating experience variances of £12 million comprise:

- a £4 million benefit from better persistency than anticipated. At 31 December 2009 a recessionary provision of £6 million (net of tax) was set aside to cover short-term adverse persistency. At 31 December 2010 this provision has been released, and persistency experience has been broadly in line with the long-term persistency assumptions;
- a £3 million benefit from mortality experience being better than anticipated;
- a £4 million benefit from higher levels of fund rebates than anticipated; and
- £1 million of other variances.

Operating assumption changes

Operating assumption changes of £(2) million comprise:

- £(12) million from changes to the modelling and assumptions underlying the investment management charges on unit-linked mirror fund contracts;
- £7 million in respect of changes to persistency assumptions for single premium bond contracts;
- £2 million from the release of the remaining expense overrun provision included at 31 December 2009; and
- £1 million from a review of mortality assumptions.

Other operating variances

Other operating variances of £(7) million including £4 million relating to AmLife.

Development costs

Development costs of £6 million include £3 million in respect of the development of the German pensions proposition, and £3 million in respect of the development of on-line systems for International business.

Lombard covered

The MCEV operating profit from Lombard is £162 million in 2010.

VNB

Further details of the calculation and analysis of the VNB are discussed in note 6.

3. Segmental analysis of MCEV earnings continued

Existing business contribution

The expected contribution of £38 million reflects the expected return on the opening value of in-force of £378 million.

Operating experience variances

Operating experience variances of £(17) million comprise:

- £(11) million from persistency experience being worse than that assumed within the long-term assumptions. This included an £8 million benefit from all territories outside Spain, but a £19 million charge resulting from significantly increased surrenders of Spanish policies in the final quarter of 2010 driven by economic conditions in Spain;
- £2 million benefit from actual expenses being lower than long-term assumptions;
- £(4) million in respect of various taxation variances;
- £(4) million from renegotiation of fees with key third-party providers;
- £3 million benefit from better than assumed mortality experience; and
- £(3) million from other small variances.

Operating assumption changes

Operating assumption changes of £20 million comprise:

- £18 million from changes to expense assumptions across the major product classes and territories;
- £8 million in respect of changes to persistency assumptions in all markets outside Spain; and
- £(6) million set up as a short-term persistency provision in respect of the Spanish market.

Other operating variances

Other operating variances of £39 million comprise:

- £32 million following changes to the corporate structure of the Lombard companies, resulting in a reduced assumed overall tax rate for the Lombard segment; and
- £7 million following a change in the operational risk capital underlying the cost of non-hedgeable risk.

FPH corporate covered

FPH corporate includes the STICS, the external lower tier 2 subordinated debt, and the cost of holding any required capital in excess of the operating segment capital policy.

The expected existing business contribution of £(30) million represents the expected annual interest costs arising on the debt held within the FPH life and pensions covered business.

The other operating variances of £(63) million represent the frictional costs of holding any required capital in excess of the operating segment capital policy.

Non-covered

FPH non-covered business reported an operating loss of £11 million due to interest payable on the lower tier 2 subordinated debt issued to Resolution holding companies offset by a number of smaller items including Sesame Bankhall operating profit of £6 million.

Resolution Limited non-covered business reported an operating loss of £(15) million due to £19 million of interest income on the lower tier 2 subordinated debt issued by FPH and £2 million on largely cash-based assets offset by £(17) million of finance costs and £(19) million from a combination of the fees payable to ROL, directors' emoluments as well as other day-to-day expenses.

3. Segmental analysis of MCEV earnings continued

Economic variances

Economic variances combine the impact of changes to economic assumptions with the investment return variances over the year.

Total economic variances of £229 million include:

- £147 million due to the net effect of positive investment returns on UK unit-linked business particularly evident in the fourth quarter of 2010;
- £50 million contribution from shareholder net worth where the value of fixed interest stocks held have increased as a result of falling yields;
- £47 million of investment benefits from the assets backing non-linked liabilities, after allowance for changes in economic assumptions;
- £(103) million from an increase in the market value of debt;
- £58 million from International and Lombard segments as a result of a combination of positive investment returns on unit-linked business and favourable exchange rate movements; and
- £30 million of other investment variances, including investment related tax variances and the reduction in frictional costs of capital due to economic conditions.

Other non-operating items

Total other non-operating items of £(25) million include:

- £(75) million in respect of the cost recharged from the non-covered business to the covered businesses of the scheduled additional pension contributions over the next four years. An offsetting item of £75 million is included within the non-covered business;
- £(19) million in respect of increased investment expense assumptions following the increase in VAT from 1 January 2011 from 17.5% to 20%;
- £55 million in respect of the proposed changes to UK corporation tax announced in June 2010. The corporation tax has been assumed to reduce by 1% to 27% in April 2011, and then by 1% each year until it reaches the ultimate rate of 24% from April 2014;
- £30 million from the recognition of a deferred tax asset;
- £(61) million in respect of non-recurring project costs within the covered business, including project costs in respect of acquiring and integrating UK businesses, Solvency II, financial reporting improvements and capital projects;
- £(14) million in FPH non-covered business in relation to stamp duty on the acquisition of the AXA UK Life Business; and
- £(14) million in Resolution Limited non-covered business in relation to costs associated with the acquisition of the AXA UK Life Business.

4. Earnings per share

Earnings per share have been calculated based on the MCEV profit after tax and on the operating profit after tax, attributable to ordinary equity holders of the parent and the weighted average number of shares in issue. The directors consider that operating earnings per share provides a better indication of operating performance.

As described in note 14 of the IFRS financial statements, in connection with the acquisition of the AXA UK Life Business, the Company undertook a rights issue and share consolidation in 2010. The earnings per share figures for 2009 have been recalculated to reflect the share consolidation and rights issue undertaken in 2010 in accordance with IAS33: Earnings per Share. In addition, the voluntary disclosure made in the 2010 interim report in respect of the year ended 31 December 2009, i.e. on a pre-share consolidation and rights issue basis, are repeated.

4. Earnings per share continued

Basic and operating earnings per share

Year ended 31 December 2010	Earnings £m	Per share pence
Profit after tax attributable to ordinary equity holders of the parent	**460**	**48.77**
Economic variances	**(229)**	**(24.28)**
Amortisation of non-covered business acquired intangible assets	**3**	**0.32**
Non-recurring items and non-operating variances	**22**	**2.33**
Tax credit on items excluded from operating profit	**60**	**6.36**
Operating profit after tax attributable to ordinary equity holders of the parent	**316**	**33.50**

		Pence per share	
Year ended 31 December 2009	Earnings £m	Pre share consolidation	Post share consolidation
Profit after tax attributable to ordinary equity holders of the parent	71	7.60	30.54
Economic variances	(40)	(4.28)	(17.21)
Amortisation of non-covered business acquired intangible assets	1	0.11	0.43
Non-recurring items and non-operating variances	(5)	(0.54)	(2.15)
Tax credit on items excluded from operating (loss)	(1)	(0.11)	(0.43)
Operating profit after tax attributable to ordinary equity holders of the parent	26	2.78	11.18

Diluted earnings per share from continuing operations

Dilutive factors comprise the expected impact of the Lombard management incentive scheme. Awards made under the FPH executive long-term incentive plan introduced in March 2010 had no dilutive impact at 31 December 2010.

	2010 £m	2010 Weighted average number of shares Number	2010 Per share Pence
Profit after tax attributable to ordinary shareholders of the parent	**460**	**943,284,481**	**48.77**
Dilution	**–**	**7,347,287**	**(0.38)**
Diluted profit after tax attributable to ordinary shareholders of the parent	**460**	**950,631,768**	**48.39**

	2009 £m	2009 Weighted average number of shares Number	2009 Per share Pence
Profit after tax attributable to ordinary shareholders of the parent	71	232,483,943	30.54
Dilution	–	400,500	(0.05)
Diluted profit after tax attributable to ordinary shareholders of the parent	71	232,884,443	30.49

The following table repeats the disclosure made in the 2010 interim report in respect of the year ended 31 December 2009 on a pre-share consolidation basis.

