27 March 2012

Resolution Limited (the "Company")

Preliminary results for the year ended 31 December 2011

Good progress towards building a sustainable business

Significant strategic momentum in 2011

- Strategic and financial clarity on value creation from underlying acquired businesses
- Run-rate synergies ahead of target, £45 million achieved; material outsourcing de-risks costs
- VNB of £151 million with improvements driven primarily by cost savings
- New business platforms delivering returns at or above targets
- Capital optimisation programme delivered £281 million of synergies against £235 million guidance
- Creation of investment management business announced
- £476 million of cash returned to shareholders through dividends and share buy-back

Prudent cash levels and resilient capital position maintained

- Sustainable free surplus generation of £291 million contributed to achievement of £400 million distributable cash target
- Overall cash generation impacted by investment markets, but £400 million buffer maintained
- Balance sheet retains low exposure to higher risk European sovereign and corporate debt
- Robust IGCA surplus of £2.1 billion representing a surplus of 219%

Good progress in the UK, International impacted by weak markets

- IFRS operating profit before tax of £681 million (2010: £275 million) (including the benefit of £404 million of one-off items from management actions)
- MCEV operating profit before tax of £517 million (2010: £412 million) (including £140 million of positive one-off assumption changes)
- UK operations made good progress reflecting actions on capital and costs
- International operations impacted by difficult markets and modelling improvements
- Lombard affected by tough markets but increased market share in difficult year for sector
- Full year dividend per share of 19.89 pence, up 10%

Looking forward

- Further update on cash return no later than 2012 interim results
- Base case exit plan to divide underlying business into two separately listed businesses

Mike Biggs, Chairman of Resolution Limited said:
"2011 was an important year for Resolution Limited. It made significant progress driving value from the businesses acquired in its UK Life Project. The Company is committed to returning surplus cash not required by the business to shareholders subject to market conditions and receiving the appropriate regulatory approvals."

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Forward-looking statements

This announcement includes statements that are, or may be deemed to be, "forward-looking statements" with respect to Resolution, its subsidiary undertakings and their outlook, plans and current goals. In some cases, these forward-looking statements can be identified by the use of forward-looking terminology, including the terms "targets", "believes", "estimates", "anticipates", "expects", "intends", "may", "will" or "should" or, in each case, their negative or other variations or comparable terminology. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend upon circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance. Resolution's actual performance, results of operations, internal rate of return, financial condition, liquidity, distributions to shareholders and the development of its acquisition, financing and restructuring and consolidation strategies may differ materially from the impression created by the forward-looking statements contained in this announcement. Forward-looking statements in this announcement are current only as of the date of this announcement. Resolution undertakes no obligation to update the forward-looking statement it may make. Nothing in this announcement should be construed as a profit forecast.

Media

There will be a conference call today for wire services at 07.30 (BST) hosted by John Tiner, Chief Executive of Resolution Operations LLP. Dial in telephone number: UK National call 0871 700 0345, UK Standard International +44 (0) 1452 555 566 Passcode: 62400398.

Analysts/Investors

A presentation to analysts will take place at 09.30am (BST) at the London Stock Exchange, 10 Paternoster Square, London EC4M 7LS. Dial in telephone number: 0800 634 5205, UK standard International +44 (0)208 817 9301. An audio cast of the presentation and the presentation slides will be available on Resolution's website, www.resolution.gg.

In accordance with the obligations for issuers of listed debt contained in the Disclosure and Transparency Rules, Friends Life Group plc will issue a separate preliminary results announcement later today.

Financial calendar

First quarter interim management statement	9 May 2012
Annual General Meeting	17 May 2012
Interim results 2012	15 August 2012

2011 final dividend

Ex-dividend date	18 April 2012
Dealing days for calculating the price of the new shares to be offered pursuant to scrip dividend scheme for the final dividend	18 April 2012 to 24 April 2012
Record date	20 April 2012
Final time and date for receipt of the mandate forms and dividend election input messages	5.00pm, 4 May 2012
Payment of dividend and first day of dealing in the new shares	21 May 2012

Website www.resolution.gg

Chairman's statement

Resolution Limited ("Resolution" or "the Company")

Overview

In 2011, Resolution Limited (the "Company") moved from the acquisition phase of its UK Life Project to the integration phase which is primarily focused on delivering value from the acquired businesses. The Company also confirmed that it would not undertake any additional projects until after completion of the UK Life Project.

The Company has sought to articulate a clear strategy for the enlarged Friends Life business to demonstrate to shareholders how it proposes to achieve the overarching goals of the UK Life Project of building a sustainable business and achieving cash returns to shareholders. In market updates on strategy in February, June and November, the Company, among other things:

- set out its plans to create value in the UK Life Project with a focus on three product areas for new business and with measurable financial targets for costs, cash flow and returns for the enlarged group;
- announced the results of its work on the cash and capital position of Friends Life and the commencement of a £250 million share buy-back which completed in October 2011;
- provided a detailed update on Friends Life's business units that focused on the execution of strategy and delivery of the financial targets; and
- announced a transformational outsourcing agreement, the intention to create an in-house asset manager, and the creation of separate 'Heritage' and 'Go to Market' business units for existing business and new business to increase management accountability.

The Operating Report that follows this statement will provide a more comprehensive summary of these strategic updates.

The full year 2011 results highlight that incremental progress is being made towards achieving the Company's financial targets. The integration of the acquired businesses is substantially on track with the planned full year run-rate savings achieved by the end of 2011. The Group's new business strategy is focused on the three product areas of Protection, Corporate Benefits and Retirement Income in the UK market where the Group has the advantage of scale and where good margins should be achievable. Returns for new business written on the chosen platforms are attractive and close to or ahead of the targets for 2013. Actions taken within the UK businesses resulting in the benefits of capital synergies and the successful merger of funds have had a positive impact on the Group's cash delivery. The Friends Life group continues to make steady progress towards its target operating return on embedded value but much work is still needed to achieve the target.

The net Market Consistent Embedded Value ("MCEV") of the Group as at 31 December 2011 was £5,796 million.

Cash returns to shareholders

At the time of the announcement of the full year 2010 results in March 2011, the Company gave guidance of its intention to increase the 2011 dividend to 18.85 pence per share, up 15% on the 2010 level.

On 7 June 2011, the directors announced that they had reviewed the Company's dividend policy and concluded that the aggregate value of the dividend payable by the Company on all shares in issue should not reduce as a result of the planned £250 million share buy-back in the second half of 2011 also announced that day. This meant that the proposed dividend per share was expected to increase as a result of the £250 million share buy-back. The share buy-back was completed on 26 October 2011. Accordingly, the proposed 2011 final dividend declared by the Board, consistent with the policy of dividends being paid one-third in respect of the interim dividend and two-thirds in respect of the final dividend, is 13.42 pence per share. This takes the dividend for 2011 to 19.89 pence per share.

The Board continues to review whether it is appropriate for the Company to move to a progressive dividend policy.

During the year, the Company generated cash of £393 million, broadly in line with its £400 million Distributable Cash Target. In addition, capital synergies of £281 million were achieved. However, these were more than offset by widening corporate bond spreads and negative equity returns. These economic variances reduced free surplus generated in the year by £352 million.

In keeping with the Company's prudent approach to capital management, it has determined that it would have been inappropriate to release capital over and above its declared dividend policy based on the resultant position at the end of 2011. The Company remains committed to the return of capital to shareholders, when prudent, and will keep the

potential to do so under review. The ongoing consideration of capital returns will take into account the performance of markets since the year end and the impact of planned management actions to further optimise capital and address the impact of market volatility. The Company will update the market no later than the 2012 interim results announcement on its intentions with respect to the second stage of the capital return program announced in June 2011. The Operating Report and Business Review that follow this statement comment on the Group's cash and capital position in more detail.

Exit

The February 2011 investor update summarised the exit options that the Company might consider in relation to the UK Life Project. These included: a cash sale, together or in parts; a direct listing as a standalone entity; a merger with another life company; or separation of the UK open business from the back book leading to separate sales or listings.

It remains the Company's intention to look for exit options involving mergers and acquisitions ("M&A") which would allow shareholders to benefit from the synergies arising from further consolidation. Whilst Resolution Operations LLP ("ROL") is actively investigating such opportunities on behalf of the Company, and has advised the Company that it believes that consolidation of the UK life industry will continue and that attractive transactions may be available, the Company considers it important to have a "self-managed" exit plan which is not reliant on M&A opportunities and could be implemented on a stand-alone basis. Such a self-managed exit plan will also form a benchmark against which M&A exit opportunities can be assessed.

The Company, with ROL, has considered the potential options and concluded that the most attractive self-managed exit plan would involve a division of Friends Life into two separately listed businesses:

- "OpenCo" - which would consist of the UK Go to Market business units, the overseas businesses, Sesame Bankhall Group, and associated support businesses; and

- "HeritageCo" - which would consist of the UK Heritage business and associated support businesses including Friends Life Investments, Friends Life's listed debt and the UK pension fund.

Accordingly the Company is now developing detailed implementation plans to ensure that such a division can be achieved by early 2014.

M&A

The Board remains of the view that value can be created from further consolidation in the UK life sector.

ROL continues to explore, on behalf of the Company, M&A transactions which might take place during the course of the UK Life Project, or which might form the basis of M&A transactions to facilitate exit. The types of transactions which ROL might investigate on behalf of the Company are set out in the Operating Report that follows. In considering future M&A transactions during the UK Life Project, the Company will assess how any business to be acquired would be expected to enhance the financial performance, and hence the exit value, of either OpenCo or HeritageCo (or both), and hence how it might increase the expected returns made for shareholders on the UK Life Project overall.

On 20 November 2011, the Company responded to press speculation and confirmed that it investigated a possible acquisition of Phoenix Group Holdings but that talks had terminated.

Relationship with Resolution Operations LLP

On 28 November 2011, the Company announced that it had agreed amendments to its Operating Agreement with ROL and various other arrangements with ROL and its affiliates. The changes enable ROL to pursue other restructuring opportunities in separate investment vehicles, subject to appropriate protections for the Company and its shareholders to minimise the risk of future conflicts.

