

# **Friends Life Holdings plc**

**Registered in England & Wales No. 06986155**

## **Annual Report and Financial Statements 2015**

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## **Directors and officers**

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### **Directors**

A D Briggs  
J R Lister  
Sir G M Williamson

### **Officer – Company Secretary**

J C Baddeley

### **Independent Auditors**

PricewaterhouseCoopers LLP  
7 More London Riverside  
London  
SE1 2RT

### **Registered Office**

Pixham End  
Dorking  
Surrey  
RH4 1QA

### **Company Number**

Registered in England & Wales No. 06986155

### **Other Information**

Friends Life Holdings plc is a member of the Aviva plc group of companies (the Aviva Group).

## Strategic report

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This strategic report is addressed to, and written for, the members of Friends Life Holdings plc (the Company) and its subsidiaries (the Group) with the aim of providing a fair review of the business development, performance during the year and position at the current time. In providing this review, the aim is to present a view that is both balanced and comprehensive and is consistent with the size and complexity of the business.

### Review of the Group's Business

The Company is a wholly-owned subsidiary of Aviva Group Holdings Limited (AGH). Its principal activity is to hold the three subordinated debt instruments listed on the London Stock Exchange.

### Financial position and performance

The financial position of the Group as at 31 December 2015 is shown in the Consolidated Statement of Financial Position on page 26, with the results shown in the Consolidated Income Statement on page 23 and the Consolidated Statement of Cash Flows on page 27.

### Significant transactions

#### *Disposals*

On 10 April 2015, Aviva plc completed the acquisition of 100% of the former Friends Life Group of Companies (FL Group). On 13 April 2015 the former FL Group companies were restructured within the Aviva Group. A key part of this restructuring involved the Group's interests in its principal subsidiaries being transferred to other Aviva Group companies.

The Company disposed of 100% of its interest in Friends Life FPG Limited (FPG), Friends Life Investments Limited (FLI) and Friends Life Funds Limited (FLFL), representing the main operating segments of the Company, related service companies and staff pension scheme. FPG, FLI and FLFL and their subsidiary undertakings are presented as discontinued operations in the Group's results for 12 months to 31 December 2015, and the prior period comparatives have been restated to reflect this classification. Following the transfer, the Group has no direct employees as all directors and employees who provide services to the Group are employed by the transferred service companies.

The Company's shareholdings in FLI and FLFL plus 68% of the Company's interest in FPG were transferred to the Company's parent undertaking, Friends Life Group Holdings Limited (FLGH), by way of a dividend in specie of £3,297 million. The Company's remaining 32% shareholding in FPG was transferred to AGH in exchange for consideration of £1,544 million in the form of an interest bearing loan payable by AGH. This loan was fully settled as at 31 December 2015.

#### *Parent Group*

On 17 December 2015 FLGH transferred its entire holding in the Group to Friends Life Group Limited (FLG) by way of in specie dividend. On the same day FLG transferred its entire holding in the Group to AGH by way of in specie dividend.

#### *Dividends paid*

During 2015, the following cash and in specie dividends were paid by the Group:

- £250 million cash dividend paid to FLGH on 30 March 2015;
- £3,297 million in specie dividend paid to FLGH on 13 April 2015;
- £1,181 million in specie dividend and £76 million cash dividend paid to FLGH on 4 September 2015; and
- £50 million cash dividend and £4 million in specie dividend paid to AGH on 22 December 2015.

#### *Step up Tier 1 Insurance Capital Securities (STICS)*

On 29 May 2015 the Company issued notification to holders of the 2005 STICS that the notes would be redeemed on 1 July 2015. Consequently the 2005 STICS had been classified as a liability from 29 May 2015, initially recognised at a fair value of £268 million, with associated accrued interest of £17 million. The liability was then settled in cash in full on 1 July 2015.

On 2 October 2015, the 2003 STICS was transferred to the Group's ultimate parent, Aviva plc, at fair value of £224m by way of novation of an intercompany loan with AGH.

### Future outlook

High level strategies of the Aviva Group are determined by the Board of Aviva plc and these are shown in the Aviva plc Annual Report and Accounts 2015 and Preliminary Announcement for the year ended 31 December 2015. The directors consider that the Group's principal activities will continue unchanged for the foreseeable future.

## Strategic report continued

### Principal risks and uncertainties

A description of the principal risks and uncertainties facing the Group and the Group's risk management policies to manage and mitigate these risks are set out in note 31 to the financial statements.

Risk factors beyond the Group's control that could cause actual results to differ materially from those estimated include:

#### *Credit risk*

The net asset value of the Group's financial resources is exposed to the potential default on its holdings of syndicated loans and long term loans to Friends Life Limited (FLL), a fellow subsidiary of Aviva plc.

#### *Interest rate risk*

The net asset value of the Group's financial resources is exposed to potential fluctuations in interest rates. The Group's holdings of syndicated loans is linked to LIBOR and so any change in LIBOR would impact the level of interest income earned by the Group. The effect of a 100 basis point increase / decrease in interest rates would be an increase / decrease in interest income (before tax) of £2 million (2014: increase / decrease of £2 million). Generally the fair value of the loans and thus the net asset value of the Group's financial resources would not be expected to be materially affected by fluctuations in interest rates.

#### *Foreign exchange risk.*

The net asset value of the Group's financial resources is exposed to potential fluctuations in foreign exchange rates through its exposure to foreign currency denominated syndicated loans and its issuance of US\$575 million (2014: US\$575 million) reset perpetual subordinated note. The US\$ cash flows for the coupons and principal up until the first reset date in 2018 have been fully hedged with cross currency derivative swaps. Foreign exchange risk in respect of the EUR and USD denominated syndicated loans has been partially hedged.

### Key performance indicators

The directors consider that the Group's key performance indicators (KPIs) that communicate the financial performance are as follows:

Measure	2015 £m	Restated 2014 £m
Investment return	145	97
Finance costs	(110)	(107)

Investment return is higher in 2015 due to the inclusion of interest on internal STICS with FLL which is reflected as an AFS investment following the restructuring of the FL Group on 13 April 2015.

By order of the Board on 9 March 2016

J C Baddeley  
Company Secretary

## Directors' report

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The directors present their annual report and financial statements for Friends Life Holdings plc and its subsidiaries (the Group) for the year ended 31 December 2015. This directors' report also comprises the management report required under Disclosure and Transparency Rule 4.1.5R.

### Directors

The names of the present directors of the Company appear on page 3.

The following directors resigned on 10 April 2015:

D P Allvey  
M G Carvill  
P J Gibbs  
M Glen  
N SL Lyons  
R K Perkin  
R A Phipps  
B J Richards  
K S Sternberg  
T C Wade

TJW Tookey resigned as director on 13 April 2015.

J R Lister was appointed as director on 13 April 2015.

### Secretary

The name of the present secretary of the Company appears on page 3. K Bailly and J C Baddeley were both appointed as secretary on 29 June 2015. V Hames resigned as secretary on 30 June 2015 and K Bailly resigned as a secretary on 25 September 2015.

### Dividends

Interim ordinary dividends of £4,858 million on the Company's ordinary shares were declared and paid during 2015 (2014: £610 million). The directors do not recommend a final dividend on the Company's ordinary shares for the year ended 31 December 2015 (2014: £nil). The total cost of dividends paid during the year, including interest on STICS of £7 million (2014: £31 million), amounted to £4,865 million (2014: £641 million).

### Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the strategic report. The financial statements sections include notes on the management of its risks including market, credit and liquidity risk (note 31).

The Group and its ultimate parent, Aviva plc, have considerable financial resources and as a consequence, the directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain macro-economic outlook. After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

### Future outlook

Likely future developments in the business of the Group are discussed in the Strategic Report on page 4.

### Events since the Statement of Financial Position date

There are no events since the Statement of Financial Position date to report.

### Financial instruments & financial risk management

The business of the Group includes the use of financial instruments. Details of the financial instruments are set out in note 13 to the financial statements.

Details of the Group's risk management objectives and policies and exposures to risk relating to financial instruments are set out in note 31 to the financial statements.

## Directors' report continued

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### Employees

Following the disposal of FPG, the Group has no employees. Aviva Employment Services Limited (AESL), Aviva Investors Employment Services Limited (AIESL), Friends Life Management Services Limited (FLMS), Friends Life Services Limited (FLSL) and Sesame Services Limited (SSL), fellow Group companies, are the employing companies for staff of the Aviva Group in the UK. Disclosures relating to employees may be found in the annual report and financial statements of these companies respectively.

### Disclosure of information to the Auditors

Each person who was a director of the Company on the date that this report was approved, confirms that:

- (a) so far as the director is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing their report, of which the auditor is unaware; and
- (b) each director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

### Independent Auditors

Following the acquisition of the Group by Aviva plc on 13 April 2015, PricewaterhouseCoopers LLP were appointed as auditors to the Group for the year ended 31 December 2015 in accordance with the provisions of the Companies Act 2006.

A resolution is to be proposed at the 2016 Annual General Meeting for the re-appointment of PricewaterhouseCoopers LLP as auditor of the Group.

A resolution will also be proposed authorising the directors to determine the auditor's remuneration.

### Qualifying Indemnity Provisions

Aviva plc, the Group's ultimate parent, granted in 2004 an indemnity to the directors of Group companies against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985. This indemnity is a "qualifying third party indemnity" for the purposes of sections 309A to 309C of the Companies Act 1985. Following the completion of the acquisition of the FL Group by Aviva plc, the directors of the Company benefit from these arrangements and these qualifying third party indemnity provisions are in force for the current directors as at the date of approving the Directors' Report by virtue of paragraph 15, Schedule 3 of The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007.

## Directors' report continued

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### Statement of directors' responsibilities

The directors are responsible for preparing the Strategic report, Directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and have elected to prepare the Company financial statements in accordance with Financial Reporting Standard 101, Reduced Disclosure Framework (FRS 101). In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB).

Under Company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing these consolidated financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union, and IFRSs as issued by the IASB have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors consider that the annual report and consolidated financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess a Group's performance, business model and strategy.

The directors are responsible for the maintenance and integrity of the Group's information on the Aviva Group website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the current directors listed on page 3 confirms that, to the best of their knowledge:

- the Company's and Group's financial statements in this report, which have been prepared in accordance with FRS 101 and IFRSs as adopted by the EU, and issued by IASB, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the Group as a whole; and
- the Strategic report, contained in the annual report, 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 it faces.

### Corporate Governance

The Group is a wholly-owned subsidiary of Aviva plc, a Group with a premium listing on the London Stock Exchange, and as such is subject to Aviva plc's system of risk management, internal control and financial reporting. Aviva plc is subject to the UK Corporate Governance Code. The Aviva plc Annual Report and Accounts sets out details of how the Aviva Group has applied the principles and complied with the provisions of the UK Corporate Governance Code during 2015 and it is available at [www.aviva.com/reports/2015ar](http://www.aviva.com/reports/2015ar). Further information on the Code can be found on the Financial Reporting Council's website, [www.frc.org.uk](http://www.frc.org.uk).

By order of the Board on 9 March 2016

J C Baddeley  
Company Secretary



# Independent auditors' report to the members of Friends Life Holdings plc

## Independent auditors' report on the financial statements

### Our opinion

In our opinion:

- Friends Life Holdings Plc's group financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2015 and of the group's loss, the company's profit and the group's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

### Separate opinion in relation to IFRSs as issued by the IASB

As explained in note A to the financial statements, the group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion, the group financial statements comply with IFRSs as issued by the IASB.

### What we have audited

The financial statements, included within the Annual Report and Financial Statements 2015 (the "Annual Report"), comprise:

- the Consolidated Income statement for the year ended 31 December 2015;
- the Company Income statement for the year ended 31 December 2015;
- the Consolidated Statement of Financial Position as at 31 December 2015;
- the Company Statement of Financial Position as at 31 December 2015;
- the Consolidated Statement of Comprehensive Income for the year then ended;
- the Company Statement of Comprehensive Income for the year then ended;
- the Consolidated Statement of Cash Flows for the year then ended;
- the Consolidated Statement of Changes in Equity for the year then ended;
- the Company Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

### Opinion on other matter prescribed by the Companies Act 2006

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

### Other matters on which we are required to report by exception

#### Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

#### Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

## Independent auditors' report to the members of Friends Life Holdings plc continued

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### Responsibilities for the financial statements and the audit

#### Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 7 and 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

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

This report, including the opinions, has been prepared for and only for the Group's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). 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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Paul Pannell (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
9 March 2016

## Accounting policies

The Company is a public limited company incorporated and domiciled in England and Wales. The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

### (A) Basis of preparation

The financial statements of the Group have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to those reporting under IFRS. In addition to fulfilling their legal obligation to comply with IFRS as adopted by the EU, the Group has also complied with IFRS as issued by the IASB and applicable at 31 December 2015. The date of transition to IFRS was 1 January 2004.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment property, available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The separate financial statements of the Company are on pages 68 to 79.

The Group and its ultimate parent company, Aviva plc, have considerable financial resources and as a consequence, the directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain macro-economic outlook. After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Following their disposal on 13 April 2015, the results of FPG and its subsidiary undertakings, FLI and FLFL were classified as results from discontinued operations in the Group's results for the 12 months ended 31 December 2015. The 2014 Consolidated Income Statement has been restated to reflect the classification of the disposed businesses as discontinued operations.

The Group's financial statements are stated in sterling, which is the Group's functional and presentation currency. Unless otherwise noted, the amounts shown in these financial statements are in millions of pound sterling (£m).

### **New standards, interpretations and amendments to published standards that have been adopted by the Group.**

The Group has adopted the following amendments to standards which became effective for the annual reporting period beginning 1 January 2015.

#### **(i) Amendments to IAS 19, Employee Benefits – Employee Contributions**

These narrow scope amendments simplify accounting for defined benefit plans that require contributions from employees or third parties. The adoption of the amendments has no impact on Group's financial statements as the Group does not have defined benefit plans that require employees or third parties to contribute to the cost of the plan.

#### **(ii) Annual Improvements to IFRSs 2011-2013**

These improvements to IFRSs consist of amendments to four IFRSs including IFRS 3 *Business Combinations* and IFRS13 *Fair Value Measurement*. The amendments clarify existing guidance and there is no impact on the Group's financial statements.

### **Standards, interpretations and amendments to published standards that are not yet effective and have not been adopted early by the Group.**

The following new standards, amendments to existing standards and interpretations have been issued, are not yet effective and have not been adopted early by the Group:

#### **(i) Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation**

These amendments provide additional guidance on how the depreciation or amortisation of property, plant and equipment and intangible assets should be calculated. The amendments to IAS 16 and IAS 38 prohibit the use of revenue-based depreciation for property, plant and equipment and significantly limit the use of revenue-based amortisation for intangible assets.

The adoption of these amendments is not expected to have any impact on the Group's financial statements as the Group has no property plant and equipment. These amendments are effective for annual reporting periods beginning on or after 1 January 2016 and have yet to be endorsed by the EU.

#### **(ii) Amendments to IAS 27, Equity Method in Separate Financial Statements**

The amendments to IAS 27 allow investments in subsidiaries to be accounted for using the equity method within the Group's financial statements. The Group does not intend on electing to use the equity method in separate financial statements. The amendments to IAS 27 are effective for annual reporting periods beginning on or after 1 January 2016 and have not yet been endorsed by the EU.

## Accounting policies continued

### (A) Basis of preparation continued

#### **(iii) *Narrow scope amendments to IFRS10, IFRS 12 and IAS 28 – Applying the Consolidation Exception***

These narrow-scope amendments clarify the application of the requirements for investment entities to measure subsidiaries at fair value instead of consolidating them. There are no implications for the Group's financial statements as the Group does not meet the definition of an investment entity. These amendments are effective for annual reporting periods beginning on or after 1 January 2016 and have not yet been endorsed by the EU.

#### **(iv) *Amendments to IAS 1 – Disclosure Initiative***

These amendments clarify guidance in IAS 1 on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. The amendments form part of the IASB's Disclosure Initiative, which explores how financial statement disclosures can be improved. The adoption of these amendments will have no impact for the Group's profit or loss or equity. The amendments are effective for annual reporting periods beginning on or after 1 January 2016 and have not yet been endorsed by the EU.

#### **(v) *Annual Improvements to IFRSs 2012-2014***

These improvements consist of amendments to five IFRSs including IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 7 Financial Instruments: Disclosures and IAS 19 Employee Benefits. The amendments clarify existing guidance. The adoption of these amendments is not expected to have a significant impact on the Group's financial statements. The amendments are effective for annual reporting periods beginning on or after 1 January 2016 and have yet to be endorsed by the EU.

#### **(vi) *IFRS 15, Revenue from Contracts with Customers***

IFRS 15 will replace IAS 18 Revenue and establishes a principle based five-step model to be applied to all contracts with customers, except for insurance contracts, financial instruments and lease contracts. IFRS 15 also includes enhanced disclosure requirements. The impact of the adoption of the new standard has yet to be fully assessed by the Group. This standard applies to annual reporting periods beginning on or after 1 January 2018 and has not yet been endorsed by the EU.

#### **(vii) *IFRS 9, Financial Instruments***

In July 2014, the IASB published IFRS 9 Financial Instruments which will replace IAS 39 Financial Instruments: Recognition and Measurement. The standard incorporates new classification and measurements requirements for financial assets, the introduction of an expected credit loss impairment model which will replace the incurred loss model of IAS 39, and new hedge accounting requirements. Under IFRS 9, all financial assets will be measured at either amortised cost or fair value. The basis of classification will depend on the business model and the contractual cash flow characteristics of the financial assets. The standard retains most of IAS 39's requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value changes attributable to own credit is to be recognised in other comprehensive income instead of the income statement. The hedge accounting requirements are more closely aligned with risk management practices and follow a more principle based approach. The IASB is currently drafting an Exposure Draft to consult on a package of temporary measures that would address the application of IFRS 9 to insurers prior to the publication of the new accounting standard for insurance contracts. A final standard is expected to be issued in 2016. The impact of the adoption of the new standard on the Group's financial statements has yet to be fully assessed. IFRS 9 has not been endorsed by the EU.

#### **(viii) *Amendments to IFRS 10 and IAS 28 – Sale of Contribution of Assets between an Investor and its Associate or Joint Venture***

Amendments to IFRS 10 and IAS 28 clarify that for transactions between an investor and its associate or joint venture, full gains are to be recognised where the assets sold or contributed constitute a business as defined in IFRS 3 Business Combinations. Where the assets sold or contributed do not constitute a business, gains and losses are recognised only to extent of other investors' interests in associate or joint venture. The adoption of these amendments is not expected to have any implications for the Group's financial statements. These amendments will be effective for annual reporting periods beginning on or after 1 January 2016. However the IASB has decided to postpone it indefinitely pending the outcome of its research project on the equity method of accounting.

The Group presents its consolidated Statement of Financial Position 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 reporting 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.

## Accounting policies continued

### (A) Basis of preparation continued

#### *Segmental Information*

The Company's interests in FPG, FLI and FLFL were disposed of in their entirety on 13 April 2015. These businesses represented all the main operating segments of the Group. As a result of this disposal, the Group no longer has any components that meet the definition of an operating segment and therefore no segmental information is provided.

### (B) Critical accounting policies and the use of estimates

The preparation of financial statements requires the Group to select accounting policies and make estimates and assumptions that affect items reported in the Consolidated Income Statement, Consolidated Statement of Financial Position, other primary statements and notes to the financial statements.

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results can always differ from those estimates, possibly significantly.

The table below sets out those items we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy.

Item	Accounting policy
Consolidation principles	L
Fair value of financial investments	M & N
Impairment of financial investments	N
Income taxes	G
Provisions and contingent liabilities	X
Fair value of derivative financial instruments	BB

### (C) Investment return

Investment return consists of dividends, interest receivable for the year, realised gains and losses, and unrealised gains and losses on fair value investments (as defined in policy N). Dividends on equity securities are recorded as revenue on the ex-dividend date. Dividends from investments in subsidiaries are recorded as revenue on the date dividends are declared. Interest income is recognised as it accrues, taking into account the effective yield on the investment and 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.

A gain or loss on a financial investment is only realised on disposal or transfer, and is the difference between the proceeds received, net of transaction costs, and its original cost or amortised cost, as appropriate. Unrealised gains and losses, arising on investments which have not been derecognised as a result of disposal or transfer, represent the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year, less the reversal of previously recognised unrealised gains and losses in respect of disposals made during the year.

### (D) Administrative and other expenses

Ongoing administrative and other expenses are recognised as incurred.

### (E) Finance costs

All borrowing costs are expensed as they are incurred and are calculated using the effective interest rate method.

## Accounting policies continued

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### (F) Foreign currency transactions

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in the Income Statement. Translation differences on debt securities and other monetary financial assets measured at fair value and designated as held at fair value through profit or loss (FVTPL) (see accounting policy N) are included in foreign exchange gains and losses in the Income Statement.

For monetary financial assets designated as Available for Sale (AFS), translation differences are calculated as if they were carried at amortised cost and so are recognised in the Income Statement, whilst foreign exchange differences arising from fair value gains and losses are recognised in other comprehensive income and included in the investment valuation reserve within equity.

Translation differences on non-monetary items, such as equities which are designated as FVTPL, are reported as part of the fair value gain or loss, whereas such differences on AFS equities are included in the investment valuation reserve.