	2009 £m	2009 Weighted average number of shares Number	2009 Per share Pence
Profit after tax attributable to ordinary shareholders of the parent	71	933,670,453	7.60
Dilution	–	1,608,435	(0.01)
Diluted profit after tax attributable to ordinary shareholders of the parent	71	935,278,888	7.59

4. Earnings per share continued

Weighted average number of ordinary shares

	2010 Actual	2010 Weighted
Issued ordinary shares at beginning of period	**2,412,451,145**	**2,412,451,145**
Effect of:		
– scrip dividend (final 2009)	**5,753,268**	**3,436,198**
– share consolidation	**(2,337,597,599)**	**(2,335,357,765)**
– rights issue	**1,370,315,835**	**865,193,173**
– scrip dividend (interim 2010)	**1,641,722**	**382,319**
– treasury shares	**(8,579,292)**	**(2,820,589)**
Number of ordinary shares at end of period	**1,443,985,079**	**943,284,481**

	2009 Actual	2009 Weighted	2009 Adjusted[i]
Issued ordinary shares at beginning of period	660,000,000	660,000,000	660,000,000
Effect of:			
– ordinary shares issued	1,752,451,145	273,670,453	1,752,451,145
Number of shares before share consolidation and rights issue	2,412,451,145	933,670,453	2,412,451,145
– share consolidation	–	(902,548,104)	(2,332,036,107)
– rights issue	–	201,361,594	520,285,297
Number of ordinary shares at end of period	2,412,451,145	232,483,943	600,700,335

(i) adjusted to include impact of share consolidation and rights issue.

5. Reconciliation of equity attributable to ordinary shareholders

Ordinary shareholders' equity on the MCEV basis reconciles to equity attributable to ordinary shareholders on the IFRS basis as follows:

	Resolution Limited	Restated Resolution Limited	FPH	Restated FPH
	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Equity attributable to ordinary shareholders on an IFRS basis	**6,227**	3,655	6,226	3,348
Less items only included on an IFRS basis:				
– IFRS reserving and other IFRS adjustments	**507**	414	507	414
– Deferred front end fees	**24**	8	24	8
– Deferred acquisition costs	**(201)**	82	(201)	82
– Acquired present value of in-force ("AVIF") (net of tax)	**(3,608)**	(2,285)	(3,608)	(2,285)
– Other intangible assets (net of tax)	**(332)**	(258)	(332)	(258)
– Other[i]	**(236)**	–	(236)	–
Add items only included on a MCEV basis:				
– Adjustment for long-term debt to market value (net of deferred tax)	**(68)**	(1)	(68)	(1)
Net worth on a MCEV basis	**2,313**	1,615	2,312	1,308
Value of in-force covered business[i]	**4,202**	1,873	4,202	1,873
Equity attributable to ordinary shareholders on a MCEV basis	**6,515**	3,488	6,514	3,181

(i) GOF and TIP businesses are classified as held for sale assets and liabilities in both the Group's IFRS and MCEV balance sheets with a net value of £281 million. Within the MCEV balance sheet the held for sale assets are further split between value of in-force covered business of £236 million and other assets. Within MCEV supplementary information the value of in-force covered business for the GOF and TIP businesses is included in the Group's total value of in-force covered business of £4,202 million.

6. New business

The tables below set out the analysis of new business in terms of volumes and profitability.

New business volumes have been shown using two measures:

- Present Value of New Business Premiums ("PVNBP"). PVNBP is equal to the total single premium sales received in the period plus the discounted value of regular premiums expected to be received over the lifetime of new contracts, and is expressed at point of sale; and
- Annual Premium Equivalent ("APE"). APE is calculated as the new regular premium per annum plus 10% of single premiums.

The MCEV new business definition is consistent with the quarterly new business disclosures.

The premium volumes and projection assumptions used to calculate the present value of regular premiums within PVNBP are the same as those used to calculate the value of new business.

The value of new business is calculated using economic assumptions at the beginning of the period for all products except immediate annuities. For annuity business, as the contribution is sensitive to the interest rate at outset, the appropriate rate for each month's new business is used.

The value of new business is calculated using operating assumptions at the end of period for all products. The operating assumptions are consistent with those used to determine the embedded value.

The value of new business is shown after the effects of the frictional costs of holding required capital and share-based payments, and after the effect of the costs of residual non-hedgeable risks on the same basis as for the in-force covered business.

The tables below exclude new business in relation to the GOF and TIP businesses.

Resolution Limited new business value for the year ended 31 December 2010

	New business premiums							
	Single £m	Regular £m	APE £m	Average annual premium multiplier(i)	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
UK Corporate								
– Group pensions	273	303	330	4.2	1,535	(4)	(5)	(0.3)
– Group protection	–	6	6	5.3	32	–	–	–
UK Individual								
– Individual protection	19	50	52	6.1	323	(9)	(13)	(4.0)
– Individual pensions	226	9	31	7.9	297	5	7	2.4
Annuities(ii)	290	–	29	–	290	19	26	9.0
Investments	239	–	24	–	239	3	4	1.7
UK total	1,047	368	472	4.6	2,716	14	19	0.7
International	515	186	238	4.8	1,405	40	43	3.0
Lombard	3,022	–	302	–	3,022	63	83	2.7
Non-UK total	3,537	186	540	4.8	4,427	103	126	2.8
Total	4,584	554	1,012	4.6	7,143	117	145	2.0

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).
(ii) The value of new business for annuities shown in the table above has been valued assuming an average illiquidity premium of 75bps over the 12 months to 31 December 2010.

6. New business continued

Resolution Limited new business value for the period from 5 November to 31 December 2009

	New business premiums Single £m	New business premiums Regular £m	APE £m	Average annual premium multiplier(i)	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
UK Corporate								
– Group pensions	61	40	46	3.7	207	(2)	(2)	(0.9)
– Group protection	–	1	1	3.0	3	–	–	–
UK Individual								
– Individual protection	–	6	6	6.2	37	(2)	(3)	(8.1)
– Individual pensions	13	1	2	4.0	17	–	–	–
Annuities(ii)	34	–	3	–	34	4	5	14.7
Investments	5	–	1	–	5	–	–	–
UK total	113	48	59	4.0	303	–	–	–
International	66	32	39	4.9	222	7	9	4.1
Lombard	1,877	–	188	–	1,877	31	43	2.3
Non-UK total	1,943	32	227	4.9	2,099	38	52	2.5
Total	2,056	80	286	4.3	2,402	38	52	2.2

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).
(ii) The value of new business for annuities shown in the table above has been valued assuming an average illiquidity premium of 80bps over the period from 5 November 2009 to 31 December 2009.

UK

The pre-tax VNB from the UK segment was £19 million, comprising:

- UK Corporate pre-tax VNB of £5 million before the contribution of the AXA UK Life Business. This amount was principally derived from the Group pensions proposition, where the market remains challenging. The fall in volumes was offset by the expense control efficiencies. A change to the methodology and modelling of tax relief also served to reduce the VNB from this proposition. The Group Protection contribution was nil and new business volumes were impacted by a smaller market and competitive price levels. The contribution of the AXA UK Life Business to UK Corporate was £(10) million. The loss reflects reduced business volumes since acquisition as a result of uncertainties in the market surrounding the AXA UK Life Business propositions ahead of the announcement of the conclusions of the Group's UK strategic review;
- UK Individual and Investments of £(2) million. The protection market remains subdued and volumes written reflect this. The contribution improved over 2010 as lower acquisition expense levels more than offset the reduction in volumes; and
- Annuities of £26 million. The contribution from annuities was adversely affected by a £3 million strengthening of the annuitant mortality basis. Annuity sales peaked in the first half of the year following changes to the minimum retirement age.

International

International VNB was £43 million in the year with volume related increases being principally offset by reduced margins, strengthened assumptions and internal model improvements.

Margin levels have suffered some compression in 2010 and reflect the overall change in business mix towards the business's regular premium savings product, as well as competitive market pressures. In addition, the contribution from new business has also been impacted by model changes following a review of modelling and assumptions underlying investment management fees.

AmLife, the 30% owned Malaysian associate, performed well over the year. The business, which mainly distributes through bancassurance and tied agency sales channels delivered sales of £10 million up 8% on 2009. VNB in the period has remained consistent with that delivered in 2009.

6. New business continued

Lombard

Lombard new business contribution of £83 million has significantly increased in 2010 driven principally by a 10% increase in annual sales whilst acquisition costs have been maintained at a level comparable to 2009. Sales volumes have benefited from an increased marketing effort and returning client confidence in a number of markets with particularly strong improvements in Belgium and the UK. The business also continued to realise sustained levels of business driven by clients restructuring their portfolios in Italy. The return in confidence is further illustrated by the increased proportion of larger cases (transactions greater than 10 million Euros) which increased from 22% of total sales in 2009 to 30% in 2010. These cases bring significant funds onto the administrative platform but have not resulted in lower margins. The new business margins achieved in 2010 of 2.7% compares to 2.3% in 2009 as the regional sales mix has tended to the higher margin areas.

Lombard sales volumes, which have traditionally been weighted towards the fourth quarter, have in 2010 been successfully spread across the year. This action has resulted in the 2010 sales profile no longer resembling the seasonal profile delivered in previous years, as significantly more business has been written in the first half of the year.

New Business Performance Metrics

New business written requires an initial capital investment to meet the set-up costs and capital requirements.