Shareholders approved the revised terms of our arrangements with ROL and its affiliates on 13 January 2012. The amended Operating Agreement ensures the ongoing commitment of ROL to secure a successful outcome for shareholders from the UK Life Project.

Governance

The Board has carried out a review of its performance and that of its principal committees during 2011, as recommended by the UK Corporate Governance Code, and has concluded that they are operating effectively. More details are set out in

the Corporate Governance Report that follows. The Board welcomed the recommendations of Lord Davies's report "Women on Boards" and published a statement on the Company's website during the year. The Board is committed to ensuring that the Group's businesses encourage diversity in general in the development of their management teams.

The Company notes the recent publication of the FSA's consultation paper on amendments to the Listing Rules, Prospectus Rules, Disclosure Rules and Transparency Rules (CP12/2). The consultation paper includes proposals to require certain existing premium listed companies that have appointed an investment adviser to either unwind their investment advisory arrangements or re-designate as a standard listed company. The Company values highly its premium listing, along with the protections that premium listing provides for its shareholders. It will be responding in detail to the FSA's proposals shortly.

Outlook

The current macroeconomic backdrop remains uncertain particularly in Europe and is expected to result in periodic volatility in investment markets. The regulatory environment is experiencing fundamental change as new measures aimed at enhancing financial stability are implemented. However, the Board is encouraged by the progress being made at Friends Life towards the achievement of the 2013 financial targets and is confident that those targets will be achieved.

Returns on the UK Life Project will reflect the level and volatility of investment markets in the period running up to exit. Subject to these being similar to current levels, the Board expects that the UK Life Project will achieve its targeted mid-teens returns.

The Board would like to acknowledge the efforts of all staff in the enlarged group and thank them for their contribution in what has been a demanding year for the business.

Operating report by Resolution Operations LLP

1. Introduction

2011 was an important year for the Company. Against a backdrop of significant investment market volatility and a comprehensive regulatory agenda that impacts the UK life sector not least in terms of time commitment and cost, the Company provided three significant investor updates in March, June and November on its UK Life Project. These aimed to provide strategic clarity and set out financial targets for the Friends Life business. Resolution Operations LLP ("ROL") is pleased to report that steady progress is being made towards the delivery of these targets but much work remains to be done.

This Operating Report will provide an update on:

- strategy, including matters likely to impact progress such as the market environment and the changing regulatory landscape;
- the UK Life Project including details of updates provided throughout 2011 and the exit;
- the performance of the business over the year; and
- the outlook.

The Business Review that follows this report will examine in more detail the progress made against the financial targets and the chosen product areas for new business.

2. Strategy

The Company confirmed in June 2011 that the original focus of the Company, which was to undertake a number of financial services restructuring opportunities in the UK and Western Europe, would be narrowed to the delivery of the UK Life Project until its completion. ROL continues to advise the Company on its strategic aims for the UK Life Project, namely the creation of a sustainable business, or sustainable businesses, that meet customers' needs while also delivering cash returns to shareholders.

For Friends Life, the Company's strategic aims have translated, in the UK, to a narrowed new business focus on the three product areas of Protection, Corporate Benefits and Retirement Income where the Company believes it has a competitive advantage and scale, and a disciplined focus on the management of the back book. Friends Life expects to deliver value by no longer writing unprofitable business, writing more capital efficient business, leveraging its product solutions and cost-efficient platforms, controlling costs, improving persistency and increasing the retention of vesting amounts in annuities. The focus of the non-UK businesses, which include International and Lombard, is on costs, retention and leveraging their leading positions in higher return specialist markets.

2.1 Market environment

The first half of 2011 was characterised by volatility in investment markets that was driven by uncertainty about the strength and sustainability of global growth, a debt crisis in Europe and geopolitical unrest in North Africa and the Middle East. The global financial environment became even more stressed in the second half of 2011 following increased concerns about the impact of the sovereign debt crisis, the trajectory of global economic growth and the strength of some banking systems. Global financial stress increased with a retrenchment in cross-border bank lending and investors reallocated capital away from "risky" assets. As the price of traded bank equity fell, spreads on corporate bonds widened and cost of sovereign debt increased, wholesale funding pressures rose sharply and exacerbated concerns over global growth and sovereign solvency. The negative feedback loop from these events impacted the environment for life insurance companies and caused a sharp downward correction in the share prices of insurance stocks, reflecting investors' concerns that insurance companies were being negatively impacted by these economic conditions. Since the end of June 2011, the UK life sector, as measured by the FTSE 350 Life Insurance Index, fell almost 25% at its lowest in September 2011 and closed the year down almost 14%. Against this backdrop, the Group's capital position has been relatively resilient to market volatility. However, widening corporate bond spreads have negatively impacted International Financial Reporting Standards ("IFRS") and Market Consistent Embedded Value ("MCEV") total profits but this has been broadly in line with the Group's published sensitivities. The impact on the Group from movements in asset prices is discussed in greater detail in the Business Review that follows.

2.2 Regulatory environment

In 2011, the UK life sector continued to prepare itself for the impact of upcoming regulation in the form of Solvency II, the introduction of auto-enrolment and the Retail Distribution Review ("RDR"), among other regulatory initiatives.

The details of Solvency II, the new capital regime expected to replace the existing capital framework, disappointingly still remain unclear with a risk of further delays in the timing of implementation. The current legislative draft looks less favourable for the UK industry with the treatment of matching premium and contract boundaries, in particular, being more onerous than the last quantitative impact study (QIS5) undertaken by the industry.

The Company continues to expect that auto-enrolment will lead to market growth in corporate pensions. Friends Life expects that the opportunity from auto-enrolment, together with its corporate pensions offering with its investment in low cost systems, should see it well placed to generate new business from new and existing schemes.

RDR is expected to significantly impact the distribution environment. Friends Life believes that its strategic decision to stop selling single premium bonds, strong nil-commission offering in corporate pensions, good relationships with employee benefit consultants, and the opportunity to sell products in the workplace position it well for the introduction of RDR. Protection is outside the scope of the RDR regime and Friends Life's strong relationships with intermediaries and growing track record in tied distribution leaves it well placed in this product segment.

3. UK Life Project

Since the launch of its UK Life Project, the Company has acquired three businesses at a price of approximately 66.9% of net MCEV. It brought these three businesses together under the Friends Life brand, which was launched in March 2011. In 2011, the Company moved firmly into the integration and value delivery phases of its UK Life Project. In order to provide greater detail on its strategic intent for the enlarged group, the Company provided the market with three updates on its plans to extract value from the businesses acquired. This report will briefly summarise the strategic updates provided over the course of 2011.

February – Delivering value

In February, the Company presented the results of the strategic review undertaken of the businesses acquired – namely, the Friends Provident business (November 2009), the AXA UK Life Business (September 2010) and Bupa Health Assurance business (January 2011). The Company indentified that the focus of its new business efforts would be on the product areas of Protection, Corporate Benefits and Retirement Income. In light of its detailed review of integration plans, the Company was also able to announce an increase in its expected cost synergies target from the acquired businesses from the £75 million of annualised cost synergies (before tax) announced on signing of the AXA transaction to £112 million per annum.

In addition, the Company identified clear financial targets that it expects its underlying businesses to meet by the end of 2013 and committed to regularly updating the market on progress in meeting them. These targets included new business strain reduction, new business internal rates of return ("IRR"), sustainable distributable cash and operating return on embedded value. The Company also highlighted that a number of options exist for it to exit the UK Life Project. The options outlined included: a cash sale, together or in parts of the Friends Life business; a direct listing of Friends Life as a standalone entity; separation of the UK open business from the UK back book leading to separate sales or listings; or merger with another life company.

One of the key strategic elements the Company identified in February as the subject of future market update was the cash and capital framework of the enlarged group where work was underway to deliver capital synergies by merging smaller acquired life companies; and evaluate the potential to transfer cash to the Group from the re-attributed inherited estate that forms part of the AXA UK Life Business.

March to June – Cash and capital update

The update in June outlined the key elements of the work completed and in progress on the cash and capital position of Friends Life. The Company announced its policy of returning excess cash released from Friends Life to shareholders to the extent that it was not expected to be required for further M&A opportunities in the short to medium term. The Company targeted a return of £500 million of excess cash to shareholders over the course of the second half of 2011 and the first half of 2012. It started this return of cash in 2011 with a £250 million on-market share buy-back which commenced immediately following the update. The Company also announced that it had planned management actions which were intended to deliver a further £235 million of capital synergies in Friends Life before the end of 2011 which

would be required, along with necessary regulatory approval, before any return of the targeted further £250 million in 2012.

The Company reiterated Friends Life's Distributable Cash Target ("DCT") of £400 million per annum and noted that over time Friends Life is expected to be in a position where the DCT is met from sustainable sources (comprising surplus emerging from the in-force business plus required capital released through run-off less new business strain and associated required capital for new business).

As part of the Group's wider cash and capital management work in 2011, the Company repaid a £400 million acquisition finance facility and issued £500 million of lower tier 2 debt in the public markets. The facility was drawn down in September 2010 to part fund the AXA UK Life Business acquisition and repaid in April 2011.

July to November – Value delivery

Having provided a framework for cash and capital and clearly identified the 2013 target financial metrics for Friends Life, the Company announced with its interim results in August 2011 the split of the UK life business between the UK legacy in-force portfolios (the "Heritage" business unit) and the UK new business in the chosen product areas (the "Go to Market" business unit).

The purpose of the update on the UK Life Project in November was to reveal the creation of a sustainable business at Friends Life and showcase the management team at Friends Life. At the Company's presentation, management of Friends Life demonstrated the clear accountability for the Heritage and Go to Market business units in the UK. The update provided details on the market context for these business units and the strategy that each of the business units would execute in order to achieve the 2013 financial targets.

The Company also announced details of a significant outsourcing agreement with Diligenta that would deliver new synergies in the coming years and de-risk the achievement of the previously announced cost savings. The other key strategic initiative announced was the creation of an in-house asset manager, Friends Life Investments ("FLI"), in order to re-capture fees currently being paid to external asset managers by bringing in-house the externally managed assets of the Group. While the initial focus of FLI is the management of fixed income assets backing annuities and shareholder funds, FLI is also exploring the potential to manage other fixed income portfolios within the Group.