### (G) Income taxes

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years. Tax, including tax relief for losses if applicable, is allocated over profits before taxation and amounts charged or credited to components of other comprehensive income and equity, as appropriate.

A provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the liability method, on all material temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The rates enacted or substantively enacted at the Statement of Financial Position date are used to determine the deferred tax assets or liabilities.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Where there is a history of tax losses, deferred tax assets are only recognised in excess of deferred tax liabilities if there is convincing evidence that future profits will be available.

Deferred tax is provided on temporary differences arising from investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax is not provided on revaluations of investments in subsidiaries as under current tax legislation no tax is expected to arise on their disposal.

Current and deferred tax relating to items recognised in other comprehensive income and directly in equity are similarly recognised in other comprehensive income and directly in equity respectively. Deferred tax related to fair value re-measurement of available for sale investments and other amounts charged or credited directly to other comprehensive income is recognised in the Statement of Financial Position as a deferred tax asset or liability.

### (H) Dividends

Interim dividends on ordinary shares are recognised in equity in the period in which they are paid. Final dividends on these shares are recognised when they have been approved by shareholders.

### (I) Goodwill, AVIF and intangible assets

#### *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. 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 (CGUs). Where the recoverable amount of the CGU is less than its carrying amount, including the related goodwill, an impairment loss is recognised in the income statement.

In a business combination, where the purchase consideration is lower than the fair value of the net assets acquired, a gain on acquisition arises, sometimes referred to as negative goodwill. Such a gain on acquisition is recognised in the income statement in the period in which it arises.

#### *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 statement of financial position, using a MCEV methodology.

## Accounting policies continued

### (I) Goodwill, AVIF and intangible assets continued

#### *AVIF continued*

AVIF is amortised over the anticipated lives of the related contracts which typically vary between five years and 35 years, with the amortisation profile being in accordance with expected profit emergence from the contracts. Any changes in estimated useful lives are accounted for prospectively with the effect of the change being recognised in the current and future periods, if relevant.

#### *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. Any changes in estimated useful lives are accounted for prospectively with the effect of the change being recognised in the current and future periods, if relevant. Amortisation is calculated using the straight-line method to allocate the cost over the estimated useful lives of the intangible assets with ranges as shown below:

	Years
Customer relationships	8 – 12
Distribution relationships	5 – 10
Brands	10 – 15
Computer software	3 – 4

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.

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.

#### *Impairment testing*

All identifiable intangible assets are reviewed at each reporting date, or where impairment indicators are present, 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 consolidated income statement.

For the purpose of impairment testing, goodwill and AVIF are allocated to the CGU, which represents the lowest level within the Group at which the intangible assets are monitored for internal management purposes.

AVIF is tested for impairment by comparing the carrying amount with its recoverable amount. The calculation of the recoverable amount is consistent with the measurement methodology for AVIF at initial recognition and is based on the current MCEV VIF balance for pre-acquisition business only, adjusted for differences between the IFRS and MCEV measurement basis for other net assets.

### (J) Property, plant & equipment

#### *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, based on highest and best use, measured at the date of revaluation. Revaluation surpluses, and their reversal, are recognised in the statement of other comprehensive income. Revaluation losses, and their reversal, are recognised in the income statement.

Equipment is recognised at cost less accumulated depreciation and impairment losses.

#### *Depreciation*

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 the asset, as follows:

	Years
Computer hardware and related software	1 – 4
Fixtures, fittings and office equipment	3 – 10

## Accounting policies continued

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### (J) Property, plant & equipment continued

#### *Depreciation continued*

Residual values and useful lives are reviewed at each financial year end and adjusted if appropriate. Any changes in estimated useful lives are accounted for prospectively with the effect of the change being recognised in the current and future periods, if relevant.

#### *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.

### (K) 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.

Investment properties are initially included in the balance sheet at cost and subsequently measured at fair value, at least annually at the reporting date. Fair values, based on highest and best use, are measured by external independent valuers, who hold a recognised and relevant professional qualification and have recent experience in the location and category of the 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.

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.

### (L) Consolidation principles

#### *Subsidiaries*

Subsidiaries are those entities over which the Group has control. The Group controls an investee if and only if the Group has all of the following:

- power over the investee,
- exposure, or rights, to variable returns from its involvement with the investee, and
- the ability to use its power over the investee to affect its returns.

The Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including: the purpose and design of an investee, relevant activities, substantive and protective rights, and voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Subsidiaries are consolidated from the date the Group obtains control and are excluded from consolidation from the date the Group loses control. All intercompany transactions, balances and unrealised surpluses and deficits on transactions between Group companies have been eliminated.

#### *Associates and joint ventures*

Associates are entities over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control. Generally, it is presumed that the Group has significant influence if it has between 20% and 50% of voting rights. Joint ventures are joint arrangements whereby the Group and other parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. In a number of these, the Group's share of the underlying assets and liabilities may be greater or less than 50% but the terms of the relevant agreements make it clear that control is not exercised. Such jointly controlled entities are referred to as joint ventures in these financial statements.

Gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the associates and joint ventures. Losses are also eliminated, unless the transaction provides evidence of an impairment of the asset transferred between entities.



## Accounting policies continued

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### (M) Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. This presumes that the transaction takes place in the principal (or most advantageous) market under current market conditions. Fair value is a market-based measure and in the absence of observable market prices in an active market, it is measured using the assumptions that market participants would use when pricing the asset or liability.

The fair value of a non-financial asset is determined based on its highest and best use from a market participant's perspective. When using this approach, the Group takes into account the asset's use that is physically possible, legally permissible and financially feasible.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received. In certain circumstances, the fair value at initial recognition may differ from the transaction price. If the fair value is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging), or is based on a valuation technique whose variables include only data from observable markets, then the difference between the fair value at initial recognition and the transaction price is recognised as a gain or loss in the Income Statement. When unobservable market data has a significant impact on the valuation of financial instruments, the difference between the fair value at initial recognition and the transaction price is not recognised immediately in the Income Statement, but deferred and recognised in the Income Statement on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out or otherwise matured.

If an asset or a liability measured at fair value has a bid price and an ask price, the price within the bid-ask spread that is most representative of fair value in the circumstances is used to measure fair value.

### (N) Financial assets

The Group classifies its investments as either financial assets at fair value through profit or loss (FVTPL), financial assets available for sale (AFS) or as loans at amortised cost.

The classification depends on the purpose for which the investments were acquired, and is determined by local management at initial recognition. The FVTPL category has two subcategories – those that meet the definition as being held for trading and those the Group chooses to designate as FVTPL (referred to in this accounting policy as 'other than trading') upon initial recognition.

In general, the other than trading category is used as, in most cases, the Group's investment or risk management strategy is to manage its financial investments on a fair value basis. Debt securities and equity securities, which the Group buys with the intention to resell in the short term, are classified as trading, as are non-hedge derivatives (see accounting policy BB below). The AFS category is used where the relevant long-term business liability (including shareholders' funds) is passively managed, as well as in certain fund management and non-insurance operations.

Purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the assets, at their fair values. Debt securities are initially recorded at their fair value, which is taken to be amortised cost, with amortisation credited or charged to the Income Statement. Investments classified as trading, other than trading and AFS are subsequently carried at fair value. Changes in the fair value of trading and other than trading investments are included in the Income Statement in the period in which they arise. Changes in the fair value of securities classified as AFS are recognised in other comprehensive income and recorded in a separate investment valuation reserve within equity.

Investments carried at fair value are measured using the methodology outlined in note 14, with values based on the quoted price within the bid-ask spread that is most representative of fair value or based on cash flow models using market observable inputs or unobservable inputs. When securities classified as AFS are sold or impaired, the accumulated fair value adjustments are transferred out of the investment valuation reserve to the Income Statement with a corresponding movement through other comprehensive income.

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. 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 less impairment losses or, if they meet the criteria for designation at fair value through profit or loss (such as the elimination of, or significant reduction in, accounting mismatches) 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. Subsequent to initial recognition, any difference between cost and redemption value is amortised through the income statement over the life of the instrument. The carrying values of loans at amortised cost are reviewed for impairment in accordance with IAS 39 at each reporting date. If there is objective evidence of impairment, for example there is a default or delinquency in payment, the impairment loss is calculated and recognised.

## Accounting policies continued

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### (O) Deferred acquisition costs

#### *Insurance 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 deferred and 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 from future margins. 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.

#### *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.

### (P) Reinsurance assets

The benefits to which the Group is entitled under its reinsurance contracts are recognised as reinsurance assets. Amounts recoverable from reinsurers are measured consistently with the amounts associated with the underlying insurance contracts that are being reinsured and in accordance with the terms of each reinsurance contract.

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 (see note 16 for further details).

### (Q) 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.

### (R) Statement of Cash Flows

#### *Cash and cash equivalents*

Cash and cash equivalents consist of cash at banks and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand with only an insignificant change in their fair values.

For the purposes of the Statement of Cash Flows, cash and cash equivalents also include bank overdrafts, which are included in payables and other financial liabilities on the Statement of Financial Position.

### (S) 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.

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.

For operations conducted in the UK, insurance contract liabilities are calculated based on the relevant PRA 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.

For conventional with-profits policies, 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.

## Accounting policies continued

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### (S) Insurance contracts continued

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.

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 the statement of other comprehensive income. 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 the consolidated statement of comprehensive income.

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 light of estimated future cash flows. Where a shortfall is identified, an additional provision is made.

### (T) Unallocated surplus

The unallocated surplus in the with-profits funds is presented as a liability and comprises all amounts available for allocation, either to policyholders or to shareholders, the allocation of which has not been determined at the balance sheet date.

Insurance and investment contract liabilities within with-profits funds are measured on a realistic basis and therefore include amounts attributable in respect of future bonuses. Such amounts are estimated in accordance with the published Principles and Practices of Financial Management (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 and includes a part which represents the value of future transfers to shareholders from the with-profits funds.

### (U) 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 Participating Features (DPF) with no significant insurance risk. The latter are mainly unitised with-profits contracts.

An investment contract is a financial liability designated on initial recognition at fair value through profit or loss, when one of the following criteria is satisfied:

- it eliminates or significantly reduces an accounting mismatch with corresponding assets which are managed on a fair value basis.
- it contains or may contain an embedded derivative.

A unit-linked contract is recognised at fair value through profit or loss and 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, the fair value of the investment contract liability includes provision for tax losses in the unit-linked funds whose benefit will ultimately accrue to the policyholders and provision for renewal commissions where intermediaries are not required to perform any service once the policy is inception. Non-unit reserves, relating primarily to deferral of front end fees in the form of unfunded units, are also included as an investment contract liability and recognised as income on a straight-line basis over the period in which services are rendered.

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 these funds.

### (V) Borrowings

The Group classifies its loans and borrowings as financial liabilities carried at amortised cost. 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. 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.

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. Interest accrued on 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.

## Accounting policies continued

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### (W) Net asset value attributable to unit-holders

OEICs and unit trusts where the Group has a controlling interest and the units are not owned by the Group are treated as a liability, as there is a contractual obligation to deliver cash, and are presented as “net asset value attributable to unit-holders”.

### (X) Provisions and contingent liabilities

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. The amount recorded as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where the effect of the time value of money is material, the provision is the present value of the expected expenditure. Provisions are not recognised for future operating losses.

Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The Group recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

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.

### (Y) Derecognition and offset of financial assets and financial liabilities

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired;
- The Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement; or
- The Group has transferred its rights to receive cash flows from the asset and either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

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

### (Z) Insurance and other payables

Insurance and other payables are recognised when due and are measured on initial recognition at the fair value of the consideration payable. Subsequent to initial recognition, derivative contract liabilities are carried at fair value and other payables are measured at amortised cost using the effective interest rate method.

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.

### (AA) Share capital

#### *Equity instruments*

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all its liabilities. Accordingly, 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 obligation 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.

## Accounting policies continued

### **(BB) Derivative financial instruments and hedging**

Derivative financial instruments include foreign exchange contracts and currency swaps that derive their value mainly from underlying foreign exchange rates.

All derivatives are initially recognised in the Statement of Financial Position at their fair value, which usually represents their cost. They are subsequently remeasured at their fair value, with the method of recognising movements in this value depending on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset on the Statement of Financial Position at the date of purchase, representing their fair value at that date.

Derivative contracts may be traded on an exchange or over-the-counter (OTC). Exchange-traded derivatives are standardised and include certain futures and option contracts. OTC derivative contracts are individually negotiated between contracting parties and include forwards, swaps, caps and floors. Derivatives are subject to various risks including market, liquidity and credit risk, similar to those related to the underlying financial instruments. Many OTC transactions are contracted and documented under International Swaps and Derivatives Association (ISDA) master agreements or their equivalent, which are designed to provide legally enforceable set-off in the event of default, reducing the Group's exposure to credit risk.

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities on the Statement of Financial Position as they do not represent the fair value of these transactions.

The Group has collateral agreements in place with relevant counterparties. Accounting policy CC below covers collateral, both received and pledged, in respect of these derivatives.

#### **Currency swaps**

Currency swaps, in their simplest form, are contractual agreements that involve the exchange of both periodic and final amounts in two different currencies. These contracts may include the net exchange of principal. Exposure to gain or loss on these contracts will increase or decrease over their respective lives as a function of maturity dates, foreign exchange rates, and the timing of payments.

#### **Foreign exchange contracts**

Foreign exchange contracts, which include spot and forward contracts, represent agreements to exchange the currency of one country for the currency of another country at an agreed price and settlement date. Foreign exchange option contracts are similar to interest rate option contracts, except that they are based on currencies, rather than interest rates. Exposure to gain or loss on these contracts will increase or decrease over their respective lives as currency exchange and interest rates fluctuate.

#### **Derivative instruments for hedging**

On the date a derivative contract is entered into, the Group designates certain derivatives as either:

- (i) a hedge of the fair value of a recognised asset or liability (fair value hedge);
- (ii) a hedge of a future cash flow attributable to a recognised asset or liability, a highly probable forecast transaction or a firm commitment (cash flow hedge); or
- (iii) a hedge of a net investment in a foreign operation (net investment hedge).

Hedge accounting is used for derivatives designated in this way, provided certain criteria are met. At the inception of the transaction, the Group documents the relationship between the hedging instrument and the hedged item, as well as the risk management objective and the strategy for undertaking the hedge transaction. The Group also documents its assessment of whether the hedge is expected to be, and has been, highly effective in offsetting the risk in the hedged item, both at inception and on an ongoing basis.

Changes in the fair value of derivatives that are designated and qualify as net investment or cash flow hedges, and that prove to be highly effective in relation to the hedged risk, are recognised in other comprehensive income and a separate reserve within equity. Gains and losses accumulated in this reserve are included in the income statement on disposal of the relevant investment or occurrence of the cash flow as appropriate.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in the Income Statement. The gain or loss on the hedged item that is attributable to the hedged risk is recognised in the Income Statement. This applies even if the hedged item is an available for sale financial asset or is measured at amortised cost. If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment made to the carrying amount of the hedged item is amortised to the Income Statement, based on a recalculated effective interest rate over the residual period to maturity. In cases where the hedged item has been derecognised, the cumulative adjustment is released to the Income Statement immediately.

For a variety of reasons, certain derivative transactions, while providing effective economic hedges under the Group's risk management positions, do not qualify for hedge accounting under the specific IFRS rules and are therefore treated as derivatives held for trading. Their fair value gains and losses are recognised immediately in net investment income.

## Accounting policies continued

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### **(CC) Collateral**

The Group receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, certain derivative contracts, in order to reduce the credit risk of these transactions. Collateral is also pledged as security for bank letters of credit. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, which is not legally segregated from the Group, is recognised as an asset in the Statement of Financial Position with a corresponding liability for the repayment in financial liabilities. However, where the Group has a currently enforceable legal right of set-off, the collateral liability and associated derivative balances are shown net, in line with market practice. Non-cash collateral received is not recognised in the Statement of Financial Position unless the Group either (a) sells or repledges these assets in the absence of default, at which point the obligation to return this collateral is recognised as a liability; or (b) the counterparty to the arrangement defaults, at which point the collateral is seized and recognised as an asset.

Collateral pledged in the form of cash, which is legally segregated from the Group, is derecognised from the Statement of Financial Position with a corresponding receivable recognised for its return. Non-cash collateral pledged is not derecognised from the Statement of Financial Position unless the Group defaults on its obligations under the relevant agreement, and therefore continues to be recognised in the Statement of Financial Position within the appropriate asset classification.

### **(DD) Share based payments**

The Group offers share-based payment plans to certain key employees. The expense charged to the income statement is based on the fair value of the options granted, the vesting period and the vesting conditions. Fair values are determined using stochastic and scenario-based modelling techniques where appropriate.

For equity-settled schemes, the fair value is determined at grant date and expensed on a straight-line basis over the vesting period in the income statement. A corresponding amount is credited to equity. At each reporting date the Group revises its estimates of the number of shares that are expected to be issued for the achievement of non-market related performance conditions: the impact of any revisions are recognised in the income statement, with a corresponding adjustment to equity over the remaining vesting period. Where a leaver is entitled to their scheme benefits, this is treated as an acceleration of vesting and hence a shortening of the period over which the expense is charged.

For cash-settled schemes, the fair value is expensed on a straight-line basis over the vesting period in the income statement and the cumulative provision for obligations under cash-settled schemes is recognised as a liability in the statement of financial position. The fair value is remeasured at each reporting date, with any changes in fair value recognised in the income statement for the period.

## Consolidated Income Statement

For the year ended 31 December 2015

	Notes	2015 £m	Restated 2014 £m
<b>Revenue</b>			
Investment return	C & 4	145	97
<b>Total revenue</b>		145	97
Administrative and other expenses	D & 5	(20)	(31)
Finance costs	E & 7	(110)	(107)
<b>Total expenses</b>		(130)	(138)
<b>Profit/(loss) before tax from continuing operations</b>		15	(41)
Tax (charge)/credit from continuing operations	G & 8	(1)	12
<b>Profit/(loss) after tax from continuing operations</b>		14	(29)
<b>Profit/(loss) after tax from discontinued operations</b>		4	(88)
<b>Profit/(loss) for the year</b>		18	(117)
Attributable to:			
Equity holders of the Company			
– From continuing operations		(6)	(60)
– From discontinued operations		4	(88)
Step-up Tier one Insurance Capital Securities (STICS) holders	AA	20	31
<b>Profit/(loss) for the year</b>		18	(117)

The Consolidated Income Statement includes the results of business classified as discontinued operations. A single amount is shown on the face of the Income Statement representing the operation's post-tax result. 2014 results have also been restated to reflect this classification.

## Consolidated Statement of Comprehensive Income

For the year ended 31 December 2015

For the year ended 31 December	2015 £m	Restated 2014 £m
<b>Profit/(loss) from continuing operations<sup>(i)</sup></b>	<b>14</b>	<b>(29)</b>
<b>Profit/(loss) from discontinued operations</b>	<b>4</b>	<b>(88)</b>
<b>Profit/(loss) for the year</b>	<b>18</b>	<b>(117)</b>
Items that may be reclassified subsequently to profit and loss:		
Investments classified as available for sale – fair value losses	(35)	–
Tax relating to items that may be reclassified to profit or loss	6	–
<b>Total items that may be reclassified subsequently to profit and loss</b>	<b>(29)</b>	<b>–</b>
Other comprehensive loss, net of tax, from continuing operations	(29)	–
Other comprehensive (loss)/income, net of tax, from discontinued operations	(17)	53
<b>Total other comprehensive (loss)/income, net of tax</b>	<b>(46)</b>	<b>53</b>
Total comprehensive loss, net of tax, from continuing operations	(15)	(29)
Total comprehensive loss, net of tax, from discontinued operations	(13)	(35)
<b>Total comprehensive loss, net of tax</b>	<b>(28)</b>	<b>(64)</b>

- (i) The profit/(loss) from continuing operations includes £20 million (2014: £31 million) attributable to STICS holders. There are no amounts in either 2015 or 2014 included in other comprehensive income which is attributable to STICS holders.