The IRR provides a measure of the return to shareholders on this initial capital investment. It is equivalent to the discount rate at which the present value of the after-tax cash flows expected to be earned over the lifetime of the business written is equal to the initial capital invested, including setting aside the required capital, to support the writing of the business.

The cash payback on new business is the time elapsed until the total of expected (undiscounted) cash flows is sufficient to recoup the initial capital invested, including the release of the required capital, to support the writing of new business.

The value of new business is shown after the effects of the frictional costs of holding required capital, and after the effect of the costs of residual non-hedgeable risks on the same basis as for the in-force covered business.

New business key performance metrics

	Year ended 31 December 2010			5 November to 31 December 2009
	Pre-tax value of new business £m	Internal rate of return on new business %	Cash payback on new business years	Pre-tax VNB £m
UK Corporate				
– Group pensions	(5)	6.2	14	(2)
– Group protection	–	4.7	16	–
UK Individual				
– Individual protection	(13)	2.7	16	(2)
– Individual pensions	7	14.2	7	–
Annuities	26	20.0	7	5
Investments	4	9.4	8	–
UK total	19	7.1	12	1
International	43	15.4	6	8
Lombard	83	26.7	4	43
Non-UK total	126	19.4	5	51
Total	145	11.2	9	52

7. Segmental analysis of Group MCEV

Year ended 31 December 2010

	Year ended 31 December 2010									As restated year ended 31 December 2009
	Free surplus £m	Required capital £m	Total net worth £m	PVFP £m	TVOG £m	Frictional costs £m	Non-hedgeable risks £m	Total VIF £m	Total £m	Total £m
UK	936	1,788	2,724	3,554	(37)	(101)	(145)	3,271	5,995	2,687
International	36	48	84	494	(1)	(2)	(18)	473	557	471
Lombard	5	75	80	524	–	(6)	(21)	497	577	440
FPH corporate (ex. STICS & lower tier 2 subordinated debt):										
– IFA and distribution	22	–	22	–	–	–	–	–	22	33
– Pension asset of FPPS	39	–	39	–	–	–	–	–	39	38
– Other	685	(26)	659	6	–	(45)	–	(39)	620	17
Gross[(ii)] MCEV of FPH	**1,723**	**1,885**	**3,608**	**4,578**	**(38)**	**(154)**	**(184)**	**4,202**	**7,810**	3,686
FPH corporate[(i)] – STICS	–	(393)	(393)	–	–	–	–	–	(393)	(318)
FPH corporate[(i)] – external lower tier 2 subordinated debt	–	(201)	(201)	–	–	–	–	–	(201)	(187)
FPH corporate – Resolution[(iii)] lower tier 2 subordinated debt	(702)	–	(702)	–	–	–	–	–	(702)	–
Net MCEV of FPH	**1,021**	**1,291**	**2,312**	**4,578**	**(38)**	**(154)**	**(184)**	**4,202**	**6,514**	3,181
Resolution Limited corporate net assets	901	–	901	–	–	–	–	–	901	307
Resolution Limited DCNs	(500)	–	(500)	–	–	–	–	–	(500)	–
Resolution[(iii)] acquisition finance facility	(400)	–	(400)	–	–	–	–	–	(400)	–
Net Group MCEV of Resolution Limited attributable to equity holders of parent	**1,022**	**1,291**	**2,313**	**4,578**	**(38)**	**(154)**	**(184)**	**4,202**	**6,515**	3,488

(i) FPH corporate includes the STICS and lower tier 2 subordinated debt and the cost of holding any required capital in excess of the operating segment capital policy.
(ii) For the purposes of this table "Gross" refers to the MCEV gross of the clean market value of the STICS and all lower tier 2 subordinated debt. The accrued interest and tax adjustment on market valuation is included in the gross MCEV of FPH corporate.
(iii) Resolution holding companies.

i) Net worth

The STICS and lower tier 2 subordinated debt are included within the MCEV at market value, as detailed in note 10.

ii) PVFP

The PVFP at 31 December 2010 includes a deduction of £26 million (2009: £45 million) from the UK and £nil (2009: £6 million) from International, as a provision against worsening 2011 persistency experience arising from recessionary conditions, and £4 million (2009: £nil) from Lombard set up as a short-term persistency provision in respect of the Spanish market.

iii) TVOG

The TVOG at 31 December 2010 of £38 million (2009: £41 million), is split between £12 million (2009: £14 million) market risk and £26 million (2009: £27 million) non-market risk. The non-market risks include lapses, annuitant longevity, and operational risk within the with-profits fund. The allowance for non-market risks is made by consideration of the impact of extreme scenarios from the Group's economic capital model.

7. Segmental analysis of Group MCEV continued

iv) Frictional costs of holding required capital

The projected required capital for life company subsidiaries is derived from the Group's capital management policy which is to hold the greater of 150% of Pillar 1 CRR excluding WPICC and 125% of ICA plus ICG.

Additionally the Group capital management policy in respect of FPH is to hold 160% of Group CRR excluding WPICC. The cost of holding this additional capital is shown in the FPH corporate segment.

At 31 December 2009 the Group's capital management policy was to hold the greater of 150% of Group CRR excluding WPICC.

v) CNHR

The cost of residual non-hedgeable risk of £184 million (2009: £113 million) is presented as an equivalent annual cost of capital charge of 2% (2009: 2%) on projected risk-based Group required capital for all non-hedgeable risk. In line with management's view of the business, no allowance has been made for diversification benefits within the non-hedgeable risks of the covered business.

8. Segmental analysis of Group MCEV earnings

The tables below show a further breakdown of the Group MCEV earnings for each of Resolution Limited and FPH respectively, comprising the MCEV earnings for the life and pensions covered business and the IFRS earnings for the respective non-covered businesses.

All figures are shown net of attributed tax.

Year ended 31 December 2010

	FPH						Resolution Limited	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FPH corporate £m	Non-covered business £m	Total £m	Resolution (ex.FPH) Non-covered business[i] £m	Total £m
Opening Group MCEV[ii]	2,687	471	440	(551)	134	3,181	307	3,488
Opening adjustments:								
– capital and dividend flows	–	–	–	–	2,165	2,165	(186)	1,979
– acquired value of AXA UK Life Business	3,343	–	–	–	155	3,498	–	3,498
– cost of acquisition of AXA UK Life Business	–	–	–	–	(2,724)	(2,724)	–	(2,724)
Adjusted opening Group MCEV	6,030	471	440	(551)	(270)	6,120	121	6,241
Operating MCEV earnings	219	65	123	(66)	(10)	331	(15)	316
Non-operating MCEV earnings	169	23	27	(93)	32	158	(14)	144
Total MCEV earnings	388	88	150	(159)	22	489	(29)	460
Other movements in IFRS net equity	–	–	–	–	(22)	(22)	(20)	(42)
Closing adjustments:								
– capital and dividend flows	(423)	(7)	3	51	314	(62)	(71)	(133)
– foreign exchange variances	–	5	(16)	–	–	(11)	–	(11)
Closing Group MCEV	5,995	557	577	(659)	44	6,514	1	6,515

(i) Resolution (ex. FPH) refers to the Group excluding the acquired assets of Friends Provident and the AXA UK Life Business.
(ii) The opening MCEV segmental split has been revised. See note 12.

8. Segmental analysis of Group MCEV earnings continued

Year ended 31 December 2009

	Restated FPH						Resolution Limited	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FPH corporate £m	Non-covered business £m	Total £m	Resolution (ex.FPH) Non-covered business[i] £m	Total £m
Opening Group MCEV	–	–	–	–	–	–	650	650
Opening adjustments:								
– acquired value of Friends Provident	2,681	458	407	(563)	87	3,070	–	3,070
– cost of acquisition of Friends Provident	–	–	–	–	–	–	(2,012)	(2,012)
– transaction costs	–	–	–	–	–	–	(16)	(16)
Adjusted opening Group MCEV	2,681	458	407	(563)	87	3,070	(1,378)	1,692
Operating MCEV earnings	8	5	29	(5)	2	39	(13)	26
Non-operating MCEV earnings	6	10	10	6	13	45	–	45
Total MCEV earnings	14	15	39	1	15	84	(13)	71
Other movements in IFRS net equity	–	–	–	–	29	29	–	29
Closing adjustments:								
– capital and dividend flows	(8)	(2)	(3)	11	3	1	1,698	1,699
– foreign exchange variances	–	–	(3)	–	–	(3)	–	(3)
Closing Group MCEV[ii]	2,687	471	440	(551)	134	3,181	307	3,488

(i) Resolution (ex. FPH) refers to the Group excluding the acquired assets of Friends Provident and the AXA UK Life Business.
(ii) The closing MCEV segmental split has been revised. See note 12.