Summary

In 2011 the Company clearly identified the strategic direction for the acquired businesses, provided measurable financial targets that it expected Friends Life to achieve by 2013, articulated its cash and capital position and policy, commenced returning excess cash to shareholders, announced a major outsourcing agreement and creation of an in-house asset manager, and showcased the Friends Life UK business and management team. In summary, it was a busy year with much achieved in terms of shaping a sustainable business at Friends Life.

3.1 Path to achieving financial targets

As noted above, the Company set out targets for the Friends Life businesses in February 2011, particularly in relation to the financial performance of UK new business. These targets are challenging; but the financial performance of the UK new business has improved in line with our expectations during 2011.

For its UK Protection business, Friends Life has targeted reducing cash new business strain to £30 million per annum, increasing gross value of new business ("VNB") to £80 million per annum and achieving a new business IRR of 20% per annum. During 2011, Friends Life wrote £92 million of new protection annual premium equivalent ("APE"), of which £22 million was on the target platform. Business written on the target platform is already achieving the targeted financial metrics. The £22 million of new APE written on the target platform resulted in £22 million gross VNB and achieved a 20% IRR with cash new business strain of only £8 million. This gives considerable confidence that as the proportion of new protection business written on the target platform increases towards 100% through 2012 (reflecting the switch of all new independent financial adviser business to this platform in the fourth quarter of 2011 and the switch of new controlled business to the target platform during 2012), Friends Life will achieve its financial targets in relation to this key product area.

For its Corporate Benefits business, Friends Life has targeted reducing cash new business strain to £75 million per annum, gross VNB of £25 million per annum and a new business IRR in double figures by 2013. In 2011, Friends Life wrote £440 million of new corporate pensions APE, of which £356 million was on the target New Generation Pensions ("NGP") platform. Cash new business strain reduced from a 2010 baseline figure of £80 million to £51 million in 2011. Incremental improvement through the year was significant, with cash new business strain reduced to only £16 million in

the second half of the year. Similarly, gross VNB increased from £5 million in the first half of 2011, to £10 million in the second half of the year, with the new business IRR achieved for the full year on the NGP platform being 9.4%. Only a modest improvement would be required from the performance achieved in the second half of 2011 in order to achieve our 2013 targets. If the impact of auto-enrolment is as positive to this product as some forecasts indicate it could be, there is potential for this business line to materially outperform the 2013 targets.

Finally, for its Retirement Income business Friends Life has targeted increasing retention rates on vesting pension funds to 50% and increasing gross VNB to £50 million per annum. Friends Life has made significant investments in capability in this area during 2011, however no changes to the original product propositions came on line during the year and retention rates were broadly unchanged from those achieved in 2010. Notwithstanding this, the retirement income business delivered gross VNB of £32 million in 2011 providing confidence that the £50 million per annum VNB target will be delivered, and potentially exceeded, in the years ahead.

Delivery against the VNB targets is critical to delivering Friends Life 10% per annum operating ROEV target, however it will not alone be sufficient. Short term interest rates remain at historically low levels, depressing the return achieved on net worth and making the achievement of the 10% operating ROEV target more challenging than it would be in more "normal" conditions. In the absence of an increase in short term interest rates and a sustained increase in equity markets, Friends Life will need to outperform against the 2013 VNB targets and the Company will need to undertake further work to optimise the Group's balance sheet in order to achieve a 10% operating ROEV.

In his statement, the Chairman comments on the Company's decision to adopt a base case self-managed exit plan involving separate listings for OpenCo and HeritageCo, and this is commented on further below. As the shape of these businesses evolves and is finalised, the Friends Life operating ROEV target will be broken down into separate targets for each business.

3.2 Cash and capital

Despite the volatile economic environment and fall in market returns during the year, Friends Life contributed £393 million of cash, broadly in line with the DCT of £400 million per annum. This amount comprises £291 million met from sustainable free surplus generation, with the balance of £102 million coming from other actions and working capital.

The £102 million included the £100 million of lower tier 2 debt raised by Friends Life in excess of the £400 million received to repay the acquisition finance facility. It also included the benefit of £281 million of capital synergies delivered against £235 million expected as a result of planned management actions. The benefits were offset by the impact of economic variances, in particular, by falling equity markets and widening corporate bond spreads, which reduced MCEV profits before tax by £600 million. Of this £600 million reduction, £352 million had a direct impact on free surplus effectively representing a reduction in the cash generated within the businesses during the year.

As a result of the actions taken to optimise Friends Life's capital position, including the delivered capital synergies, capital requirements on a Pillar 1 basis have reduced significantly. However, during the year, widening corporate bond spreads and the assessment of the overall level of economic risk, particularly in Europe, have significantly increased capital requirements on a Pillar 2 basis. Accordingly, Friends Life now needs to focus its capital management activities on both the Pillar 1 and Pillar 2 capital positions, as it is on the cusp of both bases biting.

The cash generation of the underlying business and the delivery of capital synergies were in line with the Company's expectations. However in light of the weak investment markets in the year and the increased volatility from the Pillar 2 basis now biting, the Company has determined that it would have been inappropriate to release capital over and above its declared dividend policy based on the position at the end of 2011. The Company will keep the potential to do so under review, taking account of the performance and stability of markets since the year end and the impact of planned management actions to further optimise capital and address the impact of market volatility. The Company will update the market no later than the 2012 interim results announcement on its intentions with respect to the second stage of the capital return program announced in June 2011.

Friends Life retains a strong Insurance Group Capital Adequacy position of £2,139 million, representing a surplus of 219% and continues to hold a cash buffer of £400 million after meeting its 2012 dividend and debt repayment and servicing costs.

3.3 Exit

As the Chairman has explained in his statement, the Company, advised by ROL, has concluded that in the absence of value accretive exit M&A opportunities, it needs to be ready to implement a self-managed exit plan. ROL has

recommended, and the Company has approved, a base case exit plan which involves a division of Friends Life into two separately listed businesses:

- "OpenCo" – which would consist of the UK Go to Market business units, the International businesses, Sesame Bankhall Group, and associated support businesses; and
- "HeritageCo" – which would consist of the UK Heritage business and associated support businesses including FLI, Friends Life's listed debt and the UK pension fund.

The precise division of assets and liabilities between OpenCo and HeritageCo has not been finalised yet, and will be influenced to some extent by the final form of the Solvency II regime. We expect that OpenCo will be a high operating ROEV business with relatively modest cash generation (at least in the early years), whilst HeritageCo will be highly cash generative, but lower ROEV. We also expect that the embedded value of OpenCo will be in the range of £2 billion to £3 billion at exit.

The following gives an illustrative example of the financial metrics which OpenCo and HeritageCo might be capable of exhibiting based on Friends Life's 31 December 2011 MCEV of approximately £6 billion and assuming that, after allowing for any dis-synergies arising from separating into two separate businesses, Friends Life hits its cash generation and ROEV targets in 2013.

	OpenCo	HeritageCo	Friends Life
Net MCEV	£2 billion	£4 billion	£6 billion
ROEV	20%	5%	10%
Net Cash Generation	£0.1 billion	£0.3 billion	£0.4 billion

The implementation of the Company's ongoing capital optimisation programme is expected to ensure that, by the end of 2013, the two UK business units (Go to Market and Heritage) will be divided into two separate life companies, capable of being exited independently. Friends Life has been re-aligning the majority of its resources to reflect the split between the UK Go to Market and Heritage businesses since the announcement of the creation of the Heritage business unit in August 2011. Together with ROL, it is now putting in place a programme to re-align the majority of the remaining shared service and group functions to either OpenCo or HeritageCo over the next 18 months.

Detailed planning work has commenced to ensure that the Company is able to implement this plan by early 2014. As part of this planning, consideration is being paid to the interests of current and future holders of Friends Life's listed debt instruments including ensuring each business retains only an appropriate level of gearing in the context of its gross embedded value and its cash generation capability. In the case of HeritageCo, this includes having regard to the current in-force portfolio run off, in order to maintain an appropriate level of gearing in the absence of further closed fund transactions.

We believe that the separation of OpenCo and HeritageCo will create two businesses which will be attractive to different groups of investors, both debt and equity, and will be able to adopt different strategies following exit from the Company:

- OpenCo will be a fit for purpose life company playing in key markets in which it has competitive advantage; and
- HeritageCo will adopt a UK closed life fund consolidation strategy following exit.

The value that could be created from implementation of the self-managed exit plan will form a benchmark against which exit M&A opportunities can be assessed. Following completion of legal separation of the UK Go to Market and Heritage businesses at the end of 2013, we expect that the Company will be in a position to implement the self-managed exit plan and provide OpenCo and HeritageCo with separate listings in the second or third quarters of 2014. ROL therefore currently anticipates that the Company will have completed the UK Life Project by no later than the end of 2014.

3.4 M&A

Whilst the Company and ROL's main priority for the remainder of the UK Life Project will be to deliver the targeted financial performance for the UK life business and to prepare to implement a self-managed exit during 2014, we do not rule out the possibility of further M&A.

Such transactions could include:

- the acquisition of small bolt-on businesses which would enhance or accelerate the development of the UK Go to Market business unit; and
- further acquisitions of UK closed life funds at attractive prices to enhance HeritageCo.

As the Company has noted previously, it does not expect to undertake further transactions during the remainder of the period of the UK Life Project which would dilute the returns (either as a result of the price paid, or the impact on project duration) which it currently expects to be able to realise from the businesses already acquired. Nor would the Company expect to undertake transactions which required a material capital raise from existing shareholders unless the proposed impact on project returns was exceptionally strong (in which case we would expect to bring such transactions to shareholders for approval).

4. Business performance

The Business Review that follows this report will set out in detail the results under both IFRS and MCEV bases. The 2011 results are not directly comparable to the 2010 results as they include Friends Provident business and the AXA UK Life Business for 12 months, the Bupa Health Assurance business for 11 months and the Winterthur Life UK Limited business for 2 months.

The IFRS based operating profit before tax was £681 million and included £404 million of reserving changes and one-off items that included capital synergies, the impact of the outsourcing agreement with Diligenta and the impact of expense, persistency, morbidity and mortality experience in the year.

The MCEV operating profit before tax was £517 million and includes £140 million of operating assumption changes. These operating assumption changes relate primarily to the impact of the outsourcing agreement with Diligenta which allowed the expense benefit to be recognised in the MCEV operating profit.