## Consolidated Statement of Changes in Equity

For the year ended 31 December 2015

For the year ended 31 December 2015	Attributable to equity holders of the Company			STICS holders £m	Non-controlling interests £m	Total £m
	Share capital £m	Other reserves £m	Total £m			
<b>At 1 January 2015</b>	<b>515</b>	<b>3,860</b>	<b>4,375</b>	<b>318</b>	<b>1</b>	<b>4,694</b>
(Loss)/profit for the year	–	(2)	(2)	20	–	18
Other comprehensive loss	–	(46)	(46)	–	–	(46)
<b>Total comprehensive (loss)/income</b>	<b>–</b>	<b>(48)</b>	<b>(48)</b>	<b>20</b>	<b>–</b>	<b>(28)</b>
Dividends paid	–	(4,858)	(4,858)	–	–	(4,858)
Interest paid on STICS	–	–	–	(7)	–	(7)
<b>Appropriations of profit</b>	<b>–</b>	<b>(4,858)</b>	<b>(4,858)</b>	<b>(7)</b>	<b>–</b>	<b>(4,865)</b>
Capital contribution <sup>(i)</sup>	–	1,229	1,229	–	–	1,229
Reclassification of STICS as a financial liability <sup>(ii)</sup>	–	(93)	(93)	(192)	–	(285)
Tax on reclassification of STICS as a financial liability	–	17	17	–	–	17
Tax relief on STICS interest	–	4	4	–	–	4
Share-based payments, net of settlements <sup>(iii)</sup>	–	(3)	(3)	–	–	(3)
Funding of Employee Benefit Trust <sup>(iv)</sup>	–	8	8	–	–	8
Attributable to non-controlling interests	–	–	–	–	(1)	(1)
Transfer of 2003 STICS to Aviva plc <sup>(v)</sup>	–	(85)	(85)	(139)	–	(224)
Tax on the transfer of STICS to Aviva plc	–	15	15	–	–	15
<b>At 31 December 2015</b>	<b>515</b>	<b>46</b>	<b>561</b>	<b>–</b>	<b>–</b>	<b>561</b>

For the year ended 31 December 2014	Attributable to equity holders of the Company			STICS holders £m	Non-controlling interests £m	Total £m
	Share capital £m	Other reserves £m	Total £m			
<b>At 1 January 2014</b>	<b>515</b>	<b>4,550</b>	<b>5,065</b>	<b>318</b>	<b>2</b>	<b>5,385</b>
(Loss)/profit for the year	–	(148)	(148)	31	–	(117)
Other comprehensive income	–	53	53	–	–	53
<b>Total comprehensive (loss)/income</b>	<b>–</b>	<b>(95)</b>	<b>(95)</b>	<b>31</b>	<b>–</b>	<b>(64)</b>
Dividends paid	–	(610)	(610)	–	–	(610)
Interest paid on STICS	–	–	–	(31)	–	(31)
Appropriations of profit	–	(610)	(610)	(31)	–	(641)
Tax relief on STICS interest	–	20	20	–	–	20
Share-based payments, net of settlements <sup>(iii)</sup>	–	8	8	–	(1)	7
Funding of Employee Benefit Trust <sup>(iv)</sup>	–	(13)	(13)	–	–	(13)
<b>At 31 December 2014</b>	<b>515</b>	<b>3,860</b>	<b>4,375</b>	<b>318</b>	<b>1</b>	<b>4,694</b>

- (i) The profit on disposal arising from the group reorganisation is recognised as a capital transaction (see note 1 for further details).
- (ii) Fair value on reclassification of 2005 STICS as a financial liability, as a result of the Company giving notice to the STICS holders on 29 May 2015 of intent to redeem on 1 July 2015. For further details see note 30.
- (iii) The movement in other reserves for share-based payment schemes of £(3) million for the year represents an expense of £1 million for all schemes that vested early on the acquisition of the Group by Aviva and £(4) million for the reclassification of the FLG LTIP from an equity-settled scheme to a cash-settled scheme as rewards will now be paid in cash. The movement in 2014 of £8 million represents the expense, net of scheme settlements for the year.
- (iv) During 2014 the Group provided funding of £13 million to an EBT which purchased and held shares of Friends Life Group Limited (FLG) for delivery to employees under various share-based payment schemes. In April 2015, the EBT repaid cash of £8 million to the Group.
- (v) Fair value on transfer of 2003 STICS to Aviva plc on 2 October 2015.

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 28 to 79 are an integral part of these financial statements.

## Consolidated Statement of Financial Position

### As at 31 December 2015

As at 31 December	Notes	2015 £m	2014 £m
<b>Assets</b>			
Intangible assets	I & 10	–	3,110
Property, plant and equipment	J & 11	–	44
Investment properties	K & 12	–	2,690
Investment in associate	L	–	4
Financial assets	N & 13	1,539	92,768
Deferred acquisition costs	O & 15	–	853
Reinsurance assets	P & 16	–	1,231
Current tax assets	G & 17	14	17
Deferred tax assets	G & 17	9	–
Insurance and other receivables	Q & 18	65	880
Cash and cash equivalents	R & 19	95	7,503
<b>Total assets</b>		<b>1,722</b>	<b>109,100</b>
<b>Liabilities</b>			
Insurance contracts	S & 20	–	35,750
Unallocated surplus	T & 21	–	692
Financial liabilities:			
– Investment contracts	U & 22	–	64,087
– Loans and borrowings	V & 23	1,054	1,051
Net asset value attributable to unit-holders	W & 24	–	589
Provisions	X & 25	–	176
Pension scheme deficit	26	–	7
Deferred tax liabilities	G & 17	–	961
Insurance payables, other payables and deferred income	Z & 27	107	1,093
<b>Total liabilities</b>		<b>1,161</b>	<b>104,406</b>
<b>Equity attributable to equity holders of the Company</b>			
– Share capital	AA & 28	515	515
– Other reserves	29	46	3,860
		<b>561</b>	<b>4,375</b>
Attributable to STICS holders	AA & 30	–	318
		<b>561</b>	<b>4,693</b>
Attributable to non-controlling interests		–	1
<b>Total equity</b>		<b>561</b>	<b>4,694</b>
<b>Total equity and liabilities</b>		<b>1,722</b>	<b>109,100</b>

The financial statements on pages 23 to 67 were approved by the Board of Directors on 9 March 2016 and signed on its behalf by

J R Lister  
Director

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 28 to 79 are an integral part of these financial statements.

## Consolidated Statement of Cash Flows

### For the year ended 31 December 2015

For the year ended 31 December	2015 £m	2014 £m
<b>Operating activities</b>		
Profit/ (loss) for the year	18	(117)
Adjusted for:		
– loss on remeasurement to fair value of discontinued operations	–	14
– recycling of cumulative translation differences on discontinued operations	–	46
– profit after tax from discontinued operations	(4)	–
– net realised and unrealised gains on assets at fair value	(22)	(5,610)
– finance costs	110	131
– amortisation and impairment of intangible assets	–	390
– depreciation of property and equipment	–	2
– movement in deferred acquisition costs	–	(10)
– total tax charge	1	125
– purchase of shares and other variable yield securities	–	(27,477)
– proceeds from sale of shares and other variable yield securities	–	28,653
– purchase of loans, debt securities and other fixed income securities	–	(28,520)
– proceeds from sale of loans, debt securities and other fixed income securities	–	29,927
– purchase of investment properties	–	(53)
– proceeds from sale of investment properties	–	214
– increase in insurance liabilities	–	1,160
– increase in investment contract liabilities	–	957
– increase in unallocated surplus	–	65
– decrease in provisions	–	(46)
– net movement in receivables and payables	(26)	583
Pre-tax cash inflow from operating activities	77	434
Income tax receipt/(payment)	25	(27)
<b>Net cash inflow from operating activities</b>	<b>102</b>	<b>407</b>
<b>Investing activities</b>		
Disposal of held for sale assets, net of cash transferred	(6,954)	(1,539)
Net disposal of financial investments	57	–
Additions to internally generated intangible assets	–	(2)
Net disposals of property and equipment	–	4
<b>Net cash outflow from investing activities</b>	<b>(6,897)</b>	<b>(1,537)</b>
<b>Financing activities</b>		
Repayment of loan to AGH	145	–
Repayment of the 2005 STICS	(285)	–
Net funding of EBT	8	(13)
Finance costs	(88)	(133)
STICS interest	(7)	(31)
Net movement in other borrowings, net of expenses	(13)	(19)
Dividends paid to equity holders of the Company	(376)	(610)
<b>Net cash outflow from financing activities</b>	<b>(616)</b>	<b>(806)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(7,411)</b>	<b>(1,936)</b>
Balance at beginning of year	7,503	9,530
Exchange adjustments on the translation of foreign operations	3	(91)
<b>Balance at end of year</b>	<b>95</b>	<b>7,503</b>

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 28 to 79 are an integral part of these financial statements.

## Notes to the Consolidated Financial Statements

### 1. Business disposals

#### (a) Disposal of discontinued operations

On 13 April 2015 the former FL Group companies were restructured within the Aviva Group. As part of this restructuring the Company disposed of its interests in FPG, FLI and FLFL. The Company's shareholdings in FLI and FLFL, plus 68% of the Company's interest in FPG were transferred to the Group's then parent undertaking, FLGH, by way of a dividend in specie of £3,297 million. The Company's remaining 32% shareholding in FPG was transferred to AGH in exchange for consideration of £1,544 million in the form of a loan payable by AGH. The loan was fully settled as at 31 December 2015.

The Company retained its interest in £500 million of STICS of FLL (internal STICS), an insurance undertaking of the disposal Group (see note 13 for details).

The profit on the restructure is recognised as a capital contribution:

	13 April 2015 £m
Disposal group equity attributable to shareholders	(3,612)
Dividend in specie	3,297
<b>Residual equity attributable to shareholders</b>	<b>(315)</b>
Loan consideration	1,544
<b>Capital contribution</b>	<b>1,229</b>

The results of FPG, FLI and FLFL and their subsidiary undertakings are classified as results from discontinued operations in the Group's results for 2015.

## Notes to the Consolidated Financial Statements continued

### 1. Business disposals continued

#### (b) Results of discontinued operations

	2015 Period to 13 April	2014	
	FPG, FLI, FLFL £m	FPG, FLI, FLFL £m	Lombard £m
<b>Revenue</b>			
Gross earned premiums	380	1,766	–
Premiums ceded to reinsurers	(170)	1,000	–
Net earned premiums	210	2,766	–
Fee and commission income and income from service activities	164	693	83
Investment return	6,109	7,593	1,300
<b>Total revenue</b>	<b>6,483</b>	<b>11,052</b>	<b>1,383</b>
<b>Other income<sup>(i)</sup></b>	<b>–</b>	<b>22</b>	<b>–</b>
<b>Claims, benefits and expenses</b>			
Gross claims and benefits paid	(998)	(4,065)	–
Amounts receivable from reinsurers	168	672	–
<b>Net claims and benefits paid</b>	<b>(830)</b>	<b>(3,393)</b>	<b>–</b>
Change in insurance contract liabilities	(352)	(2,729)	–
Change in investment contract liabilities	(4,526)	(2,869)	(1,215)
Transfer to unallocated surplus	–	(65)	–
Movement in net asset value attributable to unit-holders	(36)	(60)	–
<b>Movement in policyholder liabilities</b>	<b>(4,914)</b>	<b>(5,723)</b>	<b>(1,215)</b>
Acquisition expenses	(129)	(426)	(39)
Administrative and other expenses	(299)	(1,357)	(148)
Finance costs	(15)	(45)	–
<b>Total claims, benefits and expenses</b>	<b>(6,187)</b>	<b>(10,944)</b>	<b>(1,402)</b>
<b>Profit/(loss) before tax from discontinued operations</b>	<b>296</b>	<b>130</b>	<b>(19)</b>
Policyholder tax	(279)	(222)	–
<b>Profit/(loss) before shareholder tax from discontinued operations</b>	<b>17</b>	<b>(92)</b>	<b>(19)</b>
<b>Shareholder tax</b>	<b>(13)</b>	<b>75</b>	<b>8</b>
<b>Profit/(loss) after tax from discontinued operations</b>	<b>4</b>	<b>(17)</b>	<b>(11)</b>
Loss on remeasurement to fair value	–	–	(14)
Recycling of cumulative translation differences	–	–	(46)
<b>Profit/(loss) from discontinued operations</b>	<b>4</b>	<b>(17)</b>	<b>(71)</b>
Other comprehensive (loss)/income, net of tax	(17)	26	27
<b>Total comprehensive (loss)/income, net of tax</b>	<b>(13)</b>	<b>9</b>	<b>(44)</b>

(i) Represents internal recharges on pension deficit reductions of £22 million in 2014.

#### (c) Cash flows of discontinued operations

	2015 Period to 13 April	2014	
	FPG, FLI, FLFL £m	FPG, FLI, FLFL £m	Lombard £m
Operating cash flows	(45)	391	98
Investing cash flows	–	(1,536)	(1)
Financing cash flows	(295)	(706)	(6)
<b>Total cash flows</b>	<b>(340)</b>	<b>(1,851)</b>	<b>91</b>

## Notes to the Consolidated Financial Statements continued

### 1. Business disposals continued

#### (d) Major classes of assets and liabilities at disposal date (FPG, FLI and FLFL in aggregate)

	Notes	13 April 2015 £m
Intangible assets	I & 10	3,026
Property, plant and equipment	J & 11	42
Investment properties	K & 12	2,685
Investment in Associates	L	4
Financial assets	N & 13	97,359
Deferred Acquisition costs	O & 15	849
Reinsurance assets	P & 16	1,269
Insurance and other receivables	Q & 18	1,653
Cash and cash equivalents	R & 19	6,954
<b>Assets</b>		<b>113,841</b>
Insurance contracts	S & 20	36,081
Unallocated surplus	T & 21	693
Financial liabilities		
– Investment contracts	U & 22	68,789
– Loans and Borrowings	V	868
Net asset value attributable to unit-holders	W & 24	212
Provisions	X & 25	135
Pension deficits	26	26
Deferred tax liabilities	G & 17	1,125
Current tax liabilities	G & 17	51
Insurance payables, other payables and deferred income	Z & 27	1,724
<b>Liabilities</b>		<b>109,704</b>
Equity attributable to shareholders		3,612
Equity attributable to STICS holders		524
<b>Total equity attributable to equity holders of the parent</b>		<b>4,136</b>
Equity attributable to non-controlling interest		1
<b>Total equity</b>		<b>4,137</b>
<b>Total equity and liabilities</b>		<b>113,841</b>

#### (e) Disposal of Friends ASLH Limited

On 30 June 2015 the Group transferred 100% of its holding in Friends ASLH Limited to another Aviva Group company for consideration of £7 million, resulting in a £nil profit or loss on the disposal.

### 2. Directors

Mr A D Briggs is remunerated by FLMS and Mr J R Lister is remunerated by AESL, both fellow subsidiaries of the ultimate parent Company, Aviva plc. Mr Briggs and Mr Lister are remunerated for their roles as employees across the Aviva Group and they are not remunerated directly for their services as directors to the Company and the amount of time spent performing their duties is incidental to their roles across the Aviva Group. Mr Briggs is a director of Aviva plc and details of his remuneration is included in the annual report and financial statements of Aviva plc.

Sir G M Williamson is remunerated as a non-executive director of Aviva plc and details of his remuneration is included in the annual report and financial statements of Aviva plc.

## Notes to the Consolidated Financial Statements continued

### 2. Directors continued

Prior to the acquisition of the FL Group by Aviva plc on 13 April 2015, the directors of the Company as detailed on page 6 were also directors of FLG, the holding company of the FL Group and/or fellow subsidiaries. The total emoluments received by the directors until that date is detailed below, all of which was paid by FLMS or FLSL for their services to the FL Group. As for prior years, the directors did not believe that it was practicable to apportion this amount between their services as directors of the Company and their services as directors of the holding and fellow subsidiary companies. Amounts for annual bonus payments to the directors for the years ended 31 December 2015 and 2014 are included in the remuneration below:

	2015 £	2014 £
Remuneration	10,402,537	6,239,150

The total remuneration payable to directors during 2015 includes £5,636,602 (2014: £2,699,589) in respect of the highest paid director. This was the total of the costs incurred by the FL Group in respect of the highest paid director due to it being impractical to isolate the element of remuneration relating to the Company.

The Company made no contributions to pension schemes in either 2015 or 2014.

None of the directors of the Company received accruing benefits under money purchase pension or defined benefit pension schemes in 2015 or 2014.

None of the directors exercised share options in 2014 and none of the directors received or were entitled to receive shares under long term incentive schemes in 2014. The change in control resulting from the acquisition triggered a number of FLG long term awards, as included in the remuneration figure above for 2015.

### 3. Employees

Following the disposal of FPG, the Group has no employees. Aviva Employment Services Limited, Aviva Investors Employment Services Limited, Friends Life Management Services Limited, Friends Life Services Limited and Sesame Services Limited, fellow Group companies, are the employing companies for staff of the Aviva Group in the UK. Disclosures relating to employees may be found in the annual report and financial statements of these companies respectively.

### 4. Investment return

For the year ended 31 December	2015 £m	Restated 2014 £m
Interest income on loans and receivables	123	84
Movement in fair value:		
– financial assets or financial liabilities at fair value through profit or loss:	2	4
– financial derivative instruments	20	9
<b>Total investment return</b>	<b>145</b>	<b>97</b>

### 5. Administrative and other expenses

For the year ended 31 December	2015 £m	Restated 2014 £m
Non-recurring costs	–	21
Other administrative expenses	20	10
<b>Total administrative and other expenses</b>	<b>20</b>	<b>31</b>

Non-recurring costs in 2014 included charges related to separation and integration, charges for significant regulatory change, finance transformation costs including Solvency II, costs in respect of the transition and service improvement elements of the outsourcing arrangement with Diligenta, costs in relation to the proposed acquisition and strategic review costs.

## Notes to the Consolidated Financial Statements continued

### 6. Auditors' remuneration

The total remuneration payable by the Company, excluding VAT, to its principal auditors, PricewaterhouseCoopers LLP (2014: Ernst & Young LLP), is shown below.

The fees have been borne by the Group's ultimate parent, Aviva plc in 2015.

For the year ended 31 December	2015 £'000	2014 £'000
Audit of the financial statements	41	900
Audit of subsidiaries <sup>(i)</sup>	–	2,500
<b>Total audit</b>	<b>41</b>	<b>3,400</b>
Audit related assurance services	–	1,100
<b>Total audit and audit related assurance services</b>	<b>41</b>	<b>4,500</b>
Other services <sup>(ii)</sup>	–	1,200
<b>Total fees</b>	<b>41</b>	<b>5,700</b>

- (i) Included in the 2014 fee was £41,000 in respect of the audit of the Group pension schemes and £100,000 in respect of the audit of the Lombard business.  
(ii) Other services include other assurance services, all taxation services and corporate finance services (excluding amounts included in other services and all taxation advisory services) including £900,000 in relation to the acquisition of Friends Life Group Limited by Aviva plc.

### 7. Finance costs

For the year ended 31 December	2015 £m	Restated 2014 £m
Subordinated loan interest	87	85
Other interest	2	–
Retranslation of foreign currency borrowings	21	22
<b>Total finance costs</b>	<b>110</b>	<b>107</b>

### 8. Tax (charge)/credit

#### (a) Tax (charged)/credited to the Consolidated Income Statement

The total tax (charge)/credit comprises:

For the year ended 31 December	2015 £m	Restated 2014 £m
<b>Current tax</b>		
UK corporation tax at 20.25% (2014: 21.5%)	–	12
Adjustments in respect of prior periods	(1)	5
<b>Total current tax (charge)/credit</b>	<b>(1)</b>	<b>17</b>
<b>Deferred tax</b>		
Origination and reversal of temporary differences	–	(1)
Change in tax rates	–	(1)
Adjustments in respect of prior periods	–	(3)
<b>Total deferred tax charge</b>	<b>–</b>	<b>(5)</b>
<b>Total tax (charge)/credit</b>	<b>(1)</b>	<b>12</b>



## Notes to the Consolidated Financial Statements continued

### 8. Tax (charge)/credit continued

#### (b) Tax credited to the Consolidated Statement of Comprehensive Income

The tax credited to other comprehensive income comprises:

For the year ended 31 December	2015 £m	Restated 2014 £m
<b>Deferred tax</b>		
Origination and reversal of temporary differences	6	–
<b>Total deferred tax credit</b>	6	–
<b>Total tax credit</b>	6	–

#### (c) Tax reconciliation

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate of the United Kingdom as follows:

For the year ended 31 December	2015 £m	Restated 2014 £m
<b>Profit/(loss) before tax from continuing operations</b>	15	(41)
Tax on profit/(loss) from continuing operations determined with reference to the average rate of corporation tax in the UK of 20.25% (2014: 21.5%)	(3)	9
Effects of:		
– non-taxable income	3	3
– valuation of tax assets and liabilities	–	(2)
– adjustments in respect of prior periods	(1)	2
<b>Total tax (charge)/credit</b>	(1)	12

UK legislation was substantively enacted in July 2013 to reduce the UK corporation tax rate from 21% to 20% from 1 April 2015, resulting in an effective rate for the year ended 31 December 2015 of 20.25%.

As legislated in Finance (No 2) Act 2015, which was substantively enacted on 26 October 2015, the UK corporate rate will reduce further to 19% from 1 April 2017 and to 18% from 1 April 2020. The reductions in rate from 20% to 19% and then to 18% have been used in the calculation of the UK's deferred tax assets and liabilities as at 31 December 2015.

### 9. Appropriations of profit

	2015 £m	2014 £m
Ordinary dividends declared and charged to equity in the period:		
Dividend in specie	4,482	–
Interim 2015 – 9.71 pence per share, paid on 22 December 2015	50	–
Interim 2015 – 14.76 pence per share, paid on 4 September 2015	76	–
Interim 2014 – 48.54 pence per share, paid on 30 March 2015	250	–
Interim 2014 – 50.48 pence per share, paid on 31 October 2014	–	260
Interim 2014 – 19.42 pence per share, paid on 30 September 2014	–	100
Interim 2013 – 48.54 pence per share, paid on 27 March 2014	–	250
<b>Total dividends</b>	<b>4,858</b>	<b>610</b>
Interest on 2003 STICS (coupon rate 6.875%)	7	14
Interest on 2005 STICS (coupon rate 6.292%)	–	17
<b>Total appropriations of profit</b>	<b>4,865</b>	<b>641</b>

## Notes to the Consolidated Financial Statements continued

### 9. Appropriations of profit continued

As disclosed in note 1, on 13 April 2015 the Company disposed of 100% of its interest in FPG, FLI & FLFL. 68% of its interest was transferred to the parent company by the way of a dividend in specie of £3,297 million.