Within the 2010 opening adjustments the capital and dividend flows reflect the proceeds of the Resolution Limited issue of share capital net of transaction costs of £1,979 million in connection with the acquisition of the AXA UK Life Business, the subsequent purchase by Resolution of FPH issued share capital of £1,665 million and the issue of £500 million of Deferred Consideration Notes.

Other movements in IFRS net equity reflect £(22) million actuarial losses on defined benefit pension schemes and an adjustment of £(20) million for treasury shares.

Within closing adjustments the capital and dividend flows reflect £(65) million of dividend paid by FPH to Resolution holding companies and £3 million impact of share based payments. Also included are dividends paid from the life companies to FPH net of any internal loans, and capital transfers between operating segments to eliminate from the closing MCEV the impact of profits and losses that are allocated to one segment but whose net assets are classified in another.

9. Maturity profile of value of in-force business by proposition

As at 31 December 2010

	Total £m	1–5 £m	6–10 £m	11–15 £m	16–20 £m	21–25 £m	26–30 £m	31–35 £m	36–40 £m	41+ £m
UK										
With-profits funds	465	228	119	62	31	14	5	2	4	–
Protection	478	283	102	58	26	7	2	–	–	–
Investments	905	444	249	124	56	23	8	1	–	–
Pensions	992	414	267	166	89	39	12	4	1	–
Annuities	195	37	37	32	27	23	17	13	9	–
Other	236	236	–	–	–	–	–	–	–	–
UK total	3,271	1,642	774	442	229	106	44	20	14	–
Non-UK										
International	473	242	143	56	23	8	1	–	–	–
Lombard	497	196	112	77	47	29	17	10	5	4
Non-UK total	970	438	255	133	70	37	18	10	5	4
FPH corporate	(39)	(17)	(10)	(6)	(3)	(1)	(1)	(1)	–	–
Total VIF	4,202	2,063	1,019	569	296	142	61	29	19	4

The UK Other category includes the VIF in respect of the GOF and TIP business that is held for sale.

The FPH corporate VIF relates to cost of capital held in excess of the operating segment capital policy. This VIF is related to the capital requirements of the with-profits funds and the run off pattern is similar.

10. MCEV assumptions

10.1 Economic assumptions – deterministic calculations

Economic assumptions are derived actively, based on market yields on risk free fixed interest assets at the end of each reporting period.

Reference rates – risk free

The risk free reference rate is determined with reference to the swap yield curve appropriate to the currency of the cash flows. For some business types, where the impact on VIF is small, a long-term risk free reference rate has been used.

For annuity business the swap yield curve is extrapolated where necessary to provide rates appropriate to the duration of the liabilities.

	Reference rate – risk free	
	31 December 2010 %	31 December 2009 %
UK		
Long-term rate	**3.70**	4.30
Swap yield curve		
– Term 1 year	**1.14**	1.01
– Term 5 years	**2.69**	3.48
– Term 10 years	**3.70**	4.26
– Term 15 years	**4.09**	4.59
– Term 20 years	**4.15**	4.54
International long-term rate	**3.70**	4.30
Lombard long-term rate	**3.46**	3.72

10. MCEV assumptions continued

Reference rate – Illiquidity premium adjustment

The updated MCEV Principles recognise that the inclusion of an illiquidity premium within the reference rate is appropriate where the liabilities are not liquid.

In this regard, the methodology adopted for the valuation of immediate annuities in the UK uses a reference rate that has been increased above the swap yield curve to allow for an illiquidity premium. This reflects the fact that, for these products, the backing asset portfolio can be held to maturity and earns risk-free returns in excess of swaps. Any illiquidity premia in respect of assets backing other product types are recognised within the MCEV as and when they are earned.

The illiquidity premium has been evaluated by considering a number of different sources of information and methodologies. There are two main approaches being commonly used to determine the illiquidity premium within the life insurance industry:

- a "negative basis trade", which attributes a component of the difference between the spread on a corporate bond and a credit default swap (for the same issuing entity, maturity, seniority and currency) as being the illiquidity premium; and
- structural models – such as that used by the Bank of England in their analysis of corporate bond spreads – that use option pricing techniques to decompose the spread into its constituent parts including default risk, credit risk premium and a residual illiquidity premium.

Both of these methods have been used to help inform the extent of the illiquidity premium within the asset portfolios backing immediate annuity business.

No illiquidity premium has been applied for any other covered business.

The reference rate has been adjusted for immediate annuities as set out in the table below.

	Embedded value		New business	
	31 December 2010	31 December 2009	**Full year 2010**	5 November to 31 December 2009
UK immediate annuities	**75bps**	75bps	**75bps**	80bps

Expected asset returns in excess of reference rates

Margins are added to the reference rates to obtain investment return assumptions for equity, property and corporate bonds. These risk premia reflect management's expectations of asset returns in excess of the reference rate from investing in different asset classes. As a market consistent approach has been followed, these investment return assumptions affect the expected existing business contribution and the economic variances within the analysis of MCEV earnings, but do not affect the opening or closing embedded values. In addition, they will affect the additional disclosures of the payback periods.

For equities and property, the excess is calculated as the difference between the long-term rate of return and the one-year risk free reference rate. The long-term rate of return is derived using a 10 year swap rate plus a risk premium of 3% for equities (2009: 3%) and 2% for property (2009: 2%).

For cash and government bonds no excess over the one-year risk free reference rate has been assumed. For corporate bonds, the return is based on the excess of actual corporate bond spreads on the reporting date, less an allowance for defaults, over the one-year risk free reference rate.

For annuity business the excess return reflects the excess of the bond portfolio over the reference rate including the illiquidity premium adjustment.

10. MCEV assumptions continued

Expense inflation

Maintenance expenses for UK and International business (excluding Lombard) are assumed to increase in the future at a rate of 1% per annum in excess of the assumed long-term rate of inflation. This is derived from the difference between the risk free rate of return based on the FT Actuaries 15 year gilt index and the average of the FTSE Actuaries over five-year index-linked gilt yield at 5% and 0% inflation.

Maintenance expenses for Lombard are assumed to increase in the future at a rate of 0.75% per annum in excess of the assumed long-term rate of inflation. This is derived from an inflation swap curve based on a Euro-zone price index taking into account the run-off profile of the business.

	Expense inflation	
	31 December 2010 %	31 December 2009 %
UK	**4.4**	4.7
International	**4.4**	4.7
Lombard	**3.0**	3.3

Required capital

Required capital under MCEV amounted to £1,291 million (2009: £362 million, restated in note 12).

The projected required capital is derived from the Group's capital management policy which is to hold, within life company subsidiaries, the greater of 150% of Pillar 1 CRR excluding WPICC and 125% of ICA plus ICG. In addition the Group's capital management policy is to hold 160% of Group CRR excluding WPICC, and any cost of holding this additional capital is shown within the FPH corporate covered business segment.

At 31 December 2009 the Group's capital management policy was to hold 150% of Group CRR excluding WPICC.

Taxation

The opening and closing embedded values in respect of covered business are determined on an after tax basis. The tax assumptions used are based upon the best estimate of the actual tax expected to arise. The attributable tax charge and profit before tax are derived by grossing up the profit after tax at the appropriate tax rates for each of the UK, Isle of Man, Luxembourg and Malaysia. Deferred tax is provided on the mark-to-market revaluation of the STICS and lower tier 2 subordinated debt allocated to the life and pensions covered business within FPH corporate.

For non-covered business, attributed tax is consistent with the IFRS financial statements.

	Tax rates	
	31 December 2010 %	31 December 2009 %
UK	**28.0**	28.0
International		
– OLAB (UK)	**28.0**	28.0
– FPIL (Isle of Man)	**0.0**	0.0
– AmLife (Malaysia)	**25.0**	25.0
Lombard	**23.5**	28.6

The PVFP for UK and OLAB business at 31 December 2010 includes allowance for the Emergency Budget annual reductions in corporation tax to 24% in 2014. The MCEV at 31 December 2010 has been increased by £89 million for anticipated future annual reductions in corporation tax from 27% to 24% over the period to 2014 and for an ultimate rate of 24% from April 2014.

During 2010 the structure of the Lombard group of companies has been reorganised, as a result of which the effective rate of tax assumed within the MCEV results for Lombard has been reduced to 23.5% (2009: 28.6%).

VAT in the UK of 20.0% (2009: 17.5%) has been included on relevant investment management expenses and outsourced administration contracts.

10. MCEV assumptions continued

Exchange rates

The results and cash flows of all businesses, except Lombard and AmLife, are calculated in Sterling. The results and cash flows for Lombard are calculated in Euros and those of AmLife in Malaysian Ringgits, and converted to Sterling at the following rates:

	Exchange rates	
	31 December 2010	31 December 2009
Closing exchange rate		
– Euro	**0.857**	0.888
– Malaysian Ringgit	**0.207**	0.180
Average exchange rate		
– Euro	**0.859**	0.891(i)
– Malaysian Ringgit	**0.200**	0.179(i)

(i) Average exchange rates for 2009 refer to the period from 5 November 2009 to 31 December 2009.