The key highlights of the full year results include:

- steady progress with the integration of the acquired businesses with £45 million of run-rate savings achieved;
- sustainable free surplus of £291 million contributed to distributable cash target;
- management actions including delivery of capital synergies and the impact of the Diligenta outsourcing agreement have contributed positively to operating profit;
- steady progress is being made towards the achievement of the 2013 financial targets.

5. Outlook

Despite a difficult external environment, the Company has made steady progress against its strategic priorities and financial targets. The Company’s priorities in 2012 remain the development of a sustainable underlying business. As the Company advances towards an exit from its UK Life Project, work will continue towards delivering the best return for shareholders. ROL remains confident that the Company will achieve its financial and strategic targets.

Business Review

Introduction

Transformational year

2011 represented a transformational year for the Group as it transitioned from the acquisition phase of the UK Life Project towards the delivery of a focused and integrated life business.

The acquisition of Bupa Health Assurance Limited (since renamed Friends Life BHA Limited) ("BHA") in January 2011 brought with it a well regarded and efficient protection platform as well as a range of market leading Individual and Group Protection products. In addition, the second phase of the acquisition of the AXA UK Life Business was formally completed with the acquisition of Winterthur Life UK Limited ("WLUK") and disposal of the Guaranteed over Fifty ("GOF") and Trustee Investment Plan ("TIP") portfolios in November 2011.

In March 2011, the acquired businesses were rebranded as Friends Life. In August, the Group announced the restructuring, for management purposes, of the UK business into distinct 'Heritage' and 'Go to Market' businesses: Corporate Benefits, Protection and Retirement Income.

In November, the Group set out its intention to develop in-house asset management capabilities with the creation of Friends Life Investments ("FLI") to manage its significant portfolio of fixed income assets. It also announced a transformational 15 year outsourcing partnership with IT and customer service specialist, Diligenta. This outsourcing partnership has allowed the Group to increase its cost savings target from £112 million to £143 million (30% of UK 2010 baseline costs). On 1 March 2012, the new outsourcing partnership commenced with most of the Group's remaining UK Heritage service operations transferring across to Diligenta.

In December, the Group completed various Part VII transfers combining a number of smaller life companies into Friends Life Limited ("FLL"), restructuring the acquired businesses to maximise capital synergies and to continue the restructuring that supports the future direction of the business.

Business performance

The UK operating result has shown significant improvement with good progress towards strategic objectives reflecting both the improved trading performance, as the businesses integrate, and a number of one-off items including the Diligenta outsourcing arrangement. For MCEV, these benefits were partly offset by the adverse net impact of revised persistency and morbidity assumptions of £73 million, in line with guidance given with the Interim Management Statement in November.

The Corporate Benefits and Protection businesses have demonstrated improvements in the value of new business ("VNB"), internal rate of return ("IRR") and new business strain ("NBS") with the focus on strategic products' platforms and expense reductions driving the overall development of these results and offsetting the impact of adverse pensions persistency. The Retirement Income business continues to exceed its targeted IRR although the VNB was reduced by adverse market conditions in the second half of the year. The performance of the UK Heritage business reflects the challenging market conditions, adverse persistency and provisions established in respect of the Retail Distribution Review ("RDR") partially offset by the positive impact of mortality and morbidity experience.

The good progress in the UK business was offset by a poor performance in the International business; despite a 6% increase in sales volumes, VNB and IRR reduced due to an increase in the proportion of the existing lower margin 'Premier' products in Asia and a lower proportion of higher margin German business sales. The continued review of the in-force portfolio, which commenced in the first half of 2011, highlighted further issues and the business's performance was also impacted adversely by the effect of economic markets through an increased cost of guarantees in respect of certain Overseas Life Assurance Business ("OLAB") products. The International management team has been strengthened, a strategic review is well advanced and the business is focused on improving profitability, driving through reductions in new business strain and is working to meet its cash generation target.

Lombard continued to perform well, but again results reflect the economic downturn in Europe, with some adverse impact on persistency as well as sales. Notwithstanding these difficult conditions, Lombard has outperformed its peers.

The following table shows the IRR performance of the key business lines compared with the targets set for 2013.

IRR % (unless otherwise stated)	2013 Target	**2011 Full year**	2010 Full year baseline[i]	2010 Full year
UK	n/a[ii]	**7.7**	5.9	7.1
International	20+	**12.7**	15.4	15.4
Lombard[iii]	20+	**>25.0**	>25.0	>25.0
Blended group new business IRR[iii]	15+	**10.0**	8.6	11.2
New business cash strain (£m)	192	**278**	392	238

(i) 2010 full year baseline includes an estimate of 12 months BHA and AXA UK Life Business results.

(ii) Target IRRs for the Go to Market businesses are set out in the relevant sections of the UK operating review.

(iii) The 2011 Lombard IRR (and therefore the blended group IRR) now takes account of the Luxembourg regulatory regime in which DAC is an allowable asset.

Market environment

As well as affecting the operational performance, the difficult economic environment in the year has negatively impacted IFRS and MCEV total profits, and cash generation. On an IFRS basis, income on shareholder assets and the value of annual management charges ("AMCs") have fallen, and reserves for certain guarantees have increased, reducing the operating result. In addition, on an MCEV basis, the future value of in-force ("VIF") business has fallen, principally reflecting the reduced equity returns and widening of credit spreads giving rise to significant, but primarily unrealised, economic experience losses. This has had a corresponding impact on free surplus generation.

Capital strength

The Group's robust capital position has been maintained during 2011 with a Friends Life Group plc ("FLG") IGCA surplus as at 31 December 2011 of £2.1 billion (31 December 2010: £2.3 billion). The movement in the year principally reflects:

- the surplus generated offset by economic impacts, primarily credit spreads;
- the impact of the BHA transaction; and
- dividends paid to Resolution Holdings (Guernsey) Limited ("RHG").

Significant capital synergies were delivered in the year, but much of this benefit has been eroded by widening credit spreads. The Group changed its capital policy in the year from 160% to 150% of Group Capital Resource Requirements (excluding WPICC), reflecting reduced integration risk. The reduction in Pillar 1 capital requirements and increases in Pillar 2 from market movements mean that the Group is now on the cusp of both Pillars biting and accordingly capital management actions in 2012 are focused on the management of both bases.

The Group's balance sheet remains strong and the shareholder exposure to the higher risk government debts of Spain, Portugal, Italy, Ireland and Greece remains low at £6 million (31 December 2010: £7 million).

Dividends and return of capital

In accordance with previous commitments the final dividend is recommended to increase to 13.42 pence per share, resulting in a full year dividend of 19.89 pence per share. The full year dividend is an increase of 10% from 2010, reflecting the benefit of the £250 million share buy-back during the year.

The Group's available shareholder cash ("ASC") at 31 December 2011 was £853 million, including £350 million of dividends proposed by FLL in respect of 2011. FLG's contribution to its distributable cash target ("DCT") of £400 million per annum was £393 million, including £100 million of proceeds from its external LT2 debt issue that has been retained in the life companies. FLG generated sustainable free surplus of £291 million and one-off capital synergies of £281 million.

Whilst the overall cash generation of the business was in line with the Company's expectations, the weak investment markets in the year and resulting negative economic experience variances have offset the value of the capital synergies achieved. Accordingly, the Company has concluded that it would have been imprudent to make a further return of capital over and above the declared dividend policy based on the resultant 2011 position. The Company will update the market no later than the interim 2012 results announcement on its intentions with respect to the second stage of the capital return programme announced in June 2011.

The key performance indicators for the Group and an analysis of the IFRS and MCEV results are set out below followed by detailed segmental commentary, cash and capital information and an explanation of the principal risks and uncertainties for the Group and its approach to managing these.

Key performance indicators

The Group's results for 2011 include the post-acquisition results of the acquired businesses and are therefore not currently directly comparable from period to period where acquisitions have taken place in the year under review. The 2010 results included Friends Provident for 12 months and the AXA UK Life Business (including GOF and TIP but excluding WLUK) for four months while the 2011 results include Friends Provident and the AXA UK Life Business for 12 months, BHA for 11 months, GOF and TIP for 10 months and WLUK for two months.

The Group uses the following key performance indicators.

KPI: IFRS based operating profit before tax

2011: £681 million

2011 IFRS based operating profit before tax by segment	£m
UK	672
International	40
Lombard	38
Corporate	(69)
Group IFRS based operating profit before tax	**681**

2010: £275 million

2010 IFRS based operating profit before tax by segment	£m
UK	187
International	95
Lombard	33
Corporate	(40)
Group IFRS based operating profit before tax	**275**

IFRS based operating profit before tax of £681 million (31 December 2010: £275 million) benefited from the increased scale of the UK business as well as the actions taken to release negative reserves, the Diligenta outsourcing transaction and other favourable assumption changes. These were offset by the adverse impact on operating profit of poor market conditions (reflected through reduced AMCs, higher cost of guarantees and reduced long-term investment return) and the inclusion of a full year's financing costs.

KPI: IFRS (loss)/profit after tax

2011: £(31) million

2011 IFRS (loss)/profit after tax	£m
IFRS Group operating profit	681
Acquisition gain	116
Non-recurring costs	(296)
Amortisation and impairment	(759)
Investment fluctuations and other	(230)
Tax	457
Group IFRS loss after tax	**(31)**

2010: £820 million

2010 IFRS (loss)/profit after tax	£m
IFRS Group operating profit	275
Acquisition gain	883
Acquisition costs	(28)
Amortisation and impairment	(428)
Investment fluctuations and other	10
Tax	108
Group IFRS profit after tax	**820**

IFRS loss after tax of £(31) million (31 December 2010: £820 million profit) reflects investment market losses as well as the impact of one-off costs relating to separation and integration spend, the Diligenta outsourcing transaction, and other project activity. Amortisation and impairment includes the one-off impact of adoption of negative reserves and a full year charge for the AXA UK Life Business. The result benefits from the gains recognised on the acquisition of BHA and WLUK whilst the prior year result reflects the much larger gain on the acquisition of the AXA UK Life Business.