The Company paid additional in specie dividends of £1,181 million to FLGH on 4 September 2015 and £4 million to AGH on 22 December 2015 to partially settle the intercompany loan with AGH. Further, cash dividends of £76 million were paid to FLGH on 4 September 2015 and £50 million to AGH on 22 December 2015.

In 2014 the STICS met the criteria to be accounted for as equity instruments under IFRS, interest on these instruments has been treated as an appropriation of profit, charged directly to equity.

On 29 May 2015, the Company issued notification to holders of the 2005 STICS that the bonds would be redeemed on 1 July 2015. Consequently the 2005 STICS were classified as liabilities at 29 May 2015. Interest on the 2005 STICS is paid annually at a rate of 6.292%. The final interest payment was paid to the 2005 STICS holders on 1 July 2015.

On 2 October 2015, the 2003 STICS were transferred to Aviva plc at fair value of £224 million by way of novation of the intercompany loan with AGH.

As required by IAS 10: Events after the reporting period, dividends declared after the reporting date are not accrued in these accounts.

### 10. Intangible assets

The Company has no intangible assets as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

For the year ended 31 December 2015	AVIF £m	Other £m	Total £m
<b>Cost</b>			
At 1 January 2015	4,921	402	5,323
Disposals (note 1)	(4,921)	(402)	(5,323)
<b>At 31 December 2015</b>	–	–	–
<b>Accumulated amortisation and impairment</b>			
At 1 January 2015	1,935	278	2,213
Amortisation charge for the year <sup>(i)</sup>	73	11	84
Disposals (note 1)	(2,008)	(289)	(2,297)
<b>At 31 December 2015</b>	–	–	–
<b>Carrying amounts at 31 December 2015</b>	–	–	–

## Notes to the Consolidated Financial Statements continued

### 10. Intangible assets continued

For the year ended 31 December 2014	AVIF £m	Other £m	Total £m
<b>Cost</b>			
At 1 January 2014	5,520	560	6,080
Additions	–	1	1
Foreign exchange adjustments	(23)	(6)	(29)
Transferred to operations classified as held for sale	(576)	(153)	(729)
At 31 December 2014	4,921	402	5,323
<b>Amortisation and impairment</b>			
At 1 January 2014	1,893	332	2,225
Amortisation charge for the year <sup>(i)</sup>	324	60	384
Impairment charge for the year <sup>(i)</sup>	–	6	6
Foreign exchange adjustments	(11)	(5)	(16)
Transferred to operations classified as held for sale	(271)	(115)	(386)
At 31 December 2014	1,935	278	2,213
Carrying amounts at 31 December 2014	2,986	124	3,110

(i) Amortisation and impairment charges are included within discontinued operations in the Consolidated Income Statement.

Other intangibles in 2014 comprised:

	Cost £m	Amortisation and impairment £m	Net book value £m
<b>As at 31 December 2014</b>			
Customer and distribution relationships	314	(191)	123
Brand	37	(36)	1
Software	39	(39)	–
Goodwill	12	(12)	–
<b>Total</b>	402	(278)	124

## Notes to the Consolidated Financial Statements continued

### 11. Property, plant and equipment

The Group has no property, plant and equipment as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

	Owner-occupied properties £m	Computer equipment £m	Fixtures, fittings and office equipment £m	Total £m
<b>For the year ended 31 December 2015</b>				
<b>Fair value/cost</b>				
At 1 January 2015	35	9	16	60
Disposals	(35)	(9)	(16)	(60)
<b>At 31 December 2015</b>	–	–	–	–
<b>Depreciation</b>				
At 1 January 2015	–	8	8	16
Depreciation charge	–	–	2	2
Disposals	–	(8)	(10)	(18)
<b>At 31 December 2015</b>	–	–	–	–
<b>Carrying amounts at 31 December 2015</b>	–	–	–	–

	Owner-occupied properties £m	Computer equipment £m	Fixtures, fittings and office equipment £m	Total £m
<b>For the year ended 31 December 2014</b>				
<b>Fair value/cost</b>				
At 1 January 2014	40	9	19	68
Additions	–	–	1	1
Disposals	(5)	–	–	(5)
Transferred to operations classified as held for sale	–	–	(4)	(4)
<b>At 31 December 2014</b>	35	9	16	60
<b>Depreciation</b>				
At 1 January 2014	–	8	10	18
Depreciation charge	–	–	2	2
Transferred to operations classified as held for sale	–	–	(4)	(4)
<b>At 31 December 2014</b>	–	8	8	16
<b>Carrying amounts at 31 December 2014</b>	35	1	8	44

If owner-occupied properties were measured on a cost basis in 2014, the carrying amount would have been £41 million.

## Notes to the Consolidated Financial Statements continued

### 12. Investment properties

The Group has no investment properties as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

For the year ended 31 December	2015 £m	2014 £m
<b>At 1 January</b>	<b>2,690</b>	2,561
Purchases	5	53
Fair value adjustments	28	290
Foreign exchange adjustments	1	–
Disposals <sup>(i)</sup>	(2,724)	(214)
<b>At 31 December</b>	<b>–</b>	2,690

(i) Disposals include £2,685 million relating to discontinued operations as discussed in note 1.

In 2014, £1,316 million was held in with-profits funds and £1,374 million in unit-linked funds. The majority of the investment properties held in the with-profits and unit-linked funds were leased out under operating leases in order to generate a rental income to match policyholder liabilities.

Future minimum lease payments receivable under non-cancellable operating leases in 2014 were as follows:

For the year ended 31 December	2014 £m
Due in the period:	
Not later than one year	126
Later than one year and not later than five years	393
Later than five years	569
<b>Total</b>	<b>1,088</b>

### 13. Financial assets

#### a) Carrying amount

The Group's financial assets are summarised by measurement category as follows:

As at 31 December	2015 £m	2014 £m
Fair value through profit or loss (note 13(a)):		
– Designated on initial recognition	160	92,179
– Held for trading	37	588
Available for sale (note 13(b))	486	–
Loans at amortised cost (note 13(c))	856	1
<b>Total financial assets</b>	<b>1,539</b>	<b>92,768</b>

Assets held at fair value through profit or loss as at 31 December 2015 comprise syndicated loan asset investments of £160 million (2014: £198 million) and cross currency derivative swaps of £37 million (2014: £10 million)

Of the above total, £1,538 million (2014: £82,496 million) is expected to be recovered more than one year after the Statement of Financial Position date.

As at 31 December 2014 financial assets at fair value included shares and other variable yield securities, government securities, corporate bonds (including asset-backed securities (ABS) and loans at fair value), derivative financial instruments and deposits with credit institutions. Financial liabilities at fair value included unit-linked contracts, amounts due to reinsurers, net asset value attributable to unit-holders (non-controlling interest in the OEICs that are consolidated) and derivative financial instruments. These assets were disposed of following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

## Notes to the Consolidated Financial Statements continued

### 13. Financial assets continued

#### (a) Analysis of financial assets at fair value through profit or loss

As at 31 December 2015	Shareholder £m	Total £m
Loans at fair value	160	160
Derivative financial instruments	37	37
<b>Total financial assets held at fair value</b>	<b>197</b>	<b>197</b>

As at 31 December 2014	With- profits £m	Unit-linked £m	Non-linked annuities £m	Non-linked other £m	Shareholder £m	Total £m
Shares and other variable yield securities	6,081	48,951	–	109	2	55,143
Debt securities and other fixed income securities:						
– Government securities	6,837	7,240	3,010	697	28	17,812
– Corporate bonds and loans at fair value	6,693	2,513	8,082	1,278	649	19,215
Derivative financial instruments	479	13	80	5	11	588
Deposits with credit institutions	–	9	–	–	–	9
<b>Total financial assets held at fair value</b>	<b>20,090</b>	<b>58,726</b>	<b>11,172</b>	<b>2,089</b>	<b>690</b>	<b>92,767</b>

#### b) Available for sale

	2015 £m	2014 £m
Internal STICS at fair value	486	–
<b>Total assets available for sale</b>	<b>486</b>	<b>–</b>

Available for sale assets comprises the internal STICS with FLL recognised at a fair value at 31 December 2015, representing the Group's remaining holding in the group of companies disposed of on 13 April 2015.

Interest on this debt instrument is paid annually in arrears on 30 June. The STICS have no maturity but are redeemable in the whole or part at the option of FLL on 1 July 2015 and thereafter on every fifth anniversary date. The option to redeem was not taken on 1 July 2015 and the interest rate was reset to 4.39% from 6.302%.

#### c) Loans at amortised cost

As at 31 December	2015 £m	2014 £m
Other loans	856	1
<b>Total loans</b>	<b>856</b>	<b>1</b>

Other loans at amortised cost include a £500 million LT2 loan and £356 million UT2 loan with FLL. The fair values of these loans are considered to be £607 million and £435 million respectively.

#### d) Derivatives and collateral

The Group uses cross-currency swap derivative contracts to manage the risks associated with fluctuations in the US Dollar/GBP exchange rate, linked to its US Dollar denominated subordinated debt instrument, see note 23. The derivative instruments are measured at fair value through profit or loss and as at 31 December 2015 the Group has received collateral of £34 million in respect of the swaps (2014: £nil). The obligations for repayment of cash collateral received are included in note 27.

#### e) Financial assets and liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

Financial assets and liabilities are offset in the Consolidated Statement of Financial Position when the Group has a legally enforceable right to offset and has the intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

The Group has no netting arrangements and no financial assets or liabilities have been offset in the Consolidated Statement of Financial Position.

## Notes to the Consolidated Financial Statements continued

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### 14. Fair value methodology

#### (a) Basis for determining fair value hierarchy of financial instruments

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the 'fair value hierarchy' described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

##### Level 1

Inputs to Level 1 fair values are quoted prices (unadjusted) in active markets for identical assets and liabilities that the entity can access at the measurement date. An active market is one in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

##### Level 2

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the instrument. Level 2 inputs include the following:

- Quoted prices for similar assets and liabilities in active markets.
- Quoted prices for identical or similar assets and liabilities in markets that are not active, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly.
- Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, implied volatilities, and credit spreads).
- Market-corroborated inputs.

Where we use broker quotes and no information as to the observability of inputs is provided by the broker, the investments are classified as follows:

- Where the broker price is validated by using internal models with market observable inputs and the values are similar, we classify the investment as Level 2.
- In circumstances where internal models are not used to validate broker prices, or the observability of inputs used by brokers is unavailable, the investment is classified as Level 3.

##### Level 3

Inputs to Level 3 fair values are unobservable inputs for the asset or liability. Unobservable inputs may have been used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs reflect the assumptions the business unit considers that market participants would use in pricing the asset or liability. Examples are investment properties, certain private equity investments and private placements.

Third-party valuations using significant unobservable inputs validated against Level 2 internally modelled valuations are classified as Level 3, where there is a significant difference between the third-party price and the internally modelled value. Where the difference is insignificant, the instrument is classified as Level 2.

The investments in subsidiaries recorded at the fair value of the underlying subsidiary, are based on estimates and recorded as Level 3 investments. Where estimates are used, these are based on a combination of independent third party evidence and internally developed models, calibrated to market observable data where possible.

Prior to the disposal of the Friends Life companies disclosed in note 1, the majority of the Group's assets held at fair value were valued based on quoted market information or market observable data. At 31 December 2014, approximately 6% (12% excluding unit-linked assets) of the Group's assets were valued using valuation techniques where significant observable market data was not available. The fair values of financial and non-financial assets are generally provided by external parties.

## Notes to the Consolidated Financial Statements continued

### 14. Fair value methodology continued

#### (a) Basis for determining fair value hierarchy of financial instruments continued

##### Level 3 continued

The approach taken for each class of specific unlisted investment is as follows:

- Corporate bond and syndicated loan valuations are generally obtained from brokers and pricing services. 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. Instruments with single price feeds or limited trading activity are included in the level 3 category.
- Exchange-traded derivatives are valued using active market prices. The values of over the counter derivative financial instruments are estimated by applying valuation techniques, using pricing models or discounted cash flow methods.
- Investment properties and properties occupied by the Group are measured at fair value at the reporting date by external independent valuers and key assumptions include occupancy and rental income. Methods considered when determining fair values of unlisted shares and other variable yield securities include discounted cash flow techniques and net asset valuation.
- Holdings in private equity limited partnerships and companies are valued in accordance with International Private Equity and Venture Capital Board (IPEV) guidelines, based on the most recent underlying valuations available.
- The fair value of the investments in property limited partnerships is based on the latest external market valuation of the underlying property investments.
- Loans are valued using a general discounted cash flow methodology, with the discount rates derived from the relevant risk-free curve and a credit spread curve. Internal STICS are valued using discounted cash flow models and market observable yields.
- The classifications of financial liabilities take into account the types of inputs used to determine the fair value measurements.
- The Group is unable to reliably measure the fair value of investment contracts with discretionary participation features as it is not possible to model 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 hierarchy analysis below. Investment contract non-unit reserves, relating primarily to deferral of front-end fees in the form of unfunded units, have also been excluded from the fair value hierarchy analysis.

#### (b) Changes to valuation techniques

There were no changes in the valuation techniques during the year compared to those described in the 2014 annual report and financial statements.

#### (c) Fair value hierarchy

An analysis of recurring non-financial assets, 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 recurring non-financial assets, 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 and annual management fees).

As at 31 December 2015	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost	Total £m
<b>Assets held at fair value</b>					
Internal STICS at fair value	–	486	–	–	486
Syndicated loans at fair value	–	160	–	–	160
Derivative financial instruments	–	37	–	–	37
<b>Total assets held at fair value</b>	–	683	–	–	683
Loans at amortised cost	–	–	–	856	856
<b>Financial liabilities held at fair value</b>					
Derivative financial instruments	–	(5)	–	–	(5)
<b>Total liabilities held at fair value</b>	–	(5)	–	–	(5)
Loans and borrowings	–	–	–	(1,054)	(1,054)



## Notes to the Consolidated Financial Statements continued

### 14. Fair value methodology continued

#### (c) Fair value hierarchy continued

As at 31 December 2014	Including unit-linked				Excluding unit-linked			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Non-financial assets held at fair value								
Investment properties	–	–	2,690	2,690	–	–	1,316	1,316
Owner-occupied property	–	–	35	35	–	–	35	35
Financial assets held at fair value								
Shares and other variable yield securities	47,355	6,471	1,317	55,143	5,275	43	874	6,192
Debt securities and other fixed income securities:								
– Government securities	17,802	10	–	17,812	10,568	4	–	10,572
– Corporate bonds and loans at fair value (including asset-backed securities)	13,931	3,312	1,972	19,215	11,938	2,813	1,951	16,702
Derivative financial instruments	42	546	–	588	32	543	–	575
Deposits with credit institutions	9	–	–	9	–	–	–	–
Total assets held at fair value	79,139	10,339	6,014	95,492	27,813	3,403	4,176	35,392
Financial liabilities held at fair value								
Unit-linked investment contracts	–	53,233	–	53,233	–	–	–	–
Net asset value attributable to unit-holders	589	–	–	589	4	–	–	4
Derivative financial instruments	55	323	–	378	27	319	–	346
Total liabilities held at fair value	644	53,556	–	54,200	31	319	–	350

There are no non-recurring fair value measurements at 31 December 2015 or at 31 December 2014.

For the Friends Life Holdings plc £162 million subordinated debt due 2021, Friends Life Holdings plc £500 million subordinated debt due 2022 and the Friends Life Holdings plc US\$575 million reset perpetual subordinated debt, the fair value measurements are categorised as level 1.

#### (d) Transfers between levels of the fair value hierarchy

The Group's policy is to recognise transfers into and transfers out of levels 1, 2 and 3 as of the date the statement of financial position is prepared.

For financial instruments that are recognised at fair value on a recurring basis, the Company determines whether transfers have occurred between levels of the fair value hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of the reporting period.

As at 31 December 2015, for financial instruments recognised at fair value on a recurring basis, £nil (2014: £9,637 million) of corporate bonds, shares and other variable yield securities were transferred from level 1 to level 2 and £60 million (2014: £765 million) of corporate bonds, shares and other variable yield securities were transferred from level 2 to level 1. The transfers from level 1 to level 2 as at 31 December 2014 include movements arising from refinements to the methodology under which shares and other variable yield securities are classified. Other movements between level 1 and level 2 reflect changes in market activity and in the availability of current quoted prices.

## Notes to the Consolidated Financial Statements continued

### 14. Fair value methodology continued

#### (e) Further information on Level 3 assets and liabilities

The table below shows movement in the Level 3 assets and liabilities measured at fair value:

	Investment property £m	Owner- occupied properties £m	Shares and other variable yield securities £m	Corporate bonds and loans at fair value (including ABS) £m	Total assets held at fair value £m
<b>At 1 January 2015</b>	<b>2,690</b>	<b>35</b>	<b>1,317</b>	<b>1,972</b>	<b>6,014</b>
Total gains/(losses) in consolidated income statement <sup>(i)</sup>	83	—	(64)	22	41
Purchases	1	—	1	16	18
Sales	(64)	—	(262)	(44)	(370)
Net transfer to level 1 and level 2 <sup>(ii)</sup>	—	—	—	(60)	(60)
Business disposal	(2,710)	(35)	(992)	(1,906)	(5,643)
<b>At 31 December 2015</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>

	Investment property £m	Owner- occupied properties £m	Shares and other variable yield securities £m	Corporate bonds and loans at fair value (including ABS) £m	Total assets held at fair value £m
<b>At 1 January 2014</b>	<b>2,561</b>	<b>40</b>	<b>3,463</b>	<b>1,855</b>	<b>7,919</b>
Total gains/(losses) in consolidated income statement <sup>(i)</sup>	290	—	(338)	121	73
Purchases	53	—	325	609	987
Sales	(214)	(5)	(428)	(397)	(1,044)
Issues	—	—	—	191	191
Settlements	—	—	—	(15)	(15)
Net transfer (to)/from level 1 and level 2 <sup>(ii)</sup>	—	—	(202)	97	(105)
Foreign exchange adjustments	—	—	(57)	(18)	(75)
Transferred to operations classified as held for sale <sup>(iii)</sup>	—	—	(1,446)	(471)	(1,917)
<b>At 31 December 2014</b>	<b>2,690</b>	<b>35</b>	<b>1,317</b>	<b>1,972</b>	<b>6,014</b>
Total unrealised gains/(losses) for the year included in profit or loss for assets held at 31 December 2014	304	—	(89)	125	340

(i) Gains and their reversal on owner-occupied properties was recognised in the consolidated statement of comprehensive income, losses and their reversal was recognised in the income statement within discontinued operations. All other gains and losses on assets held at fair value were recognised in the income statement within discontinued operations.

(ii) Amounts were transferred to level 1 and level 2 because observable market data became available for the securities. Amounts were transferred from level 1 and level 2 because of a lack of observable market data, resulting from a decrease in market activities for the securities.

(iii) Lombard assets were transferred to operations classified as held for sale as at 30 June 2014.

## Notes to the Consolidated Financial Statements continued

### 14. Fair value methodology continued

#### (f) Level 3 financial assets sensitivity analysis

Where possible, the Group tests the sensitivity of the fair values of Level 3 investments to changes in unobservable inputs to reasonable alternatives. Valuations for Level 3 investments are sourced from independent third parties when available and, where appropriate, validated against internally-modelled valuations, third-party models or broker quotes. Where third-party pricing sources are unwilling to provide a sensitivity analysis for their valuations, the Group undertakes, where feasible, sensitivity analysis on the following basis:

- 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 fair values could be higher or lower by approximately 10% to reflect changes in the credit ratings of the underlying bonds.

On the basis of the above the sensitivity is calculated as follows:

As at 31 December	2015		2014	
	Carrying amount £m	Effect of reasonably possible alternative assumptions £m	Carrying amount £m	Effect of reasonably possible alternative assumptions £m
Unit-linked investments	–	–	464	–
Shares and other variable yield securities	–	–	874	175
Corporate bonds and loans at fair value (including asset-backed securities)	–	–	1,951	195
<b>Total level 3 financial assets</b>	–	–	3,289	370

### 15. Deferred acquisition costs

The Group has no deferred acquisition costs as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

	Insurance contracts £m	Investment contracts £m	Total £m
<b>At 1 January 2015</b>	<b>100</b>	<b>753</b>	<b>853</b>
Incurred and deferred in the period	4	23	27
Amortisation and impairment	(11)	(20)	(31)
Disposals (note 1)	(93)	(756)	(849)
<b>At 31 December 2015</b>	–	–	–

	Insurance contracts £m	Investment contracts £m	Total £m
At 1 January 2014	117	780	897
Incurred and deferred in the period	19	108	127
Amortisation and impairment	(36)	(83)	(119)
Transferred to operations classified as held for sale	–	(52)	(52)
At 31 December 2014	100	753	853

Included in the carrying values above, £nil (2014: £740 million) is expected to be recovered more than 12 months after the reporting date. Acquisition expenses that do not meet the criteria for deferral are expensed directly as incurred.