Other economic assumptions

Bonus rates on participating business have been set at levels consistent with the economic assumptions.

The MCEV allows for distribution of profit between the policyholders and shareholders within the following with-profits funds at the current rate of one-ninth of the cost of bonus:

- FPLP With Profits Fund ("FPLP WPF")
- FLAS With Profits Fund ("FLAS WPF")
- FLC Old With Profits Fund ("FLC OWPF")
- FLC New With Profits Fund ("FLC NWPF")

In addition it is assumed that the shareholder interest in the non-profit business of the FPLP WPF continues at the current rate of 60% of future profits.

FLC contains a RIE which was transferred to the FLC NPFs as part of the re-attribution of the FAELLAS inherited estate. The re-attribution was implemented as part of an intra group Part VII scheme (the "Scheme") transferring business into FLC. The Scheme took effect on 1 April 2001 and was amended as part of a subsequent transfer of mainly unit-linked business into FLC on 1 January 2007 (the "2006 Scheme").

With-profits policies which had been elected to take part in the re-attribution were transferred to the FLC New WPF. With-profits policies which were not so elected were transferred to the FLC Old WPF with a proportionate share of the FAELLAS inherited estate.

The Scheme rules require that a test be undertaken every five years to determine whether it is possible to transfer any of the RIE from the FLC NPFs to the FLC shareholders' fund or to distribute any of the inherited estate retained in the FLC Old WPF in the form of Special Bonuses (and associated transfer to the shareholders' fund). The latest five yearly test was undertaken as at 31 December 2010.

As at 31 December 2010, the RIE was £2,437 million. The results of the testing showed that just under £2.0 billion of the RIE could be available to transfer to the FLC shareholders' fund in the five-year period commencing 31 December 2010. However, such transfers are subject to FLC being able to continue to satisfy certain tests of financial strength after any such transfer. This has restricted the amount available to be transferred to the FLC shareholders' fund at the end of 2010. Following the results of the five-year testing, the FLC board determined that as at 31 December 2010 it should make:

(a) a transfer of £1,010 million of RIE from the NPFs to the shareholders' fund; and

(b) a distribution of £157 million of the inherited estate of the FLC Old WPF, which will be split 90% to with-profits policies allocated to or reinsured to the FLC Old WPF in the form of a Special Bonus and 10% to the FLC shareholders' fund.

The remaining RIE in the FLC NPFs is predominantly in the form of the VIF of non-profits business written within those funds. To the extent that this VIF emerges into cash during the five-year period commencing 31 December 2010, the cash may be available to be transferred to the FLC shareholders' fund subject to passing the relevant financial strength tests and subject to an overall cap on such further transfers of £928 million prior to the next five-year testing as at 31 December 2015. The MCEV allows for the transfer at 31 December 2010 and for best estimate projections of the amounts to be transferred in future.

10. MCEV assumptions continued

10.2 Economic assumptions – stochastic calculations

Model

The time value of financial options and guarantees is determined using a Barrie & Hibbert economic scenario generator and is calculated using 2,000 simulations. The model is consistent with the model used for the Realistic Balance Sheet and is calibrated to market conditions at the valuation date using the gilt risk free curve (extrapolated to a long-term assumption of 4% above 35 years) and implied volatilities in the market. Correlations between the asset classes are derived from historic data.

Swaption implied volatilities

	31 December 2010 Swap term				31 December 2009 Swap term			
Option term	10 yrs %	15 yrs %	20 yrs %	25 yrs %	10 yrs %	15 yrs %	20 yrs %	25 yrs %
UK Sterling								
10 years	**15.3**	**14.7**	**14.3**	**14.0**	15.4	14.9	14.2	13.9
15 years	**14.5**	**13.9**	**13.5**	**13.1**	15.7	15.0	14.0	13.6
20 years	**13.1**	**12.6**	**12.1**	**11.7**	16.3	15.2	13.9	13.3
25 years	**12.3**	**11.8**	**11.3**	**10.8**	15.7	14.3	12.9	12.3

Equity and property implied volatilities

Equity volatility is calibrated to market implied volatility and is a reasonable fit to the implied volatility of the FTSE 100 put options held by the with-profits funds. Property holdings are modelled assuming an initial volatility of 15% and a running yield of 4.7%. Sample implied volatilities are shown in the table below.

	31 December 2010		31 December 2009	
Option term	Equity %	Property %	Equity %	Property %
5 years	**27.4**	**15.9**	25.0	15.9
10 years	**27.7**	**16.2**	27.0	17.0
15 years	**28.0**	**16.4**	29.0	18.4

10.3 Other assumptions

Demographic assumptions

Other assumptions (for example mortality, morbidity and persistency) are a reflection of the best estimate of the likely behaviours, outcomes or circumstances in the future. Typically the estimates are made on an annual basis following experience investigations based on the data available at the time both from the book of business and externally sourced information. The aim is to set assumptions at a level that reflects recent experience, unless there are reliable indicators that suggest their adoption would result in a significant variance compared to these assumptions in the future. In some instances, there may be little or no direct experience to use in setting assumptions and the future outcome is therefore uncertain.

Future improvements in annuitant mortality have been assumed to be in accordance with the "medium cohort" projections (with certain amendments) published by the Continuous Mortality Investigation in 2002. The amendments are to use 75% of these projections for females and to introduce a minimum annual rate of improvement in future mortality – for males this is assumed to be 1.5% p.a. (2009: 1.0% p.a.) and for females 1.25% p.a. (2009: 0.75% p.a.).

Expense assumptions

The management expenses (including those relating to holding companies) attributable to the covered businesses have been analysed between expenses relating to the acquisition of new business, maintenance of in-force business (including investment management expenses) and development expenses.

Future maintenance expense assumptions reflect the expected ongoing expense levels required to manage the in-force business.

Productivity gains have generally only been included to the extent they have been achieved by the end of the reporting period.

In June 2009 FLSL entered into a 15 year agreement with Capita Life & Pensions Regulated Services Limited ("Capita") to outsource the administration of mature traditional life and pensions policies. This agreement includes the rationalisation of IT systems and significant longer term cost reductions. The maintenance expense assumptions for the relevant business allow for the agreed service fees with Capita. In addition allowance is made for the initial significant development expenditure and anticipated longer term savings as a result of a reduction in IT costs, which result in an overall expense overrun in FLSL.

10. MCEV assumptions continued

Future projected short-term expense overruns in the Lombard business have been allowed for by reducing the PVFP by £2 million for a projected overrun to 2012 (2009: £6 million for a projected overrun to 2013). At 31 December 2009 the PVFP for International business was reduced by £4 million for a projected overrun to 2012. No such reduction has been made to the PVFP for International at 31 December 2010.

The MCEV makes provision for certain development costs to the extent that these are known with sufficient certainty and in line with current plans.

Development costs of £28 million (2009: £5 million) have been excluded from the calculation of unit costs and have been recognised in experience variances. Development costs relate to investment in activities expected to create value in the future, but where that expected value cannot be anticipated within the current year's financial results until the value is realised.

Development costs

	Year ended 31 December 2010 £m	5 November to 31 December 2009 £m
UK	**21**	3
International	**6**	2
Lombard	**1**	–
Total	**28**	5

Non-hedgeable risks

A charge equivalent to 2% (2009: 2%) has been applied to the projected risk-based group required capital for all non-hedgeable risks over the remaining lifetime of in-force business.

In line with management's view of the business, no allowance has been made for diversification benefits within the non-hedgeable risks of the covered business.

Other assumptions

The STICS and external lower tier 2 subordinated debt are included within the MCEV at market value, based on listed bid price.

31 December 2010	Principal £m	Clean market value of debt £m	Accrued interest £m	Tax adjustment on market valuation £m	Value of debt included in FPH corporate(i) £m
STICS 2003	**210**	**172**	**2**	**9**	**183**
STICS 2005	**268**	**221**	**8**	**10**	**239**
Lower tier 2 subordinated debt (external)	**162**	**201**	**12**	**(15)**	**198**
Total	**640**	**594**	**22**	**4**	**620**

31 December 2009	Principal £m	Clean market value of debt £m	Accrued interest £m	Tax adjustment on market valuation £m	Value of debt included in FPH corporate(i) £m
STICS 2003	210	140	2	18	160
STICS 2005	268	178	9	22	209
Lower tier 2 subordinated debt (external)	162	187	12	(11)	188
Total	640	505	23	29	557

(i) The value of debt included in the FPH corporate category is the market value of debt, including accrued interest, and the tax asset/liability on the market value adjustment.