KPI: MCEV operating profit before tax

2011: £517 million

2011 MCEV operating profit before tax	£m
UK	507
International	29
Lombard	82
Corporate	(101)
Group MCEV operating profit	**517**

2010: £412 million

2010 MCEV operating profit before tax	£m
UK	306
International	68
Lombard	162
Corporate	(124)
Group MCEV operating profit	**412**

Segment results comprise covered and non-covered business.

MCEV[(i)] operating profit before tax of £517 million (31 December 2010: £412 million) reflects the increased scale of the UK operations, with improved VNB in the AXA UK Life Business, the benefit of future expense savings (secured in part through the Diligenta outsourcing transaction) partially offset by the adverse net impact of persistency and morbidity assumption changes (in line with previous guidance).

(i) The MCEV basis is in compliance with the European Insurance CFO Forum MCEV Principles ("MCEV Principles") (Copyright© Stichting CFO Forum Foundation 2008), issued in June 2008, and re-issued in amended form in October 2009.

KPI: MCEV (loss)/profit after tax

2011: £(295) million

2011 MCEV loss after tax	£m
MCEV operating profit	517
Economic variances	(600)
Amortisation of intangibles	(3)
Non-recurring and other items	(282)
Tax	73
Group MCEV loss after tax	**(295)**

2010: £460 million

2010 MCEV profit after tax	£m
MCEV operating profit	412
Economic variances	229
Amortisation of intangibles	(3)
Non-recurring and other items	(22)
Tax	(156)
Group MCEV profit after tax	**460**

MCEV loss after tax of £(295) million (31 December 2010: £460 million profit) reflects adverse economic variances driven by the fall in investment markets in the period. The result also reflects the impact of non-recurring project costs including £124 million for the Diligenta outsourcing transaction.

KPI: Group embedded value on an MCEV basis

2011: £5,796 million

2011 Group MCEV	£m
UK	5,341
International	571
Lombard	541
FLG corporate and other (gross)	655
FLG debt	(1,159)
RSL holding companies	(153)
Group MCEV	**5,796**

2010: £6,515 million

2010 Group MCEV	£m
UK	5,995
International	557
Lombard	577
FLG corporate and other (gross)	681
FLG debt	(1,296)
RSL holding companies	1
Group MCEV	**6,515**

Group embedded value on an MCEV basis of £5,796 million (31 December 2010: £6,515 million) principally reflects the payment of the cash dividend to shareholders of £226 million, the return of capital of £250 million through the share buy-back programme and the loss for the year.

FLG operating ROEV[(i)] of 6.5% (31 December 2010: 8.3%) reflects the inclusion of the AXA UK Life Business for a full year but is showing progress through the Group's targeted reduction in new business strain and achievement of synergies. The increase in full year 2011 ROEV from the annualised half year ROEV of 4.5% reflects the progress made to date in migrating UK business to target platforms and securing future cost savings in part through completion of the Diligenta outsourcing transaction.

(i) FLG operating ROEV is calculated as the annualised MCEV operating return, after tax and financing, divided by the start of period net embedded value, and is adjusted to allow for the timing of significant capital movements such as dividends and acquisitions.

KPI: Asset quality – corporate debt and asset backed securities

2011: £8.6 billion

2011 Asset quality – corporate debt and asset backed securities	**%**
AAA	13
AA	35
A	34
BBB	15
<BBB/not rated	3

2010: £8.2 billion

2011 Asset quality – corporate debt and asset backed securities	**%**
AAA	16
AA	34
A	33
BBB	12
<BBB/not rated	5

The Group has maintained high asset quality, with 97% of shareholder-related corporate debt and asset-backed securities at investment grade or above (2010: 95%). The Group has no significant shareholder exposure to sovereign debt or corporate bonds of higher risk European economies.

KPI: Available shareholder cash

Movement in available shareholder cash	**Total**
1 January 2011	**1,067**
Dividends and share buy-backs	(476)
Debt payments and servicing	(115)
FLG corporate net of WC movements	(18)
Acquisitions and disposals	(27)
Resolution Holdco's	7
Contribution of Life Companies	415
31 December 2011	**853**

Group available shareholder cash of £853 million decreased by £214 million from 31 December 2010 (£1,067 million) reflecting the return of £476 million of cash to shareholders; £226 million through dividends and £250 million through the share buy-back programme. The life companies contributed £415 million to ASC underpinned by sustainable free surplus generation of £291 million. Full year free surplus generation was impacted by a number of one-off items including delivery of one-off capital synergies of £281 million (against a target of £235 million) and adverse economic experience of £352 million. Working capital increased in the year driven by the retention of free surplus to fund future integration activity (including the Diligenta outsourcing) and increased funding retained in the life companies in response to recent adverse economic conditions.

KPI: IGCA

Movement in IGCA	Total
1 January 2011	**2,317**
Surplus emerging	143
Capital optimisation programme	103
PS06/14	157
Acquisitions and disposals	(154)
Dividend to RSL	(350)
External LT2 debt	496
Repay RSL debt	(500)
Finance costs and other	(73)
31 December 2011	**2,139**

Estimated FLG IGCA surplus capital of £2.1 billion (31 December 2010: £2.3 billion) reflects the £350 million dividend paid to RHG and the acquisition of BHA, partially offset by surplus emergence in the year.

The estimated IGCA at the end of February increased to £2.2 billion, with the impact of positive investment performance partially offset by separation and integration spend.

IFRS results

IFRS profit

The Group's IFRS results are set out below, including a reconciliation from IFRS based operating profit to the IFRS result after tax. The Group uses the operating profit measure as the Board considers that this better represents the underlying performance of the business and the way in which it is managed.

These results include the results of the acquired Friends Provident business, AXA UK Life Business, BHA and WLUK from the deemed dates of their acquisitions, which were 4 November 2009, 3 September 2010, 31 January 2011 and 7 November 2011 respectively. The results of the GOF and TIP portfolios are included for the period from 3 September 2010 until their disposal on 1 November 2011.

£m	UK	Int'l	Lombard	Corporate	RSL 2011	RSL 2010
New business strain	**(112)**	**(36)**	**(33)**	**–**	**(181)**	(145)
In-force surplus	**402**	**97**	**73**	**–**	**572**	466
Long-term investment return	**(5)**	**1**	**(1)**	**(21)**	**(26)**	13
Principal reserving changes and one-off items	**416**	**(12)**	**–**	**–**	**404**	(13)
Development costs	**(28)**	**(7)**	**(1)**	**–**	**(36)**	(28)
FLG other income and charges	**(1)**	**(3)**	**–**	**(7)**	**(11)**	(3)
RSL other income and charges	**–**	**–**	**–**	**(41)**	**(41)**	(15)
IFRS based operating profit/(loss) before tax	**672**	**40**	**38**	**(69)**	**681**	275
Short-term fluctuations in investment return					**(261)**	24
Acquisition accounting adjustments:						
Amortisation and impairment of acquired in-force business					**(675)**	(364)
Amortisation of other acquired intangible assets					**(84)**	(64)
Non-recurring items:						
Gain on acquisition of businesses					**116**	883
Costs associated with the business acquisitions					**(3)**	(28)
Other non-recurring items					**(293)**	(68)
STICS interest adjustment to reflect IFRS accounting for STICS as equity					**31**	31
Returns on F&C Commercial Property Trust					**–**	23
IFRS (loss)/profit before shareholder tax					**(488)**	712
Shareholder tax					**457**	108
IFRS (loss)/ profit after tax					**(31)**	820

IFRS based operating profit for 2011 was £681 million comprising the operating profit of the life businesses of £750 million, £28 million of corporate costs for FLG and £41 million of corporate costs for the Resolution holding companies. This result includes £404 million of principal reserving changes and one-off items which comprised:

- £221 million one-off benefit in respect of PS06/14;
- £71 million release of expense reserves, including the benefit of the savings secured through the Diligenta outsourcing; and
- a further £124 million of positive UK assumption changes offset by £12 million adverse changes in International.

Excluding the impact of these items and the equivalent one-off changes in 2010 leads to an underlying IFRS based operating profit of £277 million for 2011 compared to £288 million for 2010. The increase in the size of the Group and the improvements to new business strain (reflecting cost reductions and transition to target platforms) have been offset by the adverse impact of market conditions on operating profit (resulting in lower annual management charges for UK business, higher cost of guarantees for certain International business and lower long-term investment return assumptions), the ongoing negative impact of the adoption of PS06/14 and the poor performance in International. Further details on the operating performance of the Group are included in the relevant business unit operating sections.

Non-operating items

Investment market performance has been volatile throughout 2011 and deteriorated in the second half of the year. As a result negative short-term fluctuations in investment return amounted to £261 million, principally relating to variances against the expected return on assets backing the non-profit funds. The major movements comprise:

- adverse variances as a result of mismatches between the assets backing the Friends Life annuity portfolios and the related liabilities. These variances are a consequence of the Group's asset/liability matching approach which is typically undertaken on a realistic basis. As policyholder liabilities are reported in the results according to their treatment on a regulatory basis the differing approaches create a mismatch;
- credit default assumptions have been strengthened following the worsening of economic conditions during the second half of 2011 as evidenced by the significant widening of corporate bond spreads; and
- negative shareholder fluctuations of £46 million represent the difference between actual and expected investment returns, due to the Group's higher holding in cash combined with lower than expected rates of return.

Acquisition accounting adjustments, totalling £759 million, represent the amortisation and impairment of the intangible assets recognised on the acquisitions. These charges comprise £675 million of amortisation and impairment of acquired in-force business, and £84 million of amortisation of other intangible assets. The amortisation of acquired in-force business includes a one-off charge of £201 million (£130 million for the AXA UK Life Business, £71 million for BHA) reflecting the accelerated run-off of in-force surplus following the recognition of negative reserves in these businesses.

Non-recurring items include gains on acquisitions of £116 million. The completion of the BHA and WLUK acquisitions has resulted in gains of £68 million and £48 million respectively, offset by acquisition costs of £3 million.

The disposal of the GOF and TIP portfolios did not have a significant impact on the Group results.

Other non-recurring costs of £293 million include £84 million of costs relating to the 15 year outsourcing arrangement with Diligenta; and £209 million of other non-recurring costs. These comprise:

- separation and integration programme costs of £128 million;
- finance transformation costs of £55 million including Solvency II;
- capital optimisation project costs of £19 million; and
- other costs of £7 million.