## Notes to the Consolidated Financial Statements continued

### 16. Reinsurance assets

The Group has no reinsurance assets as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

	2015 £m	2014 £m
<b>At 1 January</b>	<b>1,231</b>	<b>2,837</b>
Premiums <sup>(i)</sup>	170	(1,000)
Claims	(168)	(672)
Other movements <sup>(ii)</sup>	36	66
Disposals (note 1)	(1,269)	–
<b>At 31 December</b>	<b>–</b>	<b>1,231</b>

(i) On 24 November 2014 an existing reinsurance treaty was amended such that the investment risk was transferred back to the Group whilst the longevity risk continued to be reinsured. A reinsurance asset of £1.6 billion was derecognised at the amendment date.

(ii) Other movements include changes in economic and non-economic assumptions.

Included in the carrying values above £nil (2014: £971 million) is expected to be recovered more than 12 months after the reporting date.

### 17. Tax assets and liabilities

#### (a) Current tax

	2015 £m	2014 £m
<b>Tax assets</b>		
Expected to be received in greater than one year	14	17
<b>Tax asset recognised in the Statement of Financial Position</b>	<b>14</b>	<b>17</b>

#### (b) Deferred taxes

Deferred tax assets and liabilities are attributable to the following:

	2015			2014		
As at 31 December	Assets £m	Liabilities £m	Net £m	Assets £m	Liabilities £m	Net £m
Property and equipment	–	–	–	23	–	23
AVIF	–	–	–	–	(544)	(544)
Other intangible assets	–	–	–	–	(17)	(17)
Unrealised gains on investments	9	–	9	–	(520)	(520)
Employee benefits	–	–	–	30	–	30
Deferred acquisition costs	–	–	–	–	(11)	(11)
Tax value of recognised tax losses	–	–	–	151	–	151
Short-term temporary differences	–	–	–	–	(73)	(73)
<b>Deferred tax assets/(liabilities)</b>	<b>9</b>	<b>–</b>	<b>9</b>	<b>204</b>	<b>(1,165)</b>	<b>(961)</b>
Offset of deferred tax assets	–	–	–	(204)	204	–
<b>Net deferred tax assets/(liabilities)</b>	<b>9</b>	<b>–</b>	<b>9</b>	<b>–</b>	<b>(961)</b>	<b>(961)</b>

At 31 December 2015, £nil of the deferred tax assets above (2014: £204 million) can be offset against deferred tax liabilities and are presented net in the Consolidated Statement of Financial Position.

The deferred tax asset of £9 million is recognised against future profits against which the asset will be utilised.

## Notes to the Consolidated Financial Statements continued

### 17. Tax assets and liabilities continued

#### (c) Movement in deferred tax assets and liabilities

For the year ended 31 December 2015	At 1 January 2015 £m	Recognised in income <sup>(i)</sup> £m	Recognised in other comprehensive income £m	Disposal of STICS £m	Disposals(n ote 1) £m	At 31 December 2015 £m
Property and equipment	23	(4)	–	–	(19)	–
AVIF	(544)	13	–	–	531	–
Other intangible assets	(17)	3	–	–	14	–
Unrealised gains on investments	(520)	(175)	6	32	666	9
Employee benefits	30	–	–	–	(30)	–
Deferred acquisition costs	(11)	–	–	–	11	–
Tax value of recognised tax losses	151	(30)	–	–	(121)	–
Short-term temporary differences	(73)	–	–	–	73	–
<b>Net deferred tax (liabilities)/assets</b>	<b>(961)</b>	<b>(193)</b>	<b>6</b>	<b>32</b>	<b>1,125</b>	<b>9</b>

(i) The £193 million tax charge recognised in income is included discontinued operations as set out in note 1.

For the year ended 31 December 2014	At 1 January 2014 £m	Recognised in income <sup>(i)</sup> £m	Recognised in other comprehensive income £m	Foreign exchange £m	Transferred to operations classified as held for sale £m	At 31 December 2014 £m
Property and equipment	12	11	–	–	–	23
AVIF	(693)	57	–	3	89	(544)
Other intangible assets	(35)	9	–	–	9	(17)
Unrealised gains on investments	(581)	61	–	–	–	(520)
Employee benefits	38	(8)	–	–	–	30
Deferred acquisition costs	(14)	4	–	–	(1)	(11)
Tax value of recognised tax losses	389	(225)	–	–	(13)	151
Short-term temporary differences	(96)	17	10	–	(4)	(73)
<b>Net deferred tax (liabilities)/assets</b>	<b>(980)</b>	<b>(74)</b>	<b>10</b>	<b>3</b>	<b>80</b>	<b>(961)</b>

(i) This amount included £12 million relating to Lombard that was included within loss after tax on discontinued operations.

#### (d) Unrecognised deferred tax assets and liabilities

As at December 2015 the group has no unrecognised deferred tax assets and liabilities.

The Group had £40 million of unrecognised deferred tax assets as at December 2014 in respect of tax losses to carry forward against future taxable profits or capital gains. Of that £40 million unrecognised deferred tax assets, £19 million related to trading losses, £12 million related to non-trade loan relationship losses and the remaining £9 million related to capital losses. None of these losses have expiry dates.

No deferred tax assets were recognised on these losses as there is currently no convincing evidence that future profits or capital gains will be available against which these losses can be utilised.

## Notes to the Consolidated Financial Statements continued

### 18. Insurance and other receivables

As at 31 December	2015 £m	2014 £m
Receivables arising out of direct insurance operations:		
– policyholders	–	92
– agents, brokers and intermediaries	–	24
Investment income receivables	2	109
Investments sold for subsequent settlement	12	53
Prepayments and accrued income	33	468
Other receivables	18	134
<b>Total insurance and other receivables</b>	<b>65</b>	<b>880</b>

Of the carrying value above, £nil (2014: £20 million) is expected to be recovered more than 12 months after the reporting date. The carrying value of each item approximates to fair value.

### 19. Cash and cash equivalents

As at 31 December	2015 £m	2014 £m
Bank and cash balances	27	3,915
Short-term deposits	68	3,588
<b>Total cash and cash equivalents</b>	<b>95</b>	<b>7,503</b>

### 20. Insurance contracts

The Group has no insurance contracts as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

#### (a) Changes in insurance contracts liabilities

The following table shows the movements in insurance contracts liabilities in the year:

For the year ended 31 December	2015 £m	2014 £m
<b>At 1 January</b>	<b>35,750</b>	<b>34,590</b>
Increase in liability from premiums	280	1,517
Release of liability due to recorded claims	(924)	(3,710)
Unwinding of discount	106	409
Change in assumptions:		
– Economic	338	1,653
– Non-economic	–	(147)
Other movements including net investment return	531	1,438
Disposals (note 1)	(36,081)	–
<b>At 31 December</b>	<b>–</b>	<b>35,750</b>

The disclosures set out below are in respect of 2014.

Included in the 2014 carrying amount above is £30,603 million which was expected to be settled more than 12 months after the reporting date.

A liability adequacy test was carried out at portfolio level and resulted in no additional provision in 2014.

## Notes to the Consolidated Financial Statements continued

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### 20. Insurance contracts continued

It should be noted that changes in the financial assets backing the liabilities were typically largely offset by corresponding changes in the economic assumptions. In addition, assumption changes on with-profits contracts resulted 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 was calculated on the basis of recognised actuarial methods, having due regard to actuarial principles and best practice, including compliance with the PRA's rules contained in the Prudential Sourcebook for Insurers.

The principal method of actuarial valuation of liabilities arising under long-term insurance contracts was the gross premium method which involves the discounting of projected income (e.g. premiums and annual management charges) and charges (e.g. claims and expenses). It includes explicit assumptions for valuation interest rates, mortality and morbidity, persistency and future expenses. The assumptions used can vary by contract type and reflect current and expected future experience. This note includes details of mortality tables, valuation interest rates and lapse rate assumptions by class of business.

For unit-linked insurance contracts and some unitised with-profits business, the liabilities were valued by adding a non-unit reserve to the bid value of units. The non-unit reserve was based on non-unit cash flows, assuming future premiums cease, unless it was more onerous to assume that they continued. In circumstances where the resultant future income was greater than charges (i.e. negative liabilities), credit could only be taken in circumstances where penalties existed to recover this income on surrender of the policy.

For the UK non-linked business, where the discounted value of future income was greater than the discounted value of future charges at a policy level (i.e. negative liabilities), credit could be taken to the extent that it offsets policies with positive liabilities within the same broad product group. For overseas business, negative liabilities were limited to zero at a policy level.

The valuation of with-profits business uses the realistic basis in accordance with FRS 27: *Life assurance*. The realistic valuation included an assessment of the cost of any future options and guarantees, anticipated future and regular bonuses and future profits on non-participating business written in the with-profits fund. The valuation excluded amounts attributable to shareholders in respect of future bonuses. In calculating the realistic liability, account was taken of the future management actions consistent with those set out in the PPFM.

Calculations were generally made on an individual policy basis; however in addition there were some global provisions which were calculated using statistical or mathematical methods. The results were expected to be approximately the same as if the individual insurance/investment contract liability was calculated for each contract.

#### c) Options and guarantees

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 comprise 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 the future, before the expiry of the option or guarantee. Under PRA rules all options and guarantees must be valued and included in policyholder liabilities.

For funds within the PRA's realistic capital methodology, options and guarantees were valued on a market consistent basis that took into account both the time value and the intrinsic value of the options and guarantees.

All material options and guarantees were valued stochastically and included in the liabilities. There were two main types of guarantees and options within the with-profits funds: maturity guarantees and guaranteed annuity options, and in addition, a return of premium guarantee for Overseas Life Assurance Business (OLAB). Maturity guarantees were in respect of conventional and unitised with-profits business and represent the sum assured and reversionary bonuses declared to date. For certain with-profits pension policies there were options guaranteeing the rates at which annuities can be purchased. OLAB return of premium guarantees related to a guarantee to repay all premiums paid to maturity.

## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### c) Options and guarantees continued

The cost of the maturity guarantees, guaranteed annuity options and return of premium guarantees had been calculated as:

		31 December 2014 £m
Maturity guarantees	FP WPF	239
	FLC New WPF	160
	FLC Old WPF	38
	FLAS WPF	187
	WL WPF	97
Guaranteed annuity options	FP WPF	645
	FLC New WPF	197
	FLC Old WPF	73
	FLAS WPF	107
	WL WPF	7
Return of premium guarantee	OLAB	110

#### (d) Year end 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 below.

The cost of with-profits guarantees was 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 was most sensitive to the level of future interest rates, future mortality rates, assumed rates of discontinuance and early retirements, and the assumptions relating to the exercise of the tax free cash option on these policies. The cost of OLAB return of premium guarantees was most sensitive to the assumed volatility of future investment returns on unit funds, the level of future interest rates and the rates of discontinuance on these policies. Further details on these assumptions are provided below.

The cost of the with-profits guarantees and OLAB return of premium guarantee was assessed using a market consistent stochastic model as the economic scenario generator (produced by Moody's Analytics) and is calculated using 2,000 simulations.

In 2014, the with-profits guarantees model was calibrated using the swap risk-free curve assuming interest rates of between 0.6% and 2.2% per annum and implied volatilities in the market as shown in the following disclosures. The OLAB return of premium guarantee model was calibrated using the Euro swap curve assuming interest rates of between 0.2% and 1.6% per annum and implied volatilities as shown in the following disclosures.

#### Swaption implied volatilities – FP WPF, FPLAL WPF, FLC New WPF, FLC Old WPF, FLAS WPF and WL WPF

Option term	31 December 2014 swap term			
	10 years	15 years	20 years	25 years
UK Sterling				
10 years	27%	26%	25%	24%
15 years	27%	27%	26%	25%
20 years	26%	25%	24%	23%
25 years	27%	26%	24%	22%



## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### (d) Year end assumptions continued

#### (i) Economic assumptions continued

#### Swaption implied volatilities - OLAB

Option term	31 December 2014 swap term			
	10 years	15 years	20 years	25 years
Euro				
10 years	35%	34%	32%	31%
15 years	35%	34%	32%	30%
20 years	32%	30%	28%	26%
25 years	28%	26%	24%	23%

For equity capital return and property total return, implied volatilities are shown in the table below:

#### FP WPF, FPLAL WPF, FLC New WPF, FLC Old WPF, FLAS WPF and WL WPF

Option term	31 December 2014	
	Equities	Property
5 years	21%	13%
10 years	22%	13%
15 years	23%	13%

#### OLAB

Option term	31 December 2014
	Equities
5 years	21%
10 years	21%
15 years	21%

The cost of with-profits guarantees also depended on management actions that would be taken under various scenarios. Regular bonus rates were set each year such that, guaranteed maturity benefits were targeted as a predefined proportion of asset share, leaving the remaining portion of the asset share to be paid as a final bonus. This management action was in line with the Individual fund's PPFM.

For FLAS WPF, FLC Old WPF and FLC New WPF, the regular bonus rates were 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 was paid as a final bonus. This management action was in line with the Individual fund's PPFM.

The guarantee cost in respect of guaranteed annuity options was 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 was 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 allowed for stochastic variation in interest rates and for future mortality improvements. The stochastic interest rate assumption reflected that implied by current market interest rate derivative prices. Future annuitant mortality within the FLL with-profits balance sheet had been derived from the premium basis at which annuities can be purchased from FLPL, which allowed for future mortality improvements.

The guarantee cost in respect of premium guarantees was assessed using a market consistent stochastic model and values both the current level of the guarantee and the time value due to uncertainty in future unit growth. The guarantee cost in each scenario was the value of the excess benefit provided by the guarantee relative to the projected unit fund at maturity, including future contractual premiums. In estimating the projected fund at maturity, the model allowed for stochastic variation in equity and cash values.

## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### (d) Year end assumptions continued

##### (ii) Non-economic assumptions

The provision for insurance contracts and investment contracts with DPF liabilities was sensitive to the principal assumptions in respect of mortality, morbidity and maintenance expenses, persistency and guaranteed annuity option take-up rates, although the relative sensitivity would vary depending on the insurance or investment contract.

Long-term estimates of future mortality and morbidity assumptions were based on standard tables wherever possible but adjusted to reflect the Group's own experience. Expense assumptions were based on recent experience for FLL and FLPL. Within FLL and FLPL, there were provisions for future expenses to cover the expected level of maintenance cost recharges payable to FLSL and FLMS under the management services agreements in place, 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 were performed at least annually for major product classes. Where industry analysis indicated that changes in expected future mortality, morbidity or other assumptions meant that claim costs would likely to rise in the future, then this was taken into account in the liability calculation.

For some classes of protection business, the benefit from a prudent view of expected future mortality improvements was taken on the realistic balance sheet. Improving mortality was assumed when valuing annuities. Also, deteriorating morbidity was assumed when valuing some critical illness business. Assumptions, for policies other than with-profits, were generally intended to be a prudent estimate of future experience.

The guaranteed annuity options and OLAB return of premium cost also depended upon other factors such as policy discontinuance and for guaranteed annuity options, the take up rate for the options. The factors were 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 varied by policy type and period and were based on recent experience.

Policy lapses and paid-up rates were generally in the ranges shown below:

#### FP WPF

	2014 % pa
Pensions – lapses	0.5 to 7
Life – lapses	4.5 to 14
Mortgage endowments – lapses	2.5 to 3
With-profits bonds – lapses	6.5
Pensions – paid-up	4 to 17
Life – paid-up	0.5 to 2

#### FLC New WPF

	2014 % pa
Pensions – lapses	4 to 10
Life – lapses	4 to 8
Mortgage endowments – lapses	1 to 6.5
With-profits bonds – lapses	5.5 to 8.5
Pensions – paid-up	4 to 12
Life – paid-up	0.5 to 2

## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### (d) Year end assumptions continued

#### (ii) Non-economic assumptions continued

##### FLC Old WPF

	2014 % pa
Pensions – lapses	4 to 10
Life – lapses	4 to 8
Mortgage endow ments – lapses	1 to 6.5
With-profits bonds – lapses	5.5 to 8.5
Pensions – paid-up	4 to 12
Life – paid-up	0.5 to 2

##### FLAS WPF

	2014 % pa
Pensions – lapses	5.5 to 11
Life – lapses	4.5 to 12
Mortgage endow ments – lapses	1 to 6.5
With-profits bonds – lapses	5.5 to 8.5
Pensions – paid-up	4.5 to 12
Life – paid-up	1 to 2

##### WL WPF

	2014 % pa
Pensions – lapses	3 to 8
Life – lapses	4 to 9
Mortgage endow ments – lapses	2 to 8
With-profits bonds – lapses	5

##### FPLAL WPF

	2014 % pa
Whole of Life – lapses	2.5 to 3.5
Whole of Life – paid-up	5

##### OLAB

	2014 % pa
Pensions – lapses	7.5
Pensions – paid-up	2.5

Early retirement rates varied by age band and policy type and were set based on recent experience.

Tax free cash option: where a guaranteed annuity option was more valuable than the cash equivalent in 2014 it was assumed that 5% to 27% of the benefit of the option was taken tax-free depending on the type of business. This was based on recent experience.

There were also guarantees and options in respect of some of the other life assurance business within the Group, but these were not considered to be material to the Group's future cash flows. In addition, these were largely matched with suitable assets and there was no material exposure to market or interest rate changes. Provisions were established using deterministic scenarios based on prudent assumptions.

## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### (e) Valuation interest rates

As explained above, with-profits business within FLL is valued in accordance with the PRA's realistic reporting regime. Valuation interest rates for other than conventional with-profits business are shown in the table below.

	Company	Class of Business	2014 %
<b>Life</b>	FLL	Endowment and Whole Life in non-profit funds	1.70
		Protection	1.70
		Endowment and Whole Life in with-profits funds	1.80
	ex-FLC	Over 50 Plan in non-profit funds	1.35
		Over 50 Plan in with-profits funds	1.65
		Additional life reserves	1.35
		Other conventional life in non-profit funds	1.35
		Other conventional life in with-profits funds	1.95
	ex-FLAS	Life annuities from FLAS	1.90
		Unit-linked life	1.35
		Conventional life	2.25
	ex-FLWL	Unit-linked life	2.25
		With-profits fund immediate annuities	1.45
		Life (other)	2.20
	FPIL	Non-profit fund life	1.65
		International Protector	2.15
<b>Income Protection</b>	FLL	Income Protection	1.60
	ex-FLC	Permanent Health Insurance	1.70
<b>Pensions</b>	FLL	Annuities in payment	2.08 to 2.72
		Protection	2.10
		Individual and Group pensions in non-profit funds	2.10
		Individual and Group pensions in with-profits funds	2.30
	ex-FLC	Unit-linked pensions	1.70
		Conventional pensions in non-profit funds	1.70
		Conventional pensions in with-profits funds	2.60
		WPAD stage 1 ring-fenced NP Fund	2.75
		WPAD stage 2 ring-fenced NP Fund	2.70
	ex-FLAS	Additional pensions reserves	1.70
		Conventional pensions	2.65
		Unit-linked pensions	2.80
	FAL	Ex-FLC annuities reinsured December 2007	2.45
		Ex-FLAS annuities reinsured July 2009	2.45
		Ex-FLC index-linked annuities reinsured December 2007	(0.55)
		Ex-FLAS index-linked annuities reinsured July 2009	(0.55)
	ex-FLWL	With-profits fund pensions (immediate annuities)	1.80
		Non-profit fund pensions (immediate annuities)	2.60
		Non-profit fund pensions (other)	2.10
		With-profits fund with-profits business deferred	1.30
		With-profits fund with-profits business other	2.75

## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### (e) Valuation interest rates continued

Within FLL certain products could have positive or negative reserves. The interest rate used for these products depended on which was more onerous.

	31 December 2014	
	Positive reserves %	Negative reserves %
FLL	1.20	3.20
ex-FLC non-critical illness	0.85	1.85
ex-FLC critical illness	1.20	2.20

#### (f) Mortality, morbidity and lapse rates

Insurance contract liabilities allowed for mortality and morbidity risk by making assumptions about the proportion of policyholders who die or become sick. Allowance for future mortality has made using the following percentages of the standard published tables below.