11. Sensitivity analysis

The table below shows the sensitivity of the embedded value and the value of new business to changes in assumptions. The sensitivities below apply to covered business only and include the impact on both shareholder net worth and VIF.

For each sensitivity, the other future experience assumptions remain unchanged, except where changes in economic assumptions directly affect them. The assumptions underlying the statutory reserving calculations remain unchanged in all sensitivities. There are no additional management actions or changes in policyholder behaviour assumed within any of the sensitivities.

The sensitivities for 2009 have been restated to align with the segmental reporting adopted in 2010.

Sensitivities shown in a single direction have broadly symmetrical impacts.

	FPH (covered business only) Year ended 31 December 2010				
	Change in MCEV (net of tax)				
Impact on MCEV	UK £m	Int'l £m	Lombard £m	FPH corporate £m	Total £m
Base MCEV	5,995	557	577	(659)	6,470
Market risk					
100bps increase in reference rates	(144)	(7)	(6)	29	(128)
100bps decrease in reference rates	153	4	1	(31)	127
Removal of illiquidity premium for immediate annuities	(425)	–	–	–	(425)
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield(i)	(192)	(20)	(46)	–	(258)
25% increase in equity/property volatility at the valuation date	(22)	–	–	–	(22)
25% increase in swaption implied volatility at the valuation date	(4)	–	–	–	(4)
100bps increase in corporate bond spreads(ii)	(312)	–	(16)	29	(299)
100bps decrease in corporate bond spreads(ii)	329	–	16	(31)	314
10% adverse movement in Sterling/overseas exchange rate(iii)	(34)	(15)	(47)	–	(96)
Insurance and other risk					
Reduction to EU minimum capital or equivalent(iv)	34	1	2	45	82
10% decrease in maintenance expenses	162	8	23	–	193
10% proportionate decrease in lapse rates	85	15	42	–	142
10% proportionate decrease in PUP rates	13	4	–	–	17
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	227	4	2	–	233
– After reinsurance	62	2	–	–	64
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	(6)	–	–	–	(6)
– After reinsurance	(49)	–	–	–	(49)

(i) The movement in embedded value from a reduction in market values comprises a £3 million (2009: £3 million) fall in the value of shareholders' net worth and a £189 million (2009: £93 million) reduction in the value of in-force covered business.

(ii) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 30bps for in-force business and 40 bps for the value of new business.

(iii) Currency risk is expressed in terms of total overseas exposure; the Group's principal currency exposures other than Sterling are the Euro and US Dollar.

(iv) Required capital is set at the greater of regulatory capital and requirements arising from internal capital management policies. In aggregate, the required capital is higher than the regulatory requirement by £1,093 million (2009: £350 million). This sensitivity shows the impact on embedded value and value of new business of using the lower regulatory capital requirement.

11. Sensitivity analysis continued

Impact on value of new business in 2010	Change in value of new business (gross of tax) UK £m	Int'l £m	Lombard £m	Total £m
Base Value of New Business	19	43	83	145
Market risk				
100bps increase in reference rates	(7)	(1)	3	(5)
100bps decrease in reference rates	2	1	(4)	(1)
Removal of illiquidity premium for immediate annuities	(20)	–	–	(20)
100bps increase in corporate bond spreads(i)	(9)	–	–	(9)
100bps decrease in corporate bond spreads(i)	8	–	–	8
Insurance and other risk				
Reduction to EU minimum capital or equivalent	3	–	–	3
10% decrease in maintenance expenses	8	2	4	14
10% proportionate decrease in lapse rates	7	2	7	16
10% proportionate decrease in PUP rates	4	2	–	6
5% decrease in mortality/morbidity – life assurance				
– Before reinsurance	8	–	–	8
– After reinsurance	2	–	–	2
5% decrease in mortality/morbidity – annuity business				
– Before reinsurance	(2)	–	–	(2)
– After reinsurance	(2)	–	–	(2)

(i) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 30bps for in-force business and 40 bps for the value of new business.

11. Sensitivity analysis continued

Impact on MCEV	FPH (covered business only) Year ended 31 December 2009 Change in MCEV (net of tax) UK £m	Int'l £m	Lombard £m	FPH corporate £m	Total £m
Base MCEV	2,687	471	440	(551)	3,047
Market risk					
100bps increase in reference rates	(72)	(6)	(9)	18	(69)
100bps decrease in reference rates	83	5	3	(19)	72
Removal of illiquidity premium for immediate annuities	(129)	–	–	–	(129)
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield	(54)	(18)	(23)	–	(95)
25% increase in equity/property volatility at the valuation date	(9)	–	–	–	(9)
25% increase in swaption implied volatility at the valuation date	(3)	–	–	–	(3)
100bps increase in corporate bond spreads	(133)	–	(10)	18	(125)
100bps decrease in corporate bond spreads	115	–	9	(19)	105
10% adverse movement in Sterling/overseas exchange rate	(10)	(21)	(42)	–	(73)
Insurance and other risk					
Reduction to EU minimum capital or equivalent	23	–	2	–	25
10% decrease in maintenance expenses	50	10	24	–	84
10% proportionate decrease in lapse rates	27	19	27	–	73
10% proportionate decrease in PUP rates	12	5	–	–	17
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	48	3	1	–	52
– After reinsurance	16	3	1	–	20
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	(35)	–	–	–	(35)
– After reinsurance	(23)	–	–	–	(23)

12. Segmental analysis

Changes to segmental analysis at 31 December 2009

Following the acquisition of the AXA UK Life Business, the Group has reviewed its segmental analysis under IFRS and MCEV reporting bases.

At 31 December 2010 the STICS and external lower tier 2 subordinated debt, are classified within MCEV covered business under "FPH corporate". At 31 December 2009 the STICS and lower tier 2 subordinated debt were classified as covered business under the UK segment.

The value of debt included in FPH corporate is calculated as the clean market value of the STICS and lower tier 2 subordinated debt plus accrued interest and tax on that debt.

In addition a number of small adjustments to the treatment of internal loans within the Group and their allocation have been made to help reconciliation between the disclosures under IFRS and MCEV. The following table shows the amendments required to the published embedded value figures for 31 December 2009.

	2010 MCEV segments					
31 December 2009	UK £m	Int'l £m	Lombard £m	FPH corporate £m	Non-covered business £m	Total MCEV (by 2009 segments) £m
2009 MCEV segments						
UK	2,668	–	–	(555)	–	2,113
International	4	471	–	–	–	475
Lombard	–	–	440	–	–	440
Non-covered business	15	–	–	4	134	153
Total FPH MCEV (by 2010 segments)	2,687	471	440	(551)	134	3,181

12. Segmental analysis continued

Changes to definitions of free surplus and required capital at 31 December 2009

The analysis of MCEV earnings for the year ended 31 December 2009 has been restated to reflect the changes in definition, and a reconciliation from the reported to the adjusted opening and closing positions is provided below. The key change has been the presentation of the STICS and external lower tier 2 subordinated debt as a deduction from required capital and hence an increase in free surplus. Other adjustments have been made to align the presentation of the free surplus and required capital with the requirements under local regulations, and hence certain items previously reported as VIF are now reported as free surplus.

	FPH						Resolution Limited	
	Covered business							
Year ended 31 December 2009 Net of tax	Free surplus £m	Required capital £m	VIF £m	MCEV £m	Non-covered business £m	Total £m	Non-covered business £m	Total £m
Previously reported adjusted opening MCEV	279	821	1,864	2,964	106	3,070	(1,378)	1,692
Adjustments:								
– STICS/lower tier 2 treatment	576	(563)	–	13	(13)	–	–	–
– capital requirement adjustments	(96)	96	–	–	–	–	–	–
– VIF/Free surplus adjustments	101	–	(95)	6	(6)	–	–	–
Restated adjusted opening MCEV	860	354	1,769	2,983	87	3,070	(1,378)	1,692

	FPH						Resolution Limited	
	Covered business							
Year ended 31 December 2009 Net of tax	Free surplus £m	Required capital £m	VIF £m	MCEV £m	Non-covered business £m	Total £m	Non-covered business £m	Total £m
Previously reported closing MCEV	286	826	1,916	3,028	153	3,181	307	3,488
Adjustments:								
– STICS/lower tier 2 treatment	570	(557)	–	13	(13)	–	–	–
– capital requirement adjustments	(93)	93	–	–	–	–	–	–
– VIF/Free surplus adjustments	49	–	(43)	6	(6)	–	–	–
Restated closing MCEV	812	362	1,873	3,047	134	3,181	307	3,488

Comparison of MCEV and IFRS classification and segments

Reconciliation of MCEV and IFRS segmentation

The covered business segments within MCEV are consistent with the IFRS business segments.