The Diligenta impact of £84 million in 2011 reflects the reserving required for transition and service improvement costs in relation to in-force insurance contract business. In accordance with IFRS, no reserves have been established for the investment contracts business. Total implementation costs for both in-force insurance and investment business are expected to be £250 million with the remainder incurred over 2012 to 2014.

Interest payable on the FLG STICS of £31 million is included as a £26 million deduction to corporate long-term investment return in the operating profit analysis, and £5 million adverse investment fluctuation. As the STICS are accounted for as equity in IFRS (with interest being recorded as a reserve movement), £31 million is added back to the non operating result to reflect the requirements of IFRS.

A shareholder tax credit of £457 million is recognised in the period and is significantly higher than the loss before tax of £488 million would imply. The principal differences between the implied and actual shareholder tax credit relate to:

- £69 million one-off shareholder tax credit triggered by the change in pricing basis on certain unit-linked funds to reflect the fact these funds were contracting;
- £60 million shareholder tax credit relating to the reduction in the rate of UK corporation tax;
- £68 million and £48 million gains on the acquisitions of BHA and WLUK respectively, which are not taxable (the tax impact of this is £31 million); and
- £190 million shareholder credit for tax reliefs, expenses and exemptions predominantly in relation to the life insurance companies in the Group which are taxed on the "I minus E" basis, an element of which is matched by liabilities which are accounted for within policyholder liabilities and form part of the loss before tax.

The tax credit includes £194 million credit in respect of the amortisation and impairment of AVIF and other acquired intangibles in the year.

The £23 million return on F&C Commercial Property Trust in 2010 reflects the market return attributable to third parties for the period up to April 2010. This was the date at which FLG ceased to consolidate the results of this company, as holdings had been reduced to below the level requiring consolidation, hence there is no impact on the 2011 results.

Summary IFRS balance sheet

£m	RSL 31 December 2011	RSL 31 December 2010
Acquired value of in-force business	**4,437**	4,685
Other intangible assets	**410**	455
Financial assets	**103,636**	99,445
Cash and cash equivalents	**8,791**	9,288
Other assets	**8,132**	8,492
Total assets	**125,406**	122,365
Insurance and investment contracts	**112,455**	107,492
Loans and borrowings		
− deferred consideration notes	**423**	500
− acquisition finance facility	**–**	400
− subordinated debt	**681**	189
− other	**91**	123
Other liabilities	**5,761**	7,112
Total liabilities	**119,411**	115,816
IFRS net assets	**5,995**	6,549
Equity attributable to equity holders of the parent	**5,672**	6,227
Attributable to non-controlling interests	**323**	322
Total equity	**5,995**	6,549
Shares in issue(i)	**1,373,527,605**	1,443,985,079

(i) Adjusted to exclude 2,661,384 Resolution Limited shares held by subsidiaries at 31 December 2011 (31 December 2010: 8,579,292).

At 31 December 2011, IFRS total equity was £5,995 million (31 December 2010: £6,549 million), with equity attributable to equity holders of the parent of £5,672 million (31 December 2010: £6,227 million). IFRS net assets per share attributable to shareholders were £4.13 (31 December 2010: £4.31) based on shares in issue at the balance sheet date, excluding the Company's shares held by subsidiaries.

The Company's issued share capital has decreased reflecting the shares repurchased and cancelled under the share buy-back programme, changes in the shares held by subsidiaries and the impact of shares issued to satisfy the scrip element of the 2010 final dividend (14 million shares) and 2011 interim dividend (3 million shares). The return of capital to shareholders through the share buy-back programme commenced on 8 June 2011, was completed on 26 October 2011 and resulted in a reduction in issued share capital of 93 million shares with a total value of £250 million. There has been a reduction in the number and value of shares in the Company held by the life companies (£7 million compared to £20 million at 31 December 2010). In accordance with IFRS requirements, these shares have been excluded from the equity attributable to equity holders of the parent.

Financial assets are predominantly invested in listed shares, other variable yield securities and corporate bonds and asset backed securities. Asset quality has been maintained with 96.9% of shareholder-related corporate bonds and asset backed securities held at investment grade or above.

As part of the financing for the acquisition of the AXA UK Life Business, a £400 million short-term funding arrangement was put in place. This was repaid in April 2011 following the successful raising of £500 million external LT2 subordinated debt by FLG.

At 31 December 2011, the ratio of debt to IFRS equity attributable to equity holders of the parent, gross of debt, was 17.4% (31 December 2010: 16.3%), with the movement primarily reflecting the decrease in equity following the return of capital to shareholders.

MCEV results

MCEV profit

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

The results and financial position of the Group's life and pensions business ("covered business") are presented on the MCEV basis with all other businesses included on an IFRS basis.

Group MCEV profit

£m	UK	Int'l	Lombard	Corporate	RSL[(i)] 2011	RSL[(ii)] 2010
Value of new business	**59**	**40**	**52**	**–**	**151**	145
Expected existing business contribution	**330**	**27**	**49**	**(46)**	**360**	247
Operating experience variances	**(9)**	**(7)**	**(12)**	**–**	**(28)**	32
Other operating variances	**9**	**(20)**	**(2)**	**19**	**6**	65
Operating assumption changes	**147**	**(3)**	**(4)**	**–**	**140**	(23)
Development costs	**(28)**	**(7)**	**(1)**	**–**	**(36)**	(28)
FLG other income and charges	**(1)**	**(1)**	**–**	**(33)**	**(35)**	(11)
RSL other income and charges	**–**	**–**	**–**	**(41)**	**(41)**	(15)
Operating profit before tax	**507**	**29**	**82**	**(101)**	**517**	412
Economic variances					**(600)**	229
Amortisation of non-covered business intangible assets					**(3)**	(3)
Costs associated with the business acquisitions					**(3)**	(28)
Non-recurring costs					**(345)**	(61)
Other non-recurring items and non-operating variances					**66**	67
(Loss)/profit from continuing operations before tax					**(368)**	616
Tax					**73**	(156)
(Loss)/profit from continuing operations after tax					**(295)**	460

(i) 2011 results comprise 12 months results for Friends Provident and the AXA UK Life Business, 11 months for BHA, ten months for GOF and TIP and two months for WLUK.

(ii) 2010 results include 12 months results for Friends Provident and four months for the AXA UK Life Business (including GOF and TIP but excluding WLUK).

Overall MCEV operating profit before tax for 2011 was £517 million compared to £412 million in 2010. Excluding the impact of one-off assumption changes for both periods gives an underlying operating profit of £377 million in 2011 and £435 million in 2010. Consistent with IFRS, the MCEV operating result has been negatively impacted by the poor performance in International and by adverse market performance with a reduction in certain longer term rates of return and a significant fall in Lombard results reflecting the challenging market conditions.

The VNB has increased from 2010 reflecting the benefit of the inclusion of a full year of sales for the AXA UK Life Business (with improvements in VNB driven primarily by cost savings), the acquisition of BHA, the impact of the Diligenta transaction (reflecting the contractualised reduction in future maintenance expenses for the new business written in 2011) offset by reduced sales and profitability in Lombard, resulting from the impact of adverse economic conditions.

The expected return on existing business has increased following the acquisition of the AXA UK Life Business (including WLUK) and BHA. However, the longer term rates of return applied to equities and properties have fallen since 2010. The longer term return for government bonds used to determine 2011 MCEV operating profit is based on the one-year risk free rate at 31 December 2010 of 1.14%, which is materially below the longer term rate that could be derived from the 10 year swap rate at 31 December 2010 of 3.70%. The use of the one year rate results in a lower expected return, and hence a lower MCEV operating profit, than that which would have been obtained had a longer term risk free rate been applied. It is estimated that applying the 10 year swap rate of 3.70% to government bonds would have increased operating profit by £49 million for the period. The Group is reviewing the appropriateness of the rate applied in its MCEV

operating profit and may, subject to any changes in industry practice, adopt a higher rate, based on the 10 year swap rate, as this is more closely aligned with the underlying characteristics of the Group's business. Any change in rate will have no impact on overall embedded value, as any increase in operating profit is offset by a decrease in economic variances.

Operating experience variances and other operating variances were £22 million adverse in the year. This reflects the adverse impact of persistency in the UK and Lombard, the negative impact of modelling changes in the International business (primarily in respect of more accurate modelling of guarantees on paid-up policies) offset by positive mortality and morbidity experience and the benefit of the change in Group capital policy to hold a minimum of 150% (previously 160%) of Group Capital Resource Requirements (excluding WPICC). Further details of this change are included in the cash and capital section.

Operating assumption changes amount to £140 million benefit in the year, comprising £185 million benefit of the Diligenta outsourcing and positive mortality changes of £30 million offset by £73 million net adverse impact of the favourable morbidity and adverse persistency assumption changes including the establishment of a provision for the expected impact of the Retail Distribution Review, and £2 million of other adverse changes. This corresponds to the guidance given in the Group's Interim Management Statement in November 2011 which anticipated an adverse impact of £40 to £70 million for operating assumption changes at 31 December 2011 in respect of persistency and morbidity.

Further details on the operating performance of the Group are included in the relevant business unit operating sections.

Non-operating items

Economic variances combine the impact of changes to economic assumptions with the investment return variances over the year. Total economic variances in 2011 had a £600 million adverse impact on results (2010: £229 million favourable). The main contribution to the adverse variance is a £419 million impact arising from the reduction in the value of future profits from annual management charges on unit-linked business (UK: £241 million, International and Lombard: £178 million). The volatile macroeconomic conditions have also resulted in corporate bond spreads widening in the second half of the year with credit default and illiquidity premium assumptions changed to take account of these conditions. These changes have resulted in a £239 million impact on the UK annuity business.

Other positive economic variances total £58 million and include the offsetting impacts of economic conditions on the time value of options and guarantees ("TVOG"), £52 million adverse, the change in market value of Group debt, £97 million favourable and £13 million of other minor, positive variances.

Costs of £3 million have been incurred relating to the acquisition of BHA and WLUK (31 December 2010: cost of acquisitions totalled £28 million).