		31 December 2014
Term assurances – FLL	Smoker male	82.5% TMS00(5)
	Smoker female	71.5% TFS00(5)
	Non-smoker male	82.5% TMN00(5)
	Non-smoker female	71.5% TFN00(5)
Term assurances – ex-FLC/ex-	Smoker male	82.5% TMS00(5)
	Smoker female	71.5% TFS00(5)
	Non-smoker male	82.5% TMN00(5)
	Non-smoker female	71.5% TFN00(5)
Term assurance – ex-FLWL	Smoker male	114% TM92ult <sup>(i)</sup>
	Smoker female	114% TF92ult <sup>(i)</sup>
	Non-smoker male	66% TM92ult <sup>(i)</sup>
	Non-smoker female	60% TF92ult <sup>(i)</sup>
Term assurance – FPIL	Smoker male	180% HKA01
	Smoker female	210% HKA01
	Non-smoker male	97.5% HKA01
	Non-smoker female	97.5% HKA01
Critical illness	FLL	CIBT02 <sup>(iii)</sup>
Critical illness	ex-FLC/ex-FLAS	CIBT02 <sup>(iii)</sup>
Other life assurances	FLL	120% AM/FC00ult
Other life assurances	ex-FLC/ex-FLAS male	140% AMC00
	ex-FLC/ex-FLAS female	125% AFC00
Unitised policies	Life – FLL	130% AM/FC00ult
	Other – FLL	110% AM/FC00ult
Unitised policies	Life/Other – ex-FLC/ex-FLAS male	105% AMC00ult
	Life/Other – ex-FLC/ex-FLAS female	110% AFC00ult
Pensions	FLL/FLPL male	65% AMC00ult
	FLL/FLPL female	55% AMFC00ult
	ex-FLC/ex-FLAS male	90.91% A67/70ult–1
	ex-FLC/ex-FLAS female	90.91% AF80ult–1
Individual income protection	FLL	60% AM/F80ult <sup>(iv)</sup>
	ex-FLC/ex-FLAS	100% AM/AF92 <sup>(iv)</sup>

## Notes to the Consolidated Financial Statements continued

### 20. Insurance contracts continued

#### (f) Mortality, morbidity and lapse rates continued

Annuities in payment	FLL/FLPL individual annuities	PCMA/PCFA00 <sup>(v)</sup>
	FLL/FLPL group annuities	PCMA/PCFA00 <sup>(v)</sup>
	ex-FLC/FAL pension annuities male	94.3% PCMA00 <sup>(vi)</sup>
	ex-FLC/FAL pension annuities female	98.9% PCFA00 <sup>(vi)</sup>
	ex-FLAS pension annuities male	94.3% PCMA00 <sup>(vi)</sup>
	ex-FLAS pension annuities female	89.7% PCFA00 <sup>(vi)</sup>
Immediate annuities – ex-FLWL	Male	101.2% PCMA00 <sup>(vi)</sup>
	Female	101.2% PCFA00 <sup>(vi)</sup>

- (i) Aids loading at 1/3 of the R6A standard requirement applied to reserving basis.
- (ii) The percentages of the table used differ by sex and smoker status. CIBT02 has been adjusted to allow for a select period as follows: Year 1: 80% of CIBT02; Year 2: 95% of CIBT02; Year 3+: 100% of CIBT02. Future deterioration in morbidity is allowed for by assuming claim rates increase by 0.50% per annum and 0.75% per annum for males and females respectively.
- (iii) 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:  
a) 0.50% per annum and 0.75% per annum for males and females respectively for standalone critical illness  
b) 0.50% per annum and 0.75% per annum for males and females respectively for accelerated critical illness
- (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.
- (vi) Future improvements in mortality are based on the CMI's core model CMI-2013 with long-term rates of 2.0% male and 1.75% female.

For protection business, lapse rates were based on recent experience with a prudent margin.

In determining liabilities for with-profits business, it was 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.

#### g) Apportionment of surplus between shareholders and with-profits policyholders

Shareholders were entitled to 100% of surplus emerging from companies within the Group, with the exception of surplus emerging in the with-profits funds.

The Group had six with-profits funds of which only FP WPF was open to new business and five (FLC New WPF, FLC Old WPF, WL WPF, FPLAL WPF and FLAS WPF) were closed to new business.

During 2014, shareholders were entitled to one-ninth of the cost of bonuses added to policies, except for:

- within the FP WPF, surplus arising on pre-demutualisation non-profit and unitised business (excluding the investment element) arose within the with-profits fund but assets of the with-profits fund equal to 60% of the surplus arising were transferred to shareholders;
- within the FP WPF, post-demutualisation policyholders were only entitled to surplus from the return on their investments; other sources of surplus were wholly-owned by shareholders including policies written by FPLAL and FLPL, where the investment element was reinsured to the FP WPF;
- within the FPLAL WPF, policyholders were entitled to all the surplus of that fund. In addition, FLL has a closed unitised with-profits fund. Shareholders were 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 was wholly reinsured to the FP WPF;
- certain unitised with-profits policies in FLL which were written in the non-profit fund and reassured to the WL WPF; and
- certain policies in FLC New WPF and FLC Old WPF with guaranteed bonus rates, where the shareholders did not receive one-ninth of guaranteed bonuses.

The effect of the fund structure was that investment risk, in respect of assets backing with-profits policies was largely borne by policyholders; shareholders bear 10% of the investment risk from conventional with-profits policies, other than within the FPLAL WPF.

Expense risk was borne by shareholders, other than within the FPLAL WPF. Increases to expenses that could be charged to the WL WPF were capped in line with RPI.

### 21. Unallocated surplus

The Group has no unallocated surplus as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1. The unallocated surplus for 2014 was £692 million.

## Notes to the Consolidated Financial Statements continued

### 22. Investment contracts

The Group has no investment contracts as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

Movement in investment contracts liabilities are shown in the table below.

For the year ended 31 December	2015 £m	2014 £m
<b>At 1 January</b>	<b>64,087</b>	83,502
Premiums	935	4,550
Claims	(1,235)	(6,513)
Investment return, annual management charges and other expenses	5,002	2,920
Foreign exchange adjustments	–	(756)
Transferred to operations classified as held for sale	–	(19,616)
Disposals (note 1)	(68,789)	–
<b>At 31 December</b>	<b>–</b>	64,087
Analysed as follows:		
Unit-linked contracts	–	53,233
Policies with DPF	–	9,335
Other non-unit reserves	–	1,519
<b>Total investment contract liabilities</b>	<b>–</b>	64,087

None of the movement in liabilities is attributable to changes in the credit risk of the liabilities. Investment return of £5,525 million (2014: £3,102 million) is included within discontinued operations in the Consolidated Income Statement arising from movements in investment contract liabilities.

Included in the carrying amount above £nil (2014: £53,311 million) is expected to be settled more than 12 months after the reporting date.

### 23. Loans and borrowings

The Group's loans and borrowings are as follows:

		2015		2014	
	Coupon %	Carrying Amount £m	Fair Value £m	Carrying Amount £m	Fair Value £m
<b>Subordinated liabilities:</b>					
Friends Life Holdings plc £162 million LT2 subordinated debt due 2021	12.00	174	222	176	228
Friends Life Holdings plc £500 million LT2 subordinated debt due 2022	8.25	498	607	497	613
Friends Life Holdings plc US\$575 million UT2 reset perpetual subordinated debt	7.875	382	435	361	417
<b>Financial reinsurance:</b>					
UK financial reinsurance treaties	Various	–	–	5	5
Heritage financial reinsurance treaties	Various	–	–	9	9
<b>Other:</b>					
Amounts owed to credit institutions (overdrafts)	Various	–	–	3	3
<b>Total loans and borrowings</b>		<b>1,054</b>	<b>1,264</b>	<b>1,051</b>	<b>1,275</b>

## Notes to the Consolidated Financial Statements continued

### 23. Loans and borrowings continued

#### Subordinated liabilities

The Company's LT2 subordinated debt 2021 is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost based on the fair value at the date of acquisition of Friends Provident by the Company.

The Company's LT2 subordinated debt 2022 is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being £500 million principal less capitalised issue costs of £2 million (2014: £3 million).

The Company's UT2 reset perpetual subordinated debt instrument is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being the US\$575 million principal translated at the effective exchange rate less capitalised issue costs of £8 million (2014: £8 million). The debt does not have a fixed repayment date but has an initial call date in November 2018 and is callable on every subsequent interest payment date from the initial call date. With effect from the initial call date, and for so long as the debt is outstanding, the interest coupon will be reset every six years at a rate equal to the six year US dollar mid swap rate plus a margin of 6.828%. The Company holds a derivative instrument to manage the risks associated with fluctuations in exchange rates on the issue of this debt.

#### Financial reinsurance

The Group has no financial reinsurance as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1. In 2014, the Group entered into a financial reinsurance treaty with Munich Reinsurance Company UK Limited and the total owed under this agreement was £5 million.

Total interest-bearing loans and borrowings are repayable as follows:

As at 31 December	2015 £m	2014 £m
Within one year or on demand	2	15
Between one and two years	2	3
Between two and three years	2	3
Between three and four years	2	4
Between four and five years	2	3
In more than five years	1,044	1,023
<b>Total loans and borrowings</b>	<b>1,054</b>	<b>1,051</b>

Annual repayments include £2 million per annum amortisation of fair value adjustments and issue costs.

Total interest expense for financial liabilities not measured at fair value through profit or loss, which arises solely from interest-bearing loans and borrowings, is £89 million (2014: £85 million).

### 24. Net asset value attributable to unit-holders

The Group has no net asset value attributable to unit-holders as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

The movements in the value of third party interests in OEICS and unit trusts that are consolidated by the Group are as follows:

	2015 £m	2014 £m
<b>At 1 January</b>	<b>589</b>	<b>621</b>
Share of total return in the year	36	60
Share of distributions in the year	(1)	(14)
Amount paid on issue of shares	(5)	273
Amount received on cancellation of shares	(8)	(259)
Disposals <sup>(i)</sup>	(611)	(92)
<b>At 31 December</b>	<b>–</b>	<b>589</b>

(i) Disposals include £212 million relating to discontinued operations as set out in note 1.

At 31 December 2014, the carrying value of the net asset value attributable to unit-holders approximated fair value.



## Notes to the Consolidated Financial Statements continued

### 25. Provisions

The Group has no provisions as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

For the year ended 31 December 2015	At 1 January 2015 £m	Charged in the period £m	Released in the period £m	Utilised in the period £m	Disposals (note 1) £m	At 31 December 2015 £m
Customer redress	117	6	(26)	(13)	(84)	–
Separation and integration	1	–	–	(1)	–	–
Outsourcing	2	–	–	(2)	–	–
ROL separation costs	1	–	–	–	(1)	–
Sesame lapses	13	2	–	(3)	(12)	–
Vacant property	8	–	–	(2)	(6)	–
Other	34	16	(6)	(12)	(32)	–
<b>Total provisions</b>	<b>176</b>	<b>24</b>	<b>(32)</b>	<b>(33)</b>	<b>(135)</b>	<b>–</b>

For the year ended 31 December 2014	At 1 January 2014 £m	Charged in the period £m	Released in the period £m	Utilised in the period £m	Transferred to operations classified as held for sale £m	At 31 December 2014 £m
Customer redress	117	35	(5)	(30)	–	117
Separation and integration	2	–	–	(1)	–	1
Outsourcing	19	–	–	(17)	–	2
ROL separation costs	3	–	(1)	(1)	–	1
Sesame lapses	16	15	–	(18)	–	13
Vacant property	13	4	–	(9)	–	8
Other	57	23	(21)	(17)	(8)	34
<b>Total provisions</b>	<b>227</b>	<b>77</b>	<b>(27)</b>	<b>(93)</b>	<b>(8)</b>	<b>176</b>

Included in the carrying amount for 2014, £28 million is expected to be settled more than 12 months after the reporting date. Where provisions were held for the longer term, discounting was applied at a rate of 3% per annum. In 2014, a net £nil is included within the charge for the year in respect of the unwind of discount and £nil relating to a change in the discount rate applied.

#### (a) Customer redress

Provision for customer redress and associated costs included:

- provisions relating to aspects of the administration of defined benefit pension schemes, totalling £47 million;
- provision for expected costs of customer redress in relation to the Sesame Bank Group (SBG) business, totalling £23 million. This includes a provision in relation to a review of past pension transfer business of £12 million, and a provision of £11 million in relation to complaints and other past business reviews. Whilst SBG is liable for redress costs, it is estimated that £10 million will be recoverable from third parties. The provisions are best estimates, based on available information. The Group's review of the SBG business is continuing and there is considerable uncertainty with regards to potential additional adverse impacts; and
- other redress provisions, totalling £47 million.

In addition to accounting provisions, an actuarial reserve of £2 million was held in insurance contract liabilities in respect of estimated further customer redress payments.

Timing and amounts are uncertain, but the provisions were expected to be largely utilised within two years.

#### (b) Separation and integration

As part of the respective purchase agreements, costs were incurred to separate the businesses purchased from AXA UK plc, Bupa Investments Limited and its parent, Bupa Finance plc, and to integrate the businesses within the Group. The remaining provision was expected to be utilised during 2015.

## Notes to the Consolidated Financial Statements continued

### 25. Provisions continued

#### (c) Outsourcing

The outsourcing provision relates to committed costs of the Diligenta outsourcing agreement. The provision was expected to be utilised during 2015.

#### (d) Resolution Operations LLP ("ROL") separation costs

Provision was made in 2012 in relation to the costs of transferring an operating agreement, under which the Company outsourced most of its operating functions, from ROL to the Group, including associated restructuring costs. The remaining provision was expected to be utilised during 2015.

#### (e) Sesame lapses

This provision was incurred in the ordinary course of business and was short term in nature, with full utilisation and reassessment on an annual basis.

#### (f) Vacant property

This provision was incurred in the ordinary course of business and was expected largely to be utilised within six years.

#### (g) Other

Other included £13 million relating to the Sesame strategic review, which was expected to be utilised during 2015, together with a number of minor provisions incurred in the ordinary course of business.

### 26. Staff pension scheme

On 1 January 2013, the FL Group set up a defined contribution arrangement for UK employees as part of the "My Money" savings and investments platform, called the Flexible Retirement Account (FRA). Employer contributions are typically in the range of 6.3% to 13% depending on contribution levels selected by members and the arrangement has a minimum employer plus member contribution level of 9.3% of pensionable salary (basic annual salary up to a defined earnings cap). The FRA has been used for auto-enrolment from the Group's UK staging date of July 2013 and each member has their own personal pension.

The FL Group had one closed defined benefit scheme: the Friends Provident Pension Scheme (FPPS), which closed to active membership on 31 December 2012. The Group has no staff pension schemes as at 31 December 2015 following the disposal of its interests in FPG, FLI and FLFL as set out in note 1.

Full details of the Aviva Group's pension arrangements are given in note 48 of the Aviva plc annual report and accounts.

#### a) An analysis of the amounts recognised in the financial statements in respect of the FPPS is set out below.

	2015 £m	2014 £m
Pension surplus/(deficit) at 1 January	59	(4)
Net interest on defined benefit asset	1	–
Employer contributions	–	23
Remeasurement gains	9	41
Administration costs <sup>(i)</sup>	(1)	(1)
<b>Pension surplus</b>	<b>68</b>	<b>59</b>
Authorised payments surplus charge (penal tax) at 35% of available surplus following deficit reduction contribution, discounted to present value <sup>(ii)</sup> (note 26b)	(57)	(66)
Remeasurement assumption changes (note 26c)	(37)	–
Disposals (note 1)	26	–
<b>Net pension deficit (excluding deficit reduction contribution) at 31 December</b>	<b>–</b>	<b>(7)</b>

(i) Administration costs are recognised within discontinued operations in the Consolidated Income Statement.

(ii) A finance charge of £2 million in 2014 relating to penal tax on the present value of pension deficit funding has also been recognised within discontinued operations in the consolidated income statement.

## Notes to the Consolidated Financial Statements continued

### 26. Staff pension scheme continued

#### b) Authorised payments surplus charge (penal tax)

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. In accordance with s207(4) Finance Act 2004, an additional liability of £66 million had been recognised at 31 December 2014, reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £190 million (£151 million of deficit reduction contributions at a present value of £131 million plus the surplus of £59 million). A deferred tax asset of £30 million (2013: £34 million) had also been recognised to reflect tax relief at a rate of 20% that was expected to be available on the deficit reduction contributions in future periods.

As part of the acquisition of the FL Group by Aviva plc, the recognition and measurements principles of the authorised payments surplus charge was aligned to the Aviva plc treatment to consider this charge as tax under IAS 12 – *Income Taxes*, rather than a restriction to the IAS 19 pension asset. This resulted in an uplift to the pension asset disclosed within Aviva plc on acquisition of £57 million.

#### c) Remeasurement assumption changes

A further additional £37 million remeasurements arising from updated assumptions are reflected in the pension asset disclosed within Aviva plc on acquisition. Full details of assumptions used in the valuation of the pension surplus are disclosed within in note 48 of the Aviva plc annual report and accounts.

### 27. Insurance and other payables

As at 31 December	2015 £m	2014 £m
Creditors arising out of direct insurance operations	–	50
Creditors arising out of reinsurance operations	–	76
Accruals and deferred income	45	220
Investments purchased for subsequent settlement	1	82
Deferred front-end fees	–	61
Derivative contracts	5	378
Obligations for repayment of cash collateral received (note 13d)	34	-
Other payables	22	226
<b>Total insurance payables, other payables and deferred income</b>	<b>107</b>	<b>1,093</b>

Included in the carrying amount above, £nil (2014: £304 million) is expected to be settled more than 12 months after the reporting date. All insurance payables, other payables and deferred income balances are carried at cost, which approximates to fair value, with the exception of derivative contract liabilities which are carried at fair value.

### 28. Ordinary share capital

Details of the Company's ordinary share capital is as follows:

The authorised share capital of the Company is represented by 515 million ordinary shares with par value of £1 each.

	2015 £m	2014 £m
<b>Allotted, called up and fully paid:</b>		
<b>515 million ordinary shares of £1</b>	<b>515</b>	<b>515</b>

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

There are no restrictions on the transfer of ordinary shares in the Company other than those imposed by laws and regulations.

## Notes to the Consolidated Financial Statements continued

### 29. Other reserves

Other reserves included in equity attributable to equity holders of the Company are as follows:

For the year ended 31 December 2015	Investment valuation reserve £m	Merger reserve £m	Contributed capital £m	Retained earnings £m	Total £m
<b>1 January 2015</b>	–	102	312	3,446	3,860
Loss for the period	–	–	–	(2)	(2)
Capital contribution	–	–	21	1,208	1,229
Reclassification of 2005 STICS to liability	–	–	–	(93)	(93)
Tax on reclassification of 2005 STICS as financial liability	–	–	–	17	17
Tax relief on STICS interest	–	–	–	4	4
Dividends paid	–	(102)	(333)	(4,423)	(4,858)
Share based payments	–	–	–	(3)	(3)
Funding of Employee Benefits (EBT)	–	–	–	8	8
Transfer of 2003 STICS to Aviva plc	–	–	–	(85)	(85)
Tax on transfer of 2003 STICS to Aviva plc	–	–	–	15	15
Other comprehensive income	(35)	–	–	(11)	(46)
<b>At 31 December 2015</b>	<b>(35)</b>	<b>–</b>	<b>–</b>	<b>81</b>	<b>46</b>

For the year ended 31 December 2014	Merger reserve £m	Contributed capital £m	Retained earnings £m	Foreign currency translation reserve £m	Total £m
<b>1 January 2014</b>	102	312	4,163	(27)	4,550
Loss for the period	–	–	(148)	–	(148)
Remeasurements of the defined benefit scheme (net of tax)	–	–	26	–	26
Tax relief on STICS interest	–	–	20	–	20
Foreign exchange adjustments (net of tax) and other items	–	–	–	(19)	(19)
Recycling of cumulative foreign exchange adjustments on disposal of foreign operations	–	–	–	46	46
Share-based payments	–	–	8	–	8
Dividends paid	–	–	(610)	–	(610)
Funding of EBT	–	–	(13)	–	(13)
<b>At 31 December 2014</b>	<b>102</b>	<b>312</b>	<b>3,446</b>	<b>–</b>	<b>3,860</b>

## Notes to the Consolidated Financial Statements continued

### 30. Step-up Tier One Insurance Capital Securities (STICS)

	2015			2014		
	2003 STICS £m	2005 STICS £m	Total £m	2003 STICS £m	2005 STICS £m	Total £m
<b>At 1 January</b>	<b>135</b>	<b>183</b>	<b>318</b>	135	183	318
Interest payable in the period	11	9	20	14	17	31
Interest paid in the period	(7)	–	(7)	(14)	(17)	(31)
Revaluation of STICS to fair value	85	93	178	–	–	–
Reclassification of 2005 STICS as a financial liability	–	(285)	(285)	–	–	–
Transfer of 2003 STICS to Aviva plc	(224)	–	(224)	–	–	–
<b>At 31 December</b>	<b>–</b>	<b>–</b>	<b>–</b>	135	183	318

The Company's external STICS have been recognised at fair value at the acquisition date of Friends Provident. The STICS are described as the 2003 STICS and the 2005 STICS, respectively, reflecting the year in which they were originally issued by Friends Provident.

As at 31 December 2014, both the 2003 STICS and the 2005 STICS were accounted for as equity as there was no requirement to settle the obligation in cash or another financial asset. Consistent with this equity classification, interest on these instruments was not treated as an expense but as an appropriation of profit.

#### 2005 STICS

On 29 May 2015 the Company issued notification to holders of the 2005 STICS that the notes would be redeemed on 1 July 2015. Consequently the 2005 STICS were classified as a liability from 29 May 2015, initially recognised at a fair value of £268 million, with associated accrued interest of £17 million. A fair value revaluation of £93 million and related reversal of deferred tax of £17 million was recognised directly in equity on reclassification. The liability was fully settled in cash on 1 July 2015.

#### 2003 STICS

On 2 October 2015, the 2003 STICS were transferred to the Group's ultimate parent, Aviva plc, at fair value of £224 million via novation of the intercompany loan with AGH. A fair value revaluation of £85 million and related reversal of deferred tax of £15 million has been recognised directly in equity on transfer.

### 31. Risk management

#### (a) The Group's approach to risk and capital management

##### *Risk management framework*

Following its acquisition by Aviva plc and its restructuring within the Aviva Group of companies on 13 April 2015, the Group's and the Company's risk profile changed significantly and as a result the Group and the Company's approach to risk management has changed accordingly. The Company no longer operates as a holding company to a group of companies, and as a result its risk management is proportionate to its remaining principal activity as the issuer of three listed debt instruments, as well as holding liquid assets as a source of liquidity for the Aviva Group.