The split of the MCEV by IFRS business segment for FPH is shown in the tables below:

FPH for the year ended 31 December 2010

	MCEV classification					
31 December 2010	**UK £m**	**Int'l £m**	**Lombard £m**	**FPH corporate £m**	**Non-covered business £m**	**Total MCEV by IFRS segments £m**
IFRS segment						
UK	**5,995**	**–**	**–**	**–**	**22**	**6,017**
International	**–**	**557**	**–**	**–**	**–**	**557**
Lombard	**–**	**–**	**577**	**–**	**6**	**583**
FPH corporate	**–**	**–**	**–**	**(659)**	**16**	**(643)**
Total MCEV (by MCEV segments)	**5,995**	**557**	**577**	**(659)**	**44**	**6,514**

12. Segmental analysis continued

FPH for the year ended 31 December 2009

31 December 2009	MCEV classification UK £m	Int'l £m	Lombard £m	FPH corporate £m	Non-covered business £m	Total MCEV by IFRS segments £m
IFRS segment						
UK	2,687	–	–	–	30	2,717
International	–	471	–	–	1	472
Lombard	–	–	440	–	6	446
FPH corporate	–	–	–	(551)	97	(454)
Total MCEV (by MCEV segments)	2,687	471	440	(551)	134	3,181

13. FPH annualised return on embedded value

	Year ended 31 December 2010 % p.a.	5 November to 31 December 2009 % p.a.
Value of new business	**3.3**	8.6
Expected existing business contribution(i)	**5.6**	5.4
Operating experience variances	**0.8**	(4.1)
Operating assumption changes	**(0.5)**	0.1
Other operating variance	**1.1**	0.0
Development costs	**(0.6)**	(0.8)
Other income and charges(ii)	**0.2**	0.5
MCEV operating profit before tax and financing	**9.9**	9.7
Impact of financing	**0.7**	0.8
Attributed tax charge on MCEV operating profit	**(2.3)**	(2.9)
MCEV operating profit after tax	**8.3**	7.6
Economic variances	**4.7**	7.8
Other non-operating items	**0.1**	0.8
Attributed tax on other activities	**(1.3)**	0.2
MCEV profit after tax	**11.8**	16.4
Acturial gains/(losses) on defined benefit pension schemes	**(0.6)**	5.7
Foreign exchange adjustments	**(0.3)**	(0.6)
Total return on MCEV over the period	**10.9**	21.5

(i) Excludes expected impact of financing of £30 million for 2010 and £5 million for the period from 5 November to 31 December 2009.
(ii) Excludes £18 million impact for 2010 (nil for 2009) of financing of non-covered debt.

The table above provides an analysis of the return on embedded value. The starting embedded value for 2010 is £3,181 million, net of the market-consistent value of debt instruments of £557 million at 31 December 2009. The starting embedded value on 5 November 2009 was £3,070 million, net of the market-consistent value of debt instruments of £563 million. These values are adjusted to allow for the timing of the rights issue, dividend payments, the acquisition of the AXA UK Life Business and the issue of lower tier 2 debt to Resolution holding companies by FPH during the period.

The MCEV operating return before tax and financing is based on the gross MCEV (i.e. before the market-consistent value of debt). The return includes both covered and non-covered business. The impact of the financing item reflects the leverage on the return on embedded value created within FPH through the use of debt instruments, net of the cost of financing these instruments.

Additional information

Definitions

Annual Premium Equivalent ("APE") represents annualised new regular premiums plus 10% of single premiums.

Annualised operating return on embedded value is calculated as the MCEV operating profit after tax over the period divided by the net embedded value at the start of the period. Where the period is not a full year, the calculated rate is then annualised.

Asset quality is the percentage of corporate bonds and asset backed securities in the shareholder and non-profit funds at investment grade compared to the total of such assets in these funds.

AXA UK Life Business means the traditional and protection businesses, most of the corporate benefits business and a minority part of the wealth management business carried on by the AXA UK Life and Savings business which were acquired by the Group.

Board denotes Resolution Limited board.

Cash payback on new business is the time at which the value of the expected cash flows, after tax, is sufficient to have recouped the capital invested to support the writing of the business. The cash flows are calculated on the same assumptions and expense basis as those used for the contribution from new business.

Company or Resolution denotes Resolution Limited.

Contribution from new business is the present value of future cash flows expected to arise from the new business sold during the year. It is calculated using economic assumptions at the beginning of the period, and is quoted after the cost of required capital, share based payments and including an apportionment of fixed acquisition expenses across products.

Equity Backing Ratio ("EBR") is the proportion of equities and property backing asset shares.

Friends Life group comprises Friends Provident Holdings (UK) plc and its subsidiaries from time to time, including the AXA UK Life Business from September 2010 and BHA from January 2011.

Group denotes Resolution Limited and its subsidiary undertakings, which do not include any member of The Resolution Group.

Group embedded value on an MCEV basis is the equity attributable to equity holders of the parent as shown in the consolidated statement of financial position – MCEV basis.

IGCA surplus capital resources are the Insurance Groups Capital Adequacy surplus capital as defined by the FSA. It is calculated as the surplus of the available resources over the capital resources requirement. It excludes the surplus capital held within the long-term funds except to the extent that they cover that fund's own capital resource requirements.

IFRS based operating profit is the profit (or loss) based on longer-term investment return excluding: (i) all investment return variances from expected investment return which is calculated on a long-term rate of return, (ii) policyholder tax, (iii) returns attributable to minority interests in policyholder funds, (iv) significant non-recurring items, (v) amortisation and impairment of acquired intangible assets and present value of acquired in-force business; and is stated after deducting interest payable on STICS.

IFRS profit/(loss) after tax is the profit/(loss) after tax as shown in the consolidated income statement.

Internal rate of return on new business ("IRR") is equivalent to the discount rate at which the present value of the after tax cash flows expected to be earned over the lifetime of the business written is equal to the capital invested to support the writing of the business. With the exception of investment return, all assumptions and expenses are consistent with those used for calculating Contribution from new business. IRR assumes best estimate investment returns after an allowance for default risk, whereas Contribution from new business assumes (market consistent) risk free rates. IRR also takes into account the funding and release of regulatory capital requirements.

Margins are defined as the pre-tax contribution from new business generated by each product type, divided by the new business volume for that product.

MCEV operating profit is the MCEV profit (or loss) based on expected investment return and excludes: (i) amortisation and impairment of non-covered business acquired intangible assets, (ii) effect of economic variances (including the impact of economic assumption changes) and (iii) significant non-recurring items.

MCEV profit after tax is the MCEV profit (or loss) after tax as shown in the consolidated income statement – MCEV basis.

Pillar 1 surplus is the excess of capital resources over capital resource requirements calculated in accordance with regulatory requirements.

Pillar 2 surplus is the excess of capital resources over the capital calculated on an economic basis required to ensure that the regulated entities can meet their liabilities, with a high likelihood, as they fall due. The result is reviewed and may be modified by the FSA. Pillar 2 requirements are not generally disclosed.

Present value of new business premiums ("PVNBP") represents new single premiums plus the expected present value of new business regular premiums.

Pro forma MCEV is the shareholders' equity on a MCEV basis, including the pre-acquisition period.

The Resolution Group means Resolution Operations LLP, Resolution Financial Markets LLP, RCAP Guernsey LP, Resolution Capital Limited and their respective subsidiary undertakings. For the avoidance of doubt, neither the Group nor the Company are part of The Resolution Group.

UK Life Project denotes the Company's restructuring project in respect of companies and/or business which have substantial operations consisting of life assurance and/or asset management activities and which are listed in, or undertake a significant part of their business in UK and/or Western Europe.