Non-recurring costs total £345 million (31 December 2010: £61 million) and include £124 million of one-off costs relating to the outsourcing agreement with Diligenta, £209 million of non-recurring costs consistent with IFRS (as explained above) and £12 million specific to MCEV. The £12 million MCEV-specific costs relate primarily to the difference between the actual tax relief expected to be received on UK pensions business of 6.5% and the approach applied in MCEV where a notional tax gross up of 26.5% is applied to the net of tax figure, resulting in a higher cost, gross of notional tax, under MCEV than under IFRS.

Other non-recurring items and non-operating variances of £66 million include a benefit of £23 million from the capital optimisation project and £35 million benefit from the impact on the UK business of the Budget in April 2011.This includes the impact on the value of in-force business of changing the corporation tax rate from 27% to 26% with effect from 1 April 2011 and changing the ultimate corporation tax rate effective from 1 April 2014 from 24% to 23%. A further £8 million of non-operating profit was generated through activities including a restructuring within Lombard.

MCEV balance sheet

Gross life and pensions MCEV £m	31 December 2011 Net worth	31 December 2011 VIF	31 December 2011 Total	31 December 2010 Total
UK	**2,456**	**2,885**	**5,341**	5,995
International	**69**	**502**	**571**	557
Lombard	**84**	**457**	**541**	577
FLG corporate	**564**	**–**	**564**	620
FLG other(i)	**91**	**–**	**91**	61
Gross FLG MCEV	**3,264**	**3,844**	**7,108**	7,810
FLG corporate – STICS	**(327)**	**–**	**(327)**	(393)
FLG corporate – lower tier 2 debt	**(632)**	**–**	**(632)**	(201)
FLG corporate – internal LT2 bond	**(200)**	**–**	**(200)**	(702)
Net FLG MCEV	**2,105**	**3,844**	**5,949**	6,514
RSL net assets (including internal LT2 bond)	**270**	**–**	**270**	901
RSL deferred consideration notes	**(423)**	**–**	**(423)**	(500)
RSL acquisition finance facility	**–**	**–**	**–**	(400)
Net Group MCEV	**1,952**	**3,844**	**5,796**	6,515
Shares in issue(ii)			**1,373,527,605**	1,443,985,079

(i) Includes IFA distribution and management services businesses including the pension asset of FPPS.

(ii) Adjusted to exclude 2,661,384 Resolution Limited shares held by subsidiaries at 31 December 2011 (31 December 2010: 8,579,292).

At 31 December 2011, net Group MCEV was £5,796 million (31 December 2010: £6,515 million) giving MCEV per share of £4.22 based on shares in issue at the balance sheet date, adjusted to exclude shares held by subsidiaries. MCEV per share at 31 December 2010 was £4.51 on a comparable basis.

At the end of the period the ratio of debt to gross Group MCEV (excluding internal debt) was 19.3% (31 December 2010: 18.7%), primarily reflecting the reduction in MCEV arising from the return of capital to shareholders. The ratio of debt to gross FLG MCEV was 16.3% (31 December 2010: 16.6%).

The Resolution holding companies' net worth, including internal and external debt, decreased by £154 million reflecting the payment of cash dividends of £226 million, the return of capital to shareholders of £250 million and corporate costs, offset in part by the receipt of a £350 million dividend from FLG.

The annualised FLG operating ROEV, after tax, for the year to 31 December 2011 is 6.5%. This represents steady progress when compared to the annualised 4.5% achieved at 30 June 2011 and 2010 baseline of 5.5%. The baseline operating ROEV includes the estimated full year impact of the AXA UK Life Business and BHA and assumes nil impact of operating variances and assumption changes. The operating ROEV at 31 December 2011 principally reflects the improvements made to the contribution of new business in the second half of the year as well as the benefit of year end assumption changes including the Diligenta outsourcing transaction. Low expected rates of return, particularly on shareholder assets, continue to provide a challenging environment in which to deliver improving returns.

UK operating review

In August 2011, the Group announced the creation of distinct 'Go to Market' and 'Heritage' UK business units, reflecting the Group's desire to improve the focus on both the profitable products and markets, and the existing in-force customer base The Go to Market businesses are Corporate Benefits, Protection, and Retirement Income. They represent scale markets where good margins are generally available and where the Group has strong market positions enabling access to those margins. The Heritage business manages products not being marketed actively and the dedicated Heritage management team is focused on retention, cash and capital. The Heritage business unit forms the bulk of the UK business by assets and in-force value.

UK AUM
£88 billion

UK Assets under management by business unit (% unless otherwise stated)	**%**
UK Heritage	81
Corporate Benefits	17
Retirement income	2
Total assets under management (£bn)	**£88bn**

UK VIF
£2.9 billion

UK VIF by business unit	**£bn**
UK Heritage	2.1
Corporate Benefits	0.6
Retirement income	0.1
Protection	0.1
Total Group VIF	**2.9**

Key financial metrics for the UK businesses are shown below, further details are included in the financial results section:

£m	**2011 Full year**	2011 Half year	2010 Full year
IFRS based operating profit before tax	**672**	364	187
MCEV operating profit before tax	**507**	184	306
Operating free surplus generation	**798**	317	157

Profitability of new business

	2011 Full year							
		Go to Market						
£m (unless otherwise stated)	**Heritage**	**Corporate Benefits**	**Protection**	**Retirement income**	**Total**	2011 Half year	2010 Full year baseline	2010 Full year
VNB	**(4)**	**15**	**16**	**32**	**59**	28	11	19
New business cash strain	**(54)**	**(51)**	**(77)**	**13**	**(169)**	(98)	(303)	(149)
IRR (%)	**6.0**	**8.3**	**5.5**	**22.0**	**7.7**	7.0	5.9	7.1
APE	**157**	**440**	**92**	**32**	**721**	372	677	472

The Group's new business strategy focuses on products and distribution channels in the UK market where the Group has a strong market position and the potential to access attractive returns. This strategy drives the focus of the Group's UK Go to Market business units whilst steps have been taken to exit or scale back sales in product lines where Friends Life will not be able to generate satisfactory returns (mainly individual pensions and investment bonds). The creation of a UK Heritage business unit will allow more active management of the products no longer actively marketed.

The activities undertaken to reduce costs through synergies and outsourcing as well as the transition of new business to the selected target platforms have significantly improved the contribution from new business. The contribution from UK new business was £59 million in the year and is significantly higher than the £11 million 2010 baseline.

A number of critical steps have now been taken as part of the drive to improve profitability to meet the Group's 2013 targets. The recognition of negative reserves in the acquired AXA UK Life Business and BHA protection books has significantly reduced new business cash strain. In addition, the focus on new business profitability across Friends Life has served to reduce cash strain down to £169 million in the year, representing a £134 million reduction on the £303 million 2010 baseline and demonstrates the significant progress made toward the target set out in early 2011 to reduce UK cash strain by £200 million.

A significant proportion of the Go to Market Protection and Corporate Benefits new business is now written on their respective target platforms. The profitability of the selected platforms is already close to or above the target 2013 returns with the target Corporate Benefits platform delivering 9.4% IRR (target: 10%) and the target Individual Protection platform delivering 20.0% IRR (target: 20%). The UK blended new business IRR has improved throughout the year with a progression from 5.9% in the 2010 full year baseline improving to 7.7% at the end of 2011. As a result, Friends Life remains confident of meeting the targeted product metrics by the end of 2013. The relevant sections below contain detailed commentary on the results for each component business within the UK operating segment.

Cost savings

Separation and Integration

The separation and integration programme is progressing well with the BHA acquisition absorbed without interruption in January 2011. The BHA separation was completed at the end of January 2012 with the exit from Bupa transitional service arrangements ("TSAs").

The joint separation plans and operational service provision between AXA and Friends Life continues to work well, with 59% of transitional service arrangements exited by the end of 2011. Further arrangements have been exited early in 2012 and the separation from AXA IT infrastructure, the most significant component of the Friends Life and AXA separation agenda, is well advanced.

There have been five site closures announced to date, being Coventry, Manchester Spring Gardens, Basingstoke, Preston and London Crosswall (the former offices of BHA, where employees moved across to Friends Life's One New Change offices at the end of January 2012).

The integration projects remain on plan with £45 million run-rate savings achieved by the end of 2011 with cumulative costs of £67 million incurred to date (£58 million in 2011). This progress represents an acceleration of synergy delivery primarily across Customer Services and IT, and has been delivered through closing legacy products to new business as well as the initial impacts of announced site exits. Cumulative separation project costs of £72 million (£57 million incurred in 2011) are also in line with plan at this stage of the project.

Diligenta

The Diligenta transaction complements the current outsourcing arrangements already in place with Capita. The service start date of this transformational transaction was 1 March 2012 when the remaining UK Heritage IT and Customer Services functions were outsourced thereby materially de-risking the future expense levels of the UK business together with significantly enhancing the level of synergies available. This certainty of future cost levels for a significant proportion of the business has been recognised in the operating results.

- IFRS based operating profit has benefited by £71 million in 2011 reflecting the release of maintenance expense reserves. Implementation costs of £84 million (which exclude costs relating to investment contracts in accordance with IFRS) have been reserved for and are presented within non-recurring costs. This results in a small net loss included in IFRS profit before tax of £13 million.
- In MCEV the recognition of the contractualised future expense savings has resulted in an uplift of £185 million in the MCEV operating result. In addition the certainty over lower ongoing maintenance expense levels has positively benefited VNB by £15 million taking the total benefit in MCEV operating profit to £200 million. Implementation costs of £124 million have been recognised as non-recurring costs in the 2011 result, reflecting the element attributable to the in-force book (for both insurance and investment contracts) at year end. As a result the outsourcing arrangement has a £76 million benefit to MCEV profit before tax.
- The Diligenta outsourcing benefits operating free surplus generation by £123 million as maintenance reserves are released, offset by £92 million costs of implementing the transaction. These impacts are in line with the MCEV result but are presented on a net of tax basis.

The Diligenta outsourcing is expected to generate annual cost savings of £60 million by 2015. Included in these expected savings is an amount of £29 million which relates to IT and Customer Service integration synergies that would otherwise have been delivered as part of the previously announced £112 million cost savings target. The contract, therefore, delivers additional expected cost savings of £31 million allowing the Group to increase the cost savings target to £143

million which will, in turn, drive improved profitability and lower new business strain. The previously committed element of the savings will still be delivered by the end of 2013 with the additional £31 million to be delivered by the end of 2015.