At 31 December 2015, there was no material difference to the risks to which the Group is exposed compared to the Company.

The Company following its acquisition adopted the Aviva plc Group's risk management framework in a phased approach, so that by 31 December 2015 this is aligned with that of the Aviva plc Group and forms an integral part of the management and Board processes and decision-making framework. At least annually the Company's management review the key risks specific to the Company.

To promote a consistent and rigorous approach to risk management, the Aviva Group has set out formal risk management policies and business standards which set out the risk strategy, framework and minimum requirements for the Aviva plc's worldwide operations, including the Group and Company.

The directors recognise the critical importance of having efficient and effective risk management systems in place and acknowledge that they are responsible for the Group and Company's framework of internal control and of reviewing its effectiveness. The framework is designed to manage rather than eliminate the risk of failure to achieve the Group and Company's objectives, and can only provide reasonable assurance against misstatement or loss. The directors of the Company are satisfied that their adherence to this Aviva Group framework provides an adequate means of managing risk in the Group and Company.

Sections (b) to (f) below are limited to the specific risks of the Group and the Company.

## Notes to the Consolidated Financial Statements continued

### 31. Risk management continued

#### (b) Credit risk

Credit risk is the risk of financial loss as a result of the default or failure of third parties to meet their payment obligations to the Group and the Company, or variations in market values as a result of changes in expectation related to these risks.

The Group and the Company's approach to managing credit risk recognises that there is a risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements.

The credit risks of the Group and the Company arise directly through exposures to loans to third parties and fellow Aviva Group counterparties, cash deposits, derivative counterparties and receivables. The Group and Company's maximum exposure to credit risk of financial assets, without taking collateral into account, is represented by the carrying amount of assets included in the Statement of Financial Position.

The Group and Company have significant financial exposure to amounts due from fellow Aviva Group companies. The credit risk arising from Aviva Group counterparties failing to meet all or part of their obligations is considered remote. Due to the nature of the intra-group loans, and the fact that these loans are not traded, the Company does not allow for fluctuations in market value caused by changing perceptions of the credit worthiness of such counterparties.

Financial assets, other than equities, are graded according to current external credit ratings issued. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. Financial investments which fall outside this range are classified as sub-investment grade. The following table provides information regarding the aggregated credit risk exposure of the Group for financial assets with external credit ratings. 'Not rated' assets capture assets not rated by external ratings agencies.

As at 31 December 2015	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Not rated £m	Total £m
Loans at fair value	–	–	–	4	46	110	–	160
Derivative financial instruments	–	–	–	–	–	–	37	37
Available for sale	–	–	486	–	–	–	–	486
Loans at amortised costs	–	–	856	–	–	–	–	856
Cash and cash equivalents	19	5	71	–	–	–	–	95
Insurance and other receivables	–	–	33	–	–	–	32	65
<b>Total</b>	<b>19</b>	<b>5</b>	<b>1,446</b>	<b>4</b>	<b>46</b>	<b>110</b>	<b>69</b>	<b>1,699</b>
<b>%</b>	<b>1%</b>	<b>–</b>	<b>85%</b>	<b>–</b>	<b>3%</b>	<b>7%</b>	<b>4%</b>	<b>100%</b>

As at 31 December 2014	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Not rated £m	Total £m
Corporate bonds and loans at fair value	204	2,158	5,598	3,776	307	159	147	12,349
Asset-backed securities	1,350	828	1,568	564	29	10	4	4,353
Derivative financial instruments	–	–	419	114	–	–	42	575
Reinsurance assets	–	1,149	82	–	–	–	–	1,231
Cash and cash equivalents	3,511	397	567	268	–	–	17	4,760
Insurance and other receivables	32	129	120	66	5	–	337	689
<b>Total</b>	<b>5,097</b>	<b>4,661</b>	<b>8,354</b>	<b>4,788</b>	<b>341</b>	<b>169</b>	<b>547</b>	<b>23,957</b>
<b>%</b>	<b>21%</b>	<b>20%</b>	<b>35%</b>	<b>20%</b>	<b>1%</b>	<b>1%</b>	<b>2%</b>	<b>100%</b>

The Group and the Company's principal counterparty exposure, amounting at 31 December 2015 to £856 million, is to fellow Aviva plc group company, FLL, which has an external insurer financial strength rating of A+, and as such the risk of counterparty default is considered remote. Due to the nature of the loans to FLL, and the fact that these loans are recognised at amortised cost are settled, and not traded, the Group and Company is not exposed to the risk of changes to their market value caused by changing perceptions of the credit worthiness of such counterparties.

## Notes to the Consolidated Financial Statements continued

### 31. Risk management continued

Although there is no contractual obligation for FLL to make interest payments or redeem the principal of the internal STICS, the Group and the Company has an expectation and is confident that interest will be paid for the reasons set out above as well as the consequential restrictions on the ability of FLL to make dividend payments and redeem capital under the terms of the internal STICS, if it defers any interest payment. The Group and Company's exposure to the internal STICS, which is classified as an equity instrument, at 31 December 2015 amounted to £486 million. The price of the internal STICS is sensitive to changes in the inputs used to determine its fair value, principally being market observable yields, as described in note 14, and as such the Group and Company is exposed to changes in market perception as to the credit worthiness of the issuers of the instruments on which the market observable yields are based, being considered a suitable proxy for the internal STICS. The impact of a 100bps increase / decrease in the market observable yields used to calculate the fair value of the internal STICS would be a £19 million decrease / £20 million increase in profit before tax and ordinary shareholders' net equity.

Although derivative instruments are not rated individually, the counterparties to these contracts all have investment grade issuer credit ratings, and the credit exposures are fully collateralised at 31 December 2015.

The credit quality of receivables and other financial assets is monitored by the Group and Company, and provisions for impairment are made for irrecoverable amounts. There were no financial assets past due or impaired in either 2015 or 2014.

Market risk is the risk of adverse financial impact resulting, directly or indirectly from fluctuations in interest rates, equity prices, foreign currency exchange rates, and property prices. Market risk arises due to fluctuations in both the value of liabilities and the value of investments held.

The management of market risk is undertaken at business unit and at Aviva Group level. Businesses manage market risks locally using the Group market risk framework and within local regulatory constraints. Group Capital is responsible for monitoring and managing market risk at Group level and has established criteria for matching assets and liabilities to limit the impact of mismatches due to market movements.

#### (c) Market risk

For each of the major components of market risk, described in more detail below, additional policies and business standards are in place to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite.

Interest rate risk	<p>Interest on the Group and Company's external borrowings and STICS and loans to Friends Life Limited are fixed, and therefore the Company is not exposed to interest rate risk through these instruments. Key terms and conditions are disclosed in notes 13 and 23.</p> <p>The Group and Company's principal exposure to interest rate risk is through its syndicated loan portfolio to third parties carried at fair value through profit or loss. The interest received on these loans is linked to LIBOR and so any change in LIBOR would impact the level of interest income earned by the Group and Company. The effect of a 100 basis point increase / decrease in interest rates would be an increase / decrease in interest income (before tax) of £2 million (2014: increase / decrease of £2 million). Generally the fair value of the loans and thus the net asset value of the Group and Company's financial resources would not be expected to be materially affected by fluctuations in interest rates.</p>
Currency risk	<p>The Group and Company has some exposure to currency risk through the USD and Euro denominated syndicated loans it holds amounting to £91 million and £48 million respectively, which have been partially hedged through the purchase of foreign exchange forward contracts. The impact of a 10% increase / decrease in the USD:GBP exchange rate would be a £2 million decrease / £3 million increase in shareholder net equity, and a 10% increase / decrease in Euro:GBP exchange rate would be £1 million decrease / increase in shareholder net equity up to the contract dates of the foreign exchange forward contracts, all of which have a duration of less than two months, beyond which date the Group and Company's sensitivity of its net equity to fluctuations in the USD:GBP and Euro:GBP exchange rate increases.</p> <p>The Group and Company is also exposed to foreign exchange risk through its issuance of US\$575 million reset perpetual subordinated note. The USD cash flows for the coupons and principal up until the first reset date in 2018 have been fully hedged with cross currency derivative swaps.</p>
Derivatives risk	<p>Derivatives are used within policy guidelines agreed by the Group Asset and Liability Committee. Derivatives are only used for efficient investment management, asset and liability management or risk hedging purposes.</p>

## Notes to the Consolidated Financial Statements continued

### 31. Risk management continued

#### (d) Liquidity risk

Liquidity risk is the risk of the Group and Company not being able to make payments as they become due because there are insufficient assets in cash form.

The Group and Company has set its investment strategy to ensure it has sufficient liquid funds to meet its expected obligations as they fall due. In extreme circumstances, the Group and Company would approach the Company's parent, Aviva plc, for additional short-term borrowing whilst the Group and Company liquidated other assets. Aviva plc maintains significant undrawn committed borrowing facilities (£1,650 million) from a range of highly-rated banks to mitigate this risk further. In addition, the Group and Company's long term subordinated debt and subordinated perpetual debt is irrevocably guaranteed by Friends Life Limited (see note 23). Aviva plc has an external issuer credit rating of A- and Friends Life Limited has an external insurer financial strength rating of A+, and therefore the likelihood of Aviva plc being unable to provide liquid funds to the Group and Company or FLL failing to honour its guarantee is considered remote.

The following table provides an analysis, by maturity date of the principal, of the carrying value of financial assets which are available to fund the repayment of liabilities as they crystallise:

	Note	On demand or within 1 year £m	1-5 years £m	Greater than 5 years £m	No fixed term (perpetual) £m	Total £m
Loans at fair value	13	1	65	94	–	160
Derivative financial instruments	13	–	37	–	–	37
Available for sale	13	–	–	–	486	486
Loans at amortised cost	13	–	356	500	–	856
Receivables and other financial assets	18	65	–	–	–	65
Cash and cash equivalents	19	95	–	–	–	95
		161	458	594	486	1,699

The following table shows the Company's financial liabilities analysed by duration:

	Note	On demand or within 1 year £m	1-5 years £m	Greater than 5 years £m	No fixed term (perpetual) £m	Total £m
Loans and borrowings	23	–	382	672	–	1,054
Insurance payables, other payables and deferred income	27	107	–	–	–	107
		107	382	672	–	1,161

The derivative financial instruments above with a positive carrying value of £37 million are comprised primarily of cross currency swaps. An increase in the USD:GBP exchange rate could result in these derivatives having a negative carrying value, requiring cash resources to fund collateral and other contractual payments.

#### (e) Operational risk

Operational risk is the risk of direct or indirect loss, arising from inadequate or failed internal processes, people and systems, or external events, including changes in the regulatory environment.

Given its limited activities, the key operational risks at 31 December 2015 to the Group and the Company are inadequate governance and lack of sufficiently robust financial controls. The risks are mitigated by the Board's adoption and implementation of the Aviva Group's risk management policies and framework and Aviva Group's financial reporting and controls framework.

#### (f) Capital management

The Group and Company's capital risk is determined with reference to the requirements of the Group and Company's stakeholders. In managing capital, the Group and Company seeks to maintain sufficient, but not excessive, financial strength to support the payment of interest due on loans and the requirements of other stakeholders. The sources of capital used by the Group and Company are equity shareholders' funds.



## Notes to the Consolidated Financial Statements continued

### 32. Share based payments

Friends Life Group operated a number of share-based payment schemes which vested/crystallised on the acquisition of the Group by Aviva plc. These are described below.

#### (i) Friends Life Group plc Long Term Incentive Plan (FLG LTIP)

The scheme was introduced in 2010 as a cash-settled share-based payment scheme, and was modified in May 2013 in order to continue to properly incentivise the Group's senior executives following a change in the Group's strategy. The LTIP terms were amended so that the implicit need for an exit event was replaced with a market value based calculation to measure performance, without altering the required internal rate of return. The change to the scheme was accounted for as a modification under IFRS 2: *Share-based payments*. The modified scheme was an equity-settled scheme, to be settled in three tranches of shares in Friends Life Group Limited (FLG) over 2014 to 2016 (Tranches A, B and C). No shares were awarded in 2014 (Tranche A) as the target share price was not achieved as at 30 June 2014.

The amount to be paid to participants was determined by a formula set out in the scheme rules. The LTIP created a profit pool equal to 2% of the growth in the value of Friends Life, as assessed under the LTIP rules. The calculation of the value of the profit pool on acquisition of the Friends Life Group by Aviva plc (refer note 1) was partly based on the value of Aviva shares over the 40 day period immediately prior to the date of the first announcement of the proposed acquisition and also involved an assessment of the market value of Friends Life using the consideration paid to Friends Life shareholders and to RCAP under the value share arrangement.

The total estimated cost of the new arrangement of £33 million was allocated pre and post acquisition based on the services dates of the participants. This resulted in a pre-acquisition cost of £27 million and a post-acquisition cost of £6 million. It had been agreed that the Group would bear the pre-acquisition cost of the LTIP awards, with no recharges to the Life Companies. The post acquisition cost will be borne by Aviva plc.

The expense recognised in the Group comprises £23 million charge (2014: £1 million charge) reflected in administrative expenses in the Consolidated Income Statement and £4 million decrease (2014: £1 million increase) in equity included in the Consolidated Statement of Financial Position representing the cumulative charge of the equity settled awards reclassified to cash-settled. The expense is recognised in Friends Life Management Services Limited (FLMS) (the employing company) and then recharged to the Group.

#### (ii) Deferred Share Award Plan (DSAP)

Certain key management had one-third of any annual bonus deferred into shares in Friends Life Group Limited (FLG) for a period of three years. The DSAP operated for a number of years and each year's deferred bonus was accounted for as a separate scheme. The fair value of the schemes was calculated at original grant date, based upon the share price at the grant date multiplied by the number of shares awarded. On acquisition all remaining awards were paid in full. A fair value charge of £Nil (2014: £1 million) has been recognised in discontinued operations in the Consolidated Income Statement with corresponding increase in equity included in the Consolidated Statement of Financial Position.

#### (iii) Contractual share awards

Certain directors were entitled to cash and shares in FLG to compensate them for awards they forfeited from their previous employer as a result of joining Friends Life. The share elements of these awards were treated as equity-settled schemes. As at 31 December 2014 all awards had vested except for one award, which was due to vest in June 2015. The vesting of this award occurred on acquisition. A fair value charge of £1 million (2014: £1 million) has been recognised in discontinued operations in the Consolidated Income Statement with corresponding increase in equity included in the Consolidated Statement of Financial Position.

#### (iv) Friends Life Group Limited Performance Share Plan (PSP)

The PSP was approved at the AGM and awards were granted by on 16 May 2014. The aim of the plan was to incentivise the executives to increase the market value of FLG over the longer term. Awards were granted subject to three performance conditions which had to be met for awards to vest: Total Shareholder Return, Embedded Value and Total Group Free Surplus Generated, with 50%, 25% and 25% respectively of shares vesting if the performance targets were achieved. All performance conditions were to be measured over a three year period. All awards vested on acquisition. A fair value charge of £Nil (2014: £1 million) has been recognised in discontinued operations in the Consolidated Income Statement with corresponding increase in equity included in the Consolidated Statement of Financial Position in 2014.

## Notes to the Consolidated Financial Statements continued

### 33. Related Undertakings

- (a) The related undertakings which are included within the consolidated financial statements as at 31 December 2015 are listed below.

Name of undertaking	Country of incorporation	Share Class	% held by Group companies	Aggregate capital and reserves at 31 December 2015 £m	Profit for the year ending 31 December 2015 £m
Enhanced Loan Investment Strategy	Luxembourg	Ordinary shares	100.00%	188	4
Enhanced Loan Investment Strategy Direct Holdings S.a.r.l	Luxembourg	Ordinary shares	100.00%	1	–

### 34. Related party transactions

- (a) The Group had the following related party transactions

- (i) Disposal

On 13 April 2015 the former FL Group companies were restructured within the Aviva group of companies. As part of this restructuring the Company disposed of its interests in FPG, FLI and FLFL. Details of the restructuring activities of the Friends Life Group are given in note 1(a).

- (ii) Loans to Group undertakings

	2015 £m	2014 £m
1-5 years	356	1
Greater than 5 years	500	–
Total	856	1

- (iii) Other transactions

#### Services provided to related parties

	2015		2014	
	Income earned in the year £m	Receivable at year end £m	Restated income earned in the year £m	Receivable at year end £m
Other Aviva Group companies	111	7	69	–

The income earned in the year relates to the interest received on intercompany loans with FLL and AGH and interest on internal STICS with FLL shown in the Income Statement is £111 million (2014: £69 million).

The related parties' receivables are not secured and no guarantees were received in respect thereof. The receivables will be settled in accordance with normal credit terms.

#### Services provided by related parties

	2015		2014	
	Expenses incurred in year £m	Payable at year end £m	Restated expenses incurred in year £m	Payable at year end £m
Other Aviva Group companies	18	22	10	–

Expenses incurred relate to share scheme charges and corporate costs of £18 million (2014: £10 million).

The related parties' payables are not secured and no guarantees were received in respect thereof. The payables will be settled in accordance with normal credit terms.

## Notes to the Consolidated Financial Statements continued

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### 34. Related party transactions continued

#### (b) Key management compensation

Following the acquisition of the FL Group by Aviva plc on 13 April 2015, key management of the Company, which comprises the directors, are not remunerated directly for their services as directors of the Company and the amount of time spent performing their duties is incidental to their role across the Aviva Group. The majority of such costs are borne by fellow Group companies and are not recharged to the Group. Refer note 2 for details of directors' remuneration.

#### (c) Ultimate parent entity

The immediate parent entity is Aviva Group Holdings Limited, a private limited Group incorporated and domiciled in England and Wales. The ultimate parent entity and controlling party is Aviva plc, a public limited Group incorporated and domiciled in England and Wales. This is the parent undertaking of the smallest and largest Group to consolidate these financial statements. Copies of Aviva plc consolidated financial statements are available on application to the Group Secretary, Aviva plc, St Helen's, 1 Undershaft, London EC3P 3DQ, and on the Aviva plc website at [www.aviva.com](http://www.aviva.com).

## Company Income Statement

	Notes	2015 £m	2014 £m
<b>Revenue</b>			
Investment return	C	753	522
<b>Total revenue</b>		<b>753</b>	<b>522</b>
Administrative and other expenses	D	(19)	(30)
Impairment of subsidiaries	E	(20)	–
Finance costs	F	(110)	(109)
<b>Total expenses</b>		<b>(149)</b>	<b>(139)</b>
<b>Profit before tax</b>		<b>604</b>	<b>383</b>
Tax credit	G	–	14
<b>Profit after tax</b>		<b>604</b>	<b>397</b>
Attributable to:			
Equity holders of the Company		584	366
STICS holders	T	20	31
<b>Profit for the year</b>		<b>604</b>	<b>397</b>

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 72 to 79 are an integral part of these financial statements.

## Company Statement of Comprehensive Income

	2015 £m	Restated 2014 £m
<b>For the year ended 31 December</b>		
<b>Profit for the year</b>	<b>604</b>	397
Items that may be reclassified subsequently to profit and loss:		
Investments classified as available for sale – fair value losses	(35)	–
Tax relating to items that may be reclassified to profit or loss	6	–
<b>Total items that may be reclassified subsequently to profit and loss</b>	<b>(29)</b>	–
<b>Total comprehensive income, net of tax</b>	<b>575</b>	397

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 72 to 79 are an integral part of these financial statements.