Abbreviations

ABI	Association of British Insurers
ABS	Asset-Backed Securities
AC	FPH Audit Committee
ACSM	Alternative Coupon Satisfaction Mechanism
AGM	Annual General Meeting
APE	Annual Premium Equivalent
ASC	Available Shareholder Cash
AVIF	Acquired Value of In-Force
AXA IM	AXA Investment Management
BCM	Resolution Limited Board Control Manual
BHA	Bupa Health Assurance Limited
BRCC	FPH Board Risk and Compliance Committee
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGU	Cash Generating Unit
CMI	Continuous Mortality Investigations
CMIR	Continuous Mortality Investigations Report
CNHR	Cost of Non-Hedgeable Risk
CRO	Chief Risk Officer
CSR	Corporate Social Responsibility
DAC	Deferred Acquisition Costs
DCN	Deferred consideration notes
DCT	Distributable Cash Target
DFF	Deferred front end fees
DPF	Discretionary Participation Features
EBR	Equity Backing Ratio
ECJ	European Court of Justice
EEA	European Economic Area
EEV	European Embedded Value

EPS	Earnings Per Share
EU	European Union
EURIBOR	Euro Interbank Offered Rate
F&C	F&C Asset Management plc
F&C CPT	F&C Commercial Property Trust
FAELLAS	Friends AELLAS Limited (formerly known as AXA Equity & Law Life Assurance Society plc)
FAL	Friends Annuities Limited (formerly known as AXA Annuity Company Limited)
FASLH	Friends ASLH Limited (formerly known as AXA Sun Life Holdings Limited)
FLAS	Friends Life Assurance Society Limited (formerly known as Sun Life Assurance Society plc)
FLC	Friends Life Company Limited (formerly known as AXA Sun Life plc)
FLSL	Friends Life Services Limited (formerly known as AXA Sun Life Services plc)
FPG	Friends Provident Group Limited (including MCEV disclosures, all subsidiary undertakings)
FPH	Friends Provident Holdings (UK) plc (including, for MCEV disclosures, all subsidiary undertakings in the period post-acquisition)
FPIL	Friends Provident International Limited
FPL	Friends Provident Limited
FPLA	Friends Provident Life Assurance Limited
FPLP	Friends Provident Life and Pensions Limited
FPP	Friends Provident Pensions Limited
FPPS	Friends Provident Pension Scheme
FRC	FPH Financial Risk Committee
FRS	Financial Reporting Standards
FSA	Financial Services Authority

FSLPM	Friends SLPM Limited (formerly known as Sun Life Pensions Management Limited)
FSLUA	Friends SLUA Limited (formerly known as Sun Life Unit Assurance Limited)
FUM	Funds under management
FVTPL	Fair value through profit or loss
GMP	Guaranteed Minimum Pension
GOF	Guaranteed Over Fifties
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICA	Individual Capital Assessment
ICG	Individual Capital Guidance
IFA	Independent Financial Adviser
IFRIC	IFRS Interpretation Committee
IFRS	International Financial Reporting Standards
IGCA	Insurance Groups Capital Adequacy
IRR	Internal Rate of Return
LDI	Liability Driven Investment
LIBOR	London Interbank Offered Rate
LTIP	Friends Provident Long-Term Incentive Plan
MCEV	Market Consistent Embedded Value
MEEM	Multi-period Excess Earnings Method
MVR	Market Value Reduction
NBS	New business strain
NPF	Non-profit fund
OEIC	Open ended investment company
OLAB	Overseas Life Assurance Business
ORC	FPH Operational Risk Committee
PHI	Permanent Health Insurance

PPFM	Principles and Practices of Financial Management
PVFP	Present Value of Future Profits
PVIF	Present Value of In-force
PVNBP	Present Value of New Business Premiums
RBS	Realistic Balance Sheet
RCM	Risk Capital Margin
RH1	Resolution Holdco No 1 LP
RHG	Resolution Holdings (Guernsey) Limited
RICS	Royal Institution of Chartered Surveyors
RIE	Re-attributed inherited estate
RISC	Risk and Investment Subcommittee
ROEV	Return on Embedded Value
ROL	Resolution Operations LLP
RPI	Retail Prices Index
RSL	Resolution Limited and its subsidiaries and subsidiary undertakings
STICS	Step-up Tier one Insurance Capital Securities
TCF	Treating Customers Fairly
TIP	Trustee Investment Plan
TSR	Total Shareholder Return
TVOG	Time Value of financial Options and Guarantees
UKLA	UK Listing Authority
VIF	Value of In-Force
VNB	Value of New Business
WLUK	Winterthur Life UK Limited
WPC	With Profits Committee
WPF	With-profits fund
WPICC	With Profits Insurance Capital Component

Shareholder information

Annual general meeting

The AGM will be held at The St Pierre Park Hotel, St. Peter Port, Guernsey, Channel Islands, with a simultaneous broadcast in the Mountbatten Room at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, United Kingdom at 11.00 am on 18 May 2010. Shareholders will receive a separate circular containing a notice of the meeting and detailing the resolutions being proposed.

Registrars

Ordinary shareholders

If you hold your shares in certificated form or in CREST, and your Shareholder Reference Number commences with a "C" or a "G", the Company's registrar can be contacted at:

Computershare Investor Services (Jersey) Limited
Queensway House
Hilgrove Street
St. Helier
Jersey
JE1 1ES

Shareholder helpline: +44 (0) 870 707 1444
Email: info@computershare.co.je

Resolution Share Account holders

If you hold your shares in the Resolution Share Account, and your Shareholder Reference Number commences with an "I", the Company's registrar can be contacted at:

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol
BS99 6ZY

Shareholder helpline: +44 (0) 870 707 1444
Email: web.queries@computershare.co.uk

Electronic communications

By providing your email address you will no longer receive paper copies of shareholder communications that are available electronically. Instead, you will receive emails advising you when and how to access documents online.

Computershare's Investor Centre is a free online service that provides shareholders with a wide variety of self-service tools to help track and manage their personal holdings in the companies they service. Investor Centre allows shareholders to manage their holdings in several different companies simultaneously.

If you currently do not receive communications electronically but would like to, please register your email address online at http://www.resolution.gg by going to the Investor Relations page and clicking on the "Shareholder Information" link on the left-hand side of the screen.

Scrip dividend

The Company will be offering a scrip dividend in respect of the final dividend for the year ended 31 December 2010. Full details of the Scrip Dividend Scheme, including how to join are available at http://www.resolution.gg by going to the Investor Relations page and clicking on the "Dividend Timetable" link on the left-hand side of the screen.

Alternatively, you can request a mandate form from Computershare by writing to them at either their Jersey or Bristol addresses, or by contacting them on +44 (0) 870 707 1444.

Share price information

The middle market price of the Company's ordinary shares on 31 December 2010 was 234.1 pence and the range during the year was 211.3 pence to 345.95 pence.

The ISIN code of the Company's ordinary shares is GG00B62W2327 and the SEDOL (Stock Exchange Daily Official List) number is B62W232.

Share price information on Resolution Limited is available in the financial press and on the Company's website – www.resolution.gg

Analysis of registered shareholder accounts 31 December 2010

Size of shareholding	Number of shares	% of total number of shares
1–1,000	4,125,601	0.2840
1,001–5,000	6,497,650	0.4473
5,001–10,000	2,247,611	0.1547
10,001–100,000	13,592,201	0.9357
100,001–500,000	56,475,572	3.8880
500,001–1,000,000	49,863,830	3.4328
1,000,001–10,000,000	486,327,130	33.4806
10,000,001–1,000,000,000	833,434,776	57.3768
Total	**1,452,564,371**	**100**

Financial calendar

First quarter interim management statement	May 2011
Annual General Meeting	18 May 2011
Interim results 2011	16 August 2011

2010 final dividend

Ex-dividend date	20 April 2011
Dealing days for calculating the price of the new shares to be offered pursuant to scrip dividend scheme for the dividend	20 April 2011 to 28 April 2011
Record date	26 April 2011
Final time and date for receipt of the mandate forms and dividend election input messages	5.00 pm, 12 May 2011
Payment of dividend and first day of dealing in the New Shares	26 May 2011

Registered office

Trafalgar Court
Les Banques
St. Peter Port
Guernsey
GY1 3QL

Registered number

Incorporated in Guernsey with registered number 49558

Company Secretary

Northern Trust International
Fund Administration Services
(Guernsey) Limited

Trafalgar Court
Les Banques
St. Peter Port
Guernsey
GY1 3QL

Operator

Resolution Operations LLP
23 Savile Row
London
W1S 2ET

Auditors

Ernst & Young LLP
1 More London Place
London
SE1 2AF

Principal banker

HSBC plc
PO Box 31
Arnold House
St Juliens Avenue
St. Peter Port
Guernsey
GY1 3NF

PR advisor

Temple Bar Advisory Limited
60 Cannon Street
London
EC4N 6LY

Sponsor and corporate broker

RBC Capital Markets
71 Queen Victoria Street
London
EC4V 4DE

Corporate broker

Barclays Capital
5 North Colonnade
Canary Wharf
London
E14 4BB

Designed and produced by **Radley Yeldar** www.ry.com

FSC www.fsc.org MIX Paper from responsible sources FSC® C022913

This report is printed on Core Silk which is FSC® certified virgin fibre. This report was printed by **Pureprint** an FSC and ISO 14001 certified printer using vegetable oil based inks.

FSC – Forest Stewardship Council. This ensures that there is an audited chain of custody from the tree in the well-managed forest through to the finished document in the printing factory.

ISO 14001 – A pattern of control for an environmental management system against which an organisation can be accredited by a third party.

Resolution Limited

Registered Office
Trafalgar Court, Les Banques
St. Peter Port, Guernsey GY1 3QL

www.resolution.gg