## Company Statement of Changes in Equity

	Attributable to equity holders of the Company					
	Share capital £m	Other reserves £m	Profit and loss account £m	Total £m	STICS holders £m	Total £m
<b>For the year ended 31 December 2015</b>						
<b>At 1 January 2015</b>	<b>515</b>	<b>414</b>	<b>3,900</b>	<b>4,829</b>	<b>488</b>	<b>5,317</b>
Profit for the year	–	–	584	584	20	604
Other comprehensive (loss)/income	–	(35)	6	(29)	–	(29)
<b>Total comprehensive (loss)/income</b>	<b>–</b>	<b>(35)</b>	<b>590</b>	<b>555</b>	<b>20</b>	<b>575</b>
Dividends paid	–	(435)	(4,423)	(4,858)	–	(4,858)
Interest paid on STICS	–	–	–	–	(7)	(7)
<b>Appropriations of profit</b>	<b>–</b>	<b>(435)</b>	<b>(4,423)</b>	<b>(4,858)</b>	<b>(7)</b>	<b>(4,865)</b>
Capital contribution <sup>(i)</sup>	–	21	–	21	–	21
Reclassification of the 2005 STICS to financial liability	–	–	–	–	(285)	(285)
Tax relief on STICS interest	–	–	4	4	–	4
Funding of Employee Benefit Trust <sup>(ii)</sup>	–	–	8	8	–	8
Transfer of 2003 STICS to Aviva plc <sup>(iii)</sup>	–	–	(8)	(8)	(216)	(224)
<b>At 31 December 2015</b>	<b>515</b>	<b>(35)</b>	<b>71</b>	<b>551</b>	<b>–</b>	<b>551</b>

	Attributable to equity holders of the Company					
	Share capital £m	Other reserves £m	Profit and loss account £m	Total £m	STICS holders £m	Total £m
<b>For the year ended 31 December 2014</b>						
<b>At 1 January 2014</b>	<b>515</b>	<b>414</b>	<b>4,157</b>	<b>5,086</b>	<b>488</b>	<b>5,574</b>
Profit for the year	–	–	366	366	31	397
Other comprehensive income	–	–	–	–	–	–
<b>Total comprehensive income/(loss)</b>	<b>–</b>	<b>–</b>	<b>366</b>	<b>366</b>	<b>31</b>	<b>(64)</b>
Dividends paid	–	–	(610)	(610)	–	(610)
Interest paid on STICS	–	–	–	–	(31)	(31)
<b>Appropriations of profit</b>	<b>–</b>	<b>–</b>	<b>(610)</b>	<b>(610)</b>	<b>(31)</b>	<b>(641)</b>
Funding of Employee Benefit Trust <sup>(ii)</sup>	–	–	(13)	(13)	–	(13)
<b>At 31 December 2014</b>	<b>515</b>	<b>414</b>	<b>3,900</b>	<b>4,829</b>	<b>488</b>	<b>5,317</b>

- (i) The capital contribution reflects the impact of disposal of FPG on the carrying value of Company's equity investments in FLL. These were revalued from historic cost to market value at the date of disposal with the £21 million net asset impact being shown as a capital contribution reflecting the IAS 1 requirement that transactions with owners in their capacity as owners are reflected in the Statement of Changes in Equity as notional capital contributions or distributions.
- (ii) During 2014 the Group provided funding of £13 million to an EBT which purchased and held shares of Friends Life Group Limited (FLG) for delivery to employees under various share-based payment schemes. In April 2015, the EBT repaid cash of £8 million to the Group.
- (iii) Fair value on transfer of 2003 STICS to Aviva plc on 2 October 2015.

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 72 to 79 are an integral part of these financial statements.

## Company Statement of Financial Position

As at 31 December	Notes	2015 £m	2014 £m
<b>Fixed assets investments</b>			
Shares in Group undertakings	H	–	4,846
Other investments in Group undertakings	I	856	1,356
Financial assets	J	486	–
		<b>1,342</b>	6,202
<b>Current assets</b>			
Financial assets	J, K & L	226	215
Trade receivables:			
Amounts owed by Group undertakings	M	44	33
Prepayments		1	1
Other trade receivables	N	47	66
Cash		53	193
<b>Total current assets</b>		<b>371</b>	508
Trade payables: amounts falling due within one year			
Accruals	O	(45)	(45)
Amounts owed to Group undertakings	P	(22)	(40)
Loans due to Group companies		–	(6)
Obligations for repayment of cash collateral received	L	(34)	–
<b>Total current liabilities</b>		<b>(101)</b>	(91)
<b>Net current assets</b>		<b>270</b>	417
<b>Total assets less current liabilities</b>		<b>1,612</b>	6,619
Trade payables: amounts falling due after more than one year			
Loans and borrowings	Q	(1,061)	(1,042)
Loans due to Group companies		–	(260)
<b>Net (liabilities)/assets</b>		<b>(1,061)</b>	5,317
<b>Capital and reserves</b>			
– Called-up share capital	S	515	515
– Profit and loss account	T	71	3,900
– Other reserves	T	(35)	414
<b>Equity shareholders' funds attributable to shareholders of parent company</b>		<b>551</b>	4,829
<b>STICS holders</b>	U	–	488
<b>Total equity</b>		<b>551</b>	5,317

The financial statements on pages 68 to 76 were approved by the Board of Directors on 9 March 2016 and signed on its behalf by

J R Lister  
Director

The accounting policies (identified alphabetically) on pages 11 to 22 and notes (identified numerically) on pages 72 to 79 are an integral part of these financial statements.

## Notes to the Company's Financial Statements

### A Basis of preparation

The Company is a public limited Company incorporated and domiciled in the England and Wales.

The Company presents individual financial statements prepared in accordance with Financial Reporting Standard 101, 'Reduced Disclosure Framework' (FRS 101). The financial statements have been prepared under the historical cost convention as modified by the revaluation of fixed asset investments. The Company has transitioned to FRS 101 from previously extant UK Generally Accepted Accounting Practice (UK GAAP) for all periods presented. Following a review of the requirements of FRS 101 it has been concluded that the application of these requirements has had no impact on the financial position, performance and cashflows of the Company and as such no restatement has been required to the 2014 comparatives and no reconciling differences have been presented.

The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

FRS 101 Reference	Details
FRS 101 paragraph 8(a): Paragraphs 45(b) and 46 to 52 of IFRS 2 ' <i>Share-based payment</i> '	Details of the number and weighted-average exercise prices of share options, and how the fair value of goods or services received was determined
FRS 101 paragraph 8(d): IFRS 7 ' <i>Financial instruments: disclosures</i> '	All requirements
FRS 101 paragraph 8(e): Paragraphs 91 to 99 of IFRS 13, ' <i>Fair value measurement</i> '	Disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities
FRS 101 paragraph 8(f): Paragraph 38 of IAS 1, ' <i>Presentation of financial statements</i> '	Comparative information requirements in respect of: <ul style="list-style-type: none"> <li>• paragraph 79(a)(iv) of IAS 1;</li> <li>• paragraph 73(e) of IAS 16 Property, plant and equipment;</li> <li>• paragraph 118(e) of IAS 38 Intangible assets (reconciliations between the carrying amount at the beginning and end of the period)</li> </ul>
FRS 101 paragraph 8(g): The following paragraphs of IAS 1, ' <i>Presentation of financial statements</i> '	<ul style="list-style-type: none"> <li>• paragraph 10(d) - statement of cash flows</li> <li>• paragraph 10(f) - a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements),</li> <li>• paragraph 16 (statement of compliance with all IFRS),</li> <li>• paragraph 38A (requirement for minimum of two primary statements, including cash flow statements),</li> <li>• paragraph 38B-D (additional comparative information),</li> <li>• paragraph 40A-D (requirements for a third statement of financial position</li> <li>• paragraph 111 (cash flow statement information), and</li> <li>• paragraph 134-136 (capital management disclosures)</li> </ul>
FRS 101 paragraph 8(h): IAS 7, ' <i>Statement of cash flows</i> '	All requirements
FRS 101 paragraph 8(i): Paragraph 30 and 31 of IAS 8 ' <i>Accounting policies, changes in accounting estimates and errors</i> '	Requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective
FRS 101 paragraph 8(j): Paragraph 17 of IAS 24, ' <i>Related party disclosures</i> '	Key management compensation
FRS 101 paragraph 8(k): The requirements in IAS 24, ' <i>Related party disclosures</i> '	Requirement to disclose related party transactions entered into between two or more members of a group.

The Directors have adopted the going concern basis in preparing the Company's financial statements (see basis of preparation in policy A of the Group's consolidated financial statements).

The Company has followed the accounting policies as those shown in the Group's consolidated financial statements. There were no significant judgements applied in selecting these accounting policies.



## Notes to the Company's Financial Statements continued

### B Auditors' remuneration

The total remuneration payable by the Company, excluding VAT, to its principal auditors, PricewaterhouseCoopers LLP (2014: Ernst & Young LLP), is shown below.

The fees have been borne by the Company's ultimate parent, Aviva plc in 2015.

For the year ended 31 December	2015 £'000	2014 £'000
Audit of the financial statements <sup>(i)</sup>	41	21
<b>Total fees</b>	<b>41</b>	<b>21</b>

(i) In 2015, audit of the financial statements includes the audit of the consolidated financial statements.

Fees paid for services other than the statutory audit of the Company and other Group undertakings are disclosed in note 6 of the Group's consolidated financial statements.

### C Investment return

For the year ended 31 December	2015 £m	2014 £m
Dividend income	610	425
Interest income on loans and receivables	113	81
Movement in fair value:		
– financial assets or financial liabilities at fair value through profit or loss:	3	(1)
– financial derivative instruments	27	17
<b>Total investment return</b>	<b>753</b>	<b>522</b>

### D Administrative and other expenses

For the year ended 31 December	2015 £m	2014 £m
Non-recurring costs	–	21
Other administrative expenses	19	9
<b>Total administrative and other expenses</b>	<b>19</b>	<b>30</b>

### E Impairment of subsidiaries

Impairment of subsidiaries of £20 million relates to the write-down of the net asset value of Friends ASLH when it was transferred to another Aviva Group company as discussed in note 1(e) to the Group's consolidated financial statements.

### F Finance costs

Details of the finance costs are set out in note 7 to the Group's consolidated financial statements.

## Notes to the Company's financial statements continued

### G Tax credit

#### (a) Tax credited to the Income Statement

The total tax credit comprises:

For the year ended 31 December	2015 £m	2014 £m
<b>Current tax</b>		
UK corporation tax at 20.25% (2014: 21.5%)	1	11
Adjustments in respect of prior periods	(1)	3
<b>Total current tax (charge)/credit</b>	–	14
<b>Total tax credit</b>	–	14

#### (b) Tax credited to Statement of Comprehensive Income

The tax credited to other comprehensive income comprises:

For the year ended 31 December	2015 £m	2014 £m
<b>Deferred tax</b>		
Origination and reversal of temporary differences	6	–
<b>Total deferred tax credit</b>	6	–
<b>Total tax credit</b>	6	–

#### (c) Tax reconciliation

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate of the United Kingdom as follows:

For the year ended 31 December	2015 £m	2014 £m
<b>Profit/(loss) before tax from continuing operations</b>	<b>604</b>	<b>383</b>
Tax on profit/(loss) from continuing operations determined with reference to the average rate of corporation tax in the UK of 20.25% (2014: 21.5%)	(122)	(83)
Effects of:		
– non-taxable income	127	94
– impairment of investment in subsidiaries	(4)	–
– adjustments in respect of prior periods	(1)	3
<b>Total tax (charge)/credit</b>	–	14

UK legislation was substantively enacted in July 2013 to reduce the UK corporation tax rate from 21% to 20% from 1 April 2015, resulting in an effective rate for the year ended 31 December 2015 of 20.25%.

As legislated in Finance (No 2) Act 2015, which was substantively enacted on 26 October 2015, the UK corporate rate will reduce further to 19% from 1 April 2017 and to 18% from 1 April 2020. The reductions in rate from 20% to 19% and then to 18% have been used in the calculation of the UK's deferred tax assets and liabilities as at 31 December 2015.

## Notes to the Company's financial statements continued

### H Shares in Group undertakings

	2015 Subsidiary undertakings £m	2014 Subsidiary undertakings £m
<b>Cost</b>		
At 1 January	4,846	4,541
Additions <sup>(i)(ii)(iii)</sup>	22	305
Impairment of subsidiaries <sup>(iv)</sup>	(20)	–
Disposals	(4,848)	–
<b>At 31 December</b>	<b>–</b>	<b>4,846</b>

- (i) The Company purchased additional shares of £300 million in FPG on 26 September 2014, funded by the repurchase of preference shares by FLL.  
(ii) On 25 September 2014, the Company subscribed for and was issued 4.5 million ordinary shares of £1.00 each in the capital of FLFL in connection with FLFL's authorisation under the Alternative Investment Fund Managers Directive.  
(iii) The impairment of a debtor related to the acquisition of Friends ASLH Limited (FASLH) was accounted for as an increase in the cost of investment of £22 million.  
(iv) Impairment of subsidiaries relates to the write-down of the net asset value of Friends ASLH as set out in note E.

#### Disposals

On 13 April 2015 the former FL Group companies were restructured within the Aviva Group. A key part of this restructuring involved the Company's interests in its principal subsidiaries being transferred to other Aviva Group companies. The Company disposed of 100% of its interest in FPG, FLI and FLFL, representing the main operating segments of the Group, related service companies and staff pension scheme. Refer to note 1(a) of the Group's Consolidated Financial Statements for further details.

On 30 June 2015 the Company transferred 100% of its holding in Friends ASLH Limited to another Aviva Group company for consideration of £7 million. Refer to note 1(e) of the Group's Consolidated Financial Statements for further details.

### I Other investments in Group undertakings

	2015 £m	2014 £m
<b>Equity</b>		
FLL STICS (coupon rate 6.302% p.a.) <sup>(i)(ii)</sup>	–	500
<b>Loans to Group undertakings</b>		
FLL LT2 (coupon rate 8.25% p.a.)	500	500
FLL UT2 (coupon rate 7.916% p.a.)	356	356
<b>Total</b>	<b>856</b>	<b>1,356</b>

- (i) Interest on this debt instrument is paid annually in arrears on 30 June. The STICS have no maturity but are redeemable in the whole or part at the option of FLL on 1 July 2015 and thereafter on every fifth anniversary date.  
(ii) This instrument was reclassified as a financial asset, recognised as an Available For Sale investment (as discussed in note J) following the disposal of FPG.

## Notes to the Company's financial statements continued

### J Financial Assets

a) Carrying value

As at 31 December	2015 £m	2014 £m
<b>Fixed Assets:</b>		
Available for sale <sup>(i)</sup>	486	–
<b>Total fixed assets</b>	<b>486</b>	<b>–</b>
<b>Current Assets:</b>		
Fair value through profit or loss:		
– Designated on initial recognition	189	205
– Held for trading	37	10
<b>Total current assets</b>	<b>226</b>	<b>215</b>

(i) Following the disposal of FPG as set out in note 1 of the consolidated financial statements, the Company continues to hold debt and equity investments in FLL, an indirect subsidiary of FPG. These investments are now treated as available for sale assets with fair value movements being recorded in the other comprehensive income.

### K Fair value methodology

Refer to note 14 to the Group's consolidated financial statements for further details on the fair value methodology.

In accordance with the requirements of IFRS 7: *Financial instruments: disclosures*, financial assets which are measured at fair value have been classified into three categories as set out below.

As at 31 December 2015	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m	Total £m
<b>Assets</b>					
Other investments in Group undertakings	–	–	–	856	856
Internal STICS at fair value (Available For Sale)	–	486	–	–	486
<b>Total fixed assets</b>	–	<b>486</b>	–	<b>856</b>	<b>1,342</b>
Syndicated loans at fair value (FVTPL)	–	189	–	–	189
Derivative financial instruments (Held for trading)	–	37	–	–	37
<b>Total current assets</b>	–	<b>226</b>	–	–	<b>226</b>
<b>Liabilities</b>					
Loans and borrowings	–	–	–	(1,061)	(1,061)

The fair value of available for sale assets have been valued with reference to observable market inputs.

The fair value of the syndicated loans is driven mainly by the fair values of syndicated loan assets within the fund. These are generally provided by brokers and pricing services. Where the number of transactions declines under the current market conditions, valuations become more subjective. Syndicated loan 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.

The company holds a cross-currency swap derivative instrument. The fair value of the cross-currency swap derivative is modelled with reference to observable market inputs.

### L Derivative instruments

The Company uses cross-currency swap derivative contracts to manage the risks associated with fluctuations in the US Dollar/GBP exchange rate, linked to its US Dollar denominated subordinated debt instrument, see note J. The derivative instruments are measured at fair value through profit or loss and as at 31 December 2015 the Company has received collateral of £34 million in respect of the swaps (2014: £nil). The obligations for repayment of cash collateral received are reflected in the Company Statement of Financial Position.

## Notes to the Company's financial statements continued

### M Amounts owed by Group undertakings

As at 31 December	2015 £m	2014 £m
Accrued interest	33	33
Amounts due from fellow Group companies	11	–
<b>Amounts owed by Group undertakings</b>	<b>44</b>	<b>33</b>

### N Other trade receivables

As at 31 December	2015 £m	2014 £m
Corporation tax asset	14	36
Deferred tax asset <sup>(i)</sup>	7	–
Indemnity asset	6	30
Investments sold for subsequent settlement	20	–
<b>Total other trade receivables</b>	<b>47</b>	<b>66</b>

(i) The deferred tax asset of £7 million is recognised against future profits against which the asset will be utilised.

### O Accruals

Accruals are comprised of the accrued interest expenses on the UT2 and LT2 subordinated debts discussed in note Q.

### P Amounts owed to Group undertakings

The amounts due to Group undertakings are repayable on demand. No interest is payable on these amounts.

### Q Loans and borrowings

	Coupon %	2015 £m	2014 £m
Friends Life Holdings plc US\$575 million UT2 reset perpetual subordinated debt	7.875	382	361
Friends Life Holdings plc £500 million LT2 subordinated debt due 2022	8.250	498	497
Friends Life Holdings plc £162 million LT2 subordinated debt due 2021	12.000	181	184
<b>Total loans and borrowings</b>		<b>1,061</b>	<b>1,042</b>

On 8 November 2012, the Company issued a US\$575 million UT2 reset perpetual subordinated debt instrument with a coupon of 7.875%, which is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost of £382 million (2014: £361 million) being the US\$575 million principal translated at the effective exchange rate less capitalised issue costs of £8 million. The debt does not have a fixed repayment date but does carry a callable reset feature for four years time (initial call in November 2018) and on every subsequent interest payment date from the reset date. Derivative instruments were entered into on 8 November 2012 to manage the risks associated with fluctuations in exchange rates on the issue of this debt. The derivative instruments have a six year duration, coupon costs are fixed at £28 million per annum and potential redemption of the US\$575 million perpetual subordinated debt instrument is fixed at £356 million. The proceeds of the debt issue were initially used to invest in the £356 million FLL subordinated debt instrument, see note I.

On 21 April 2011, the Company issued a £500 million LT2 debt instrument with a coupon of 8.25% and maturity of 2022, which is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being £500 million principal less capitalised issue costs of £2 million (2014: £3 million). The proceeds of the debt issue were initially used to invest in the £500 million FLL LT2 debt instrument, see note I.

The £162 million LT2 debt was transferred to the Company from FPG on 15 December 2010 and recognised at a fair value of £198 million on initial recognition. The debt has subsequently been measured at amortised cost and is irrevocably guaranteed on a subordinated basis by FLL.

## Notes to the Company's financial statements continued

### R Risk management objectives and policies for mitigating risks

Details of the objectives, policies and processes for mitigating credit risk, market risk and liquidity risk are set out in note 31 to the Group's consolidated financial statements. None of the financial assets are deemed to be past due or impaired.

### S Share capital

Details of the Company's share capital are set out in note 28 to the Group's consolidated financial statements.

### T Other reserves

	Investment valuation reserve £m	Merger reserve <sup>(i)</sup> £m	Contributed capital <sup>(ii)</sup> £m	Profit and loss account £m	Total £m
<b>At 31 December 2015</b>					
1 January 2015	–	102	312	3,900	4,314
Profit for the period	–	–	–	584	584
Other comprehensive income	(35)	–	–	6	(29)
Capital contribution <sup>(iii)</sup>	–	–	21	–	21
Dividends	–	(102)	(333)	(4,423)	(4,858)
Tax relief on STICS interest	–	–	–	4	4
Transfer of 2003 STICS to Aviva plc	–	–	–	(8)	(8)
Funding of Employee Benefit Trust (EBT)	–	–	–	8	8
<b>At 31 December 2015</b>	<b>(35)</b>	<b>–</b>	<b>–</b>	<b>71</b>	<b>36</b>

  

	Merger reserve <sup>(i)</sup> £m	Contributed capital <sup>(ii)</sup> £m	Profit and loss account £m	Total £m
<b>At 31 December 2014</b>				
1 January 2014	102	312	4,157	4,571
Profit for the period	–	–	366	366
Dividends	–	–	(610)	(610)
Funding of EBT	–	–	(13)	(13)
<b>At 31 December 2014</b>	<b>102</b>	<b>312</b>	<b>3,900</b>	<b>4,314</b>

(i) Represents premium arising on issue of shares in the Company in 2009 which has been recognised as a merger reserve.

(ii) Cash contribution from FLGL to finance the elements of consideration paid in cash on acquisition of FPG in 2009.

(iii) The capital contribution reflects the impact of disposal of FPG on the carrying value of Company's equity investments in FLL. These were revalued from historic cost to market value at the date of disposal with the £21m net asset impact being shown as a capital contribution reflecting the IAS 1 requirement that transactions with owners in their capacity as owners are reflected in the statement of changes in equity as notional capital contributions or distributions.

## Notes to the Company's financial statements continued

### U STICS

	2003 STICS £m	2005 STICS £m	Total £m
<b>At 1 January 2015</b>	<b>212</b>	<b>276</b>	<b>488</b>
Interest payable in the period	11	9	20
Interest paid in the period	(7)	–	(7)
Reclassification of 2005 STICS as a financial liability	–	(285)	(285)
Revaluation of STICS to fair value	8	–	8
Transfer of 2003 STICS to Aviva plc	(224)	–	(224)
<b>At 31 December 2015</b>	<b>–</b>	<b>–</b>	<b>–</b>

  

	2003 STICS £m	2005 STICS £m	Total £m
At 1 January 2014	212	276	488
Interest payable in the period	14	17	31
Interest paid in the period	(14)	(17)	(31)
At 31 December 2014	212	276	488

### V Directors remuneration

Details of directors' remuneration is set out in note 2 to the Group's Consolidated financial statements.

### W Immediate and ultimate parent company

Details of the immediate and ultimate parent Company are set out in note 34(c) of the Group's Consolidated financial statements.

### X Post balance sheet events

There are no post balance sheet events to report.