The total one-off costs of delivering the outsourcing arrangement are expected to be £250 million although £20 million of previously expected one-off costs will be avoided, resulting in net additional one-off cost of £230 million over 2011 to 2014. Combined with the £45 million of other run-rate savings delivered in 2011 and referred to above, a total of £105 million of savings has now been achieved or contractualised.

Expenses

The Group has made good progress in reducing the UK cost base during 2011. UK acquisition and maintenance expenses totalled £441 million, which includes £14 million of temporary cost, primarily VAT on transitional service arrangements as part of the separation of the AXA UK Life Business from AXA UK, and £7 million of expenses incurred by the GOF and TIP businesses prior to their transfer back to AXA UK. Including a full year impact of WLUK expenses would increase 2011 underlying UK expenses from £420 million to £446 million. This represents a reduction on 2010 UK baseline expenses of £476 million on a comparable basis, including the effect of inflation during 2011. The full effect of the run-rate savings set out above will be realised in 2012.

Cash delivery and capital optimisation

The Group's strategy to improve cash delivery is materially influenced by the actions taken within the UK business. The UK delivered operating free surplus of £798 million in the year to 31 December 2011 reflecting both the improved trading performance, as the businesses integrate, the Diligenta outsourcing transaction and a number of other one-off items.

Capital optimisation

The recognition of negative reserves has materially reduced the cash strain of the Protection business and the business as a whole. The progress and control of new business strain is also a key lever in the Group's drive to improve cash generation. Further operational improvements will be delivered as the business focuses new business on the highly efficient Protection and Corporate Benefits strategic platforms whilst the outsourcing arrangement with Diligenta has enabled the UK Heritage business to variabilise its cost base, de-risking the inevitably detrimental effect of a fixed cost base on incremental business written on products that are no longer marketed.

The impact of adopting certain elements of PS06/14 guidance in the acquired BHA and AXA UK Life Business significantly benefited the 2011 IFRS based operating profit. The recognition of negative reserves, and resulting reduced capital requirements on protection products, has effectively accelerated the surplus generated on these products although lower in-force surplus releases are subsequently expected in future as a result. In addition, as the profit profile of these products has changed, the corresponding amortisation of deferred acquisition costs ("DAC") has likewise been accelerated. The resulting one-off benefit to IFRS based operating profit is £221 million in the year, with a corresponding benefit of £12 million to new business strain and a reduction of £40 million in the emerging in-force surplus in 2011. This reduction in in-force surplus is expected to reduce to £25 million to £30 million in 2012 based on current expectations of in-force run-off. The overall net impact on IFRS based operating profit for 2011 (excluding improvements in new business strain) is £181 million. IFRS based profit after tax remains largely unaffected, despite the increased one-off benefit as the earlier recognition of surplus is offset by the accelerated run-off of acquired value of in-force business.

The MCEV operating profit is not significantly affected by the recognition of negative reserves as the benefit realised is largely offset by the accelerated run-off of the value of in-force. A free surplus benefit of £161 million has been recognised with this enhancing operating free surplus generation.

Further capital efficiencies have been delivered in the second half of 2011 through the completion of a number of Part VII transfers. These have successfully transferred business from a number of smaller life companies into FLL. The completion of these transfers has reduced aggregate Pillar 1 capital requirements by around £113 million and released £181 million of surplus capital. Further Part VII transfers are planned for 2012 with these aiming to reduce the number of UK life companies from the current five down to two by the end of 2013.

Financial results

UK IFRS based operating profit

£m	**2011 Full year**(i)	2011 Half year(ii)	2010 Full year(iii)
New business strain	**(112)**	(66)	(89)
In-force surplus	**402**	214	280
Long-term investment return	**(5)**	4	30
Principal reserving changes and one-off items	**416**	222	(15)
Development costs	**(28)**	(10)	(21)
Other income and charges	**(1)**	–	2
IFRS based operating profit before tax	**672**	364	187

(i) 2011 full year results comprise 12 months results for Friends Provident and the AXA UK Life Business, 11 months for BHA and two months for WLUK.

(ii) 2011 half year results comprise six months results for Friends Provident, six months for the AXA UK Life Business and five months for BHA.

(iii) 2010 full year results include 12 months results for Friends Provident and four months for the AXA UK Life Business.

In the year to 31 December 2011 the UK segment delivered IFRS based operating profit before tax of £672 million (31 December 2010: £187 million), representing an increase of £485 million on the prior year. The increase reflects the greater scale of the UK business, in particular a full 12 months of operating profit from the AXA UK Life Business, and improved performance including the recognition of management actions and other reserving benefits.

Despite these operating improvements, on an underlying basis, after removing principal reserving changes and one-off items, the full year profit of £256 million is lower than the annualised half year result of £284 million. This reduction principally reflects the impact of adverse economic conditions on in-force surplus generation, partially offset by reduced new business strain as the cost reductions and transition to target platforms take effect.

UK new business strain and in-force surplus

Details of new business strain and in-force surplus for the UK business are set out below.

Reconciliation of new business cash strain to IFRS new business strain

£m	**2011 Full year**	2011 Half year	2010 Full year
Total UK new business cash strain	**(169)**	(98)	(149)
DAC/DFF adjustments	**60**	33	59
Other IFRS adjustments	**(3)**	(1)	1
Total UK IFRS new business strain	**(112)**	(66)	(89)

New business cash strain has benefitted from a number of factors in the year with good progress being made towards the target £200 million reduction in UK new business cash strain. IFRS new business strain of £112 million reflects some of these benefits with the principal driver of improvement, in the second half of the year, being a reduction in costs as Protection new business is transferred to the target platform.

The implementation of PS06/14 reserving changes and the recognition of negative reserves across the UK Protection portfolio means that DAC is no longer recognised on this business. This change in treatment offsets the reserving benefits which are apparent in cash strain and as a consequence the benefit to IFRS new business strain is reduced. DAC continues to be recognised on pensions and investments business and has moved in line with expectations given the current product mix and levels of new business.

Reconciliation of in-force cash surplus to IFRS in-force surplus

£m	**2011 Full year**	2011 Half year	2010 Full year
Total UK cash surplus	**354**	207	268
DAC/DFF adjustments	**(7)**	(1)	8
Other IFRS adjustments	**55**	8	4
Total UK IFRS surplus	**402**	214	280

UK cash surplus generated in the year of £354 million (30 June 2011: £207 million) reflects the volatility in the macroeconomic environment in particular lower average equity markets and lower risk free rates. The lower level of

equity markets resulted in a reduction in fees generated on unit-linked funds in the year as well as leading to an increase in reserves to reflect the impact of lower annual management charges in the future. In addition, the fall in risk free rates has resulted in an increased cost of product guarantees, whilst the basis changes to income protection morbidity removed the benefit of the half year positive variance from the full year surplus.

The IFRS in-force surplus of £402 million (30 June 2011: £214 million) reflects the negative economic impacts experienced during the period, partially offset by the reversal of the increased reserving level referred to above, which is not allowable on the IFRS basis. This is reflected in the proportionally higher size of other IFRS adjustments to the change in cash surplus compared to previous periods.

The £7 million net amortisation of DAC and deferred front end fees ("DFF") reflects the relatively small value of these costs that has been capitalised in the post-acquisition period. On the acquisition of the business, the existing capitalised deferred acquisition costs and deferred front end fees were eliminated and recognised within the acquired value of in-force ("AVIF"). In the post-acquisition period, as new business is written, the capitalisation of acquisition expenses and front end fees resumed and hence the amortisation charged against in-force surplus will increase each year for pensions and investments business.

Longer-term investment return

£m	**2011 Full year**	2011 Half year	2010 Full year
Longer-term return on life and pension shareholder funds – excluding debt	**70**	35	76
Longer-term return on life and pension shareholder funds – debt	**(75)**	(31)	(46)
Total	**(5)**	4	30

Longer-term investment return has fallen in the second half of 2011 with a net loss of £5 million in the year driven by an increase in financing costs. This primarily reflects the increased debt held in the UK business with £500 million transferred from Friends Life holding companies in April 2011 and a further £200 million transferred in December 2011.

Principal reserving changes and one-off items

Principal reserving changes and one-off items comprise a £221 million one-off benefit in respect of PS06/14, £71 million release of expense reserves, including the benefit of the savings secured through the Diligenta outsourcing, and a further £124 million of assumption changes primarily in respect of favourable mortality and morbidity experience and some positive persistency experience in protection.

UK operating expenses

£m	**2011 Full year**	2011 Half year	2010 Full year baseline(i)	2010 Full year
Acquisition	**178**	89	220	130
Maintenance	**263**	130	256	140
	441	219	476	270
Development	**28**	10	23	21
Total	**469**	229	499	291

(i) 2010 full year baseline includes an estimate of 12 months AXA UK Life Business, BHA and WLUK operating expenses.

UK operating expenses, which exclude commission payments and non-recurring costs totalled £469 million in the year with acquisition and maintenance expenses amounting to £441 million. Acquisition and maintenance expenses remain the focus for the UK business in the drive to reduce expenses by £143 million (£112 million by the end of 2013) from a 2010 baseline of £476 million. 2011 expenses include two months of WLUK operating expenses whilst the baseline includes a full 12 months charge of £31 million.

Actions to reduce operating expenses have been progressing well with £45 million of run-rate savings being made to date. However given the timing of these savings only a £27 million benefit is reflected in the 2011 expense base. These include the implementation of the revised strategy announced in February 2011 resulting in streamlined UK sales and marketing functions and synergies from reorganisation of operations prior to outsourcing services to Diligenta. Offsetting this reduction are a number of temporary increases, including VAT on services provided by AXA UK and short-term increases in Finance and Governance functions to strengthen capabilities during integration, which will not recur beyond 2013 as the integration of the UK businesses completes.

Development costs of £28 million mainly comprise £7 million of spend on the new Corporate platform, £6 million investment into the Retirement Income strategy and £4 million in the development of auto-enrolment capabilities

including the development of an auto-enrolment hub aimed at reducing the legislative burden on clients. Other development spend includes investment in data modelling for the Protection business as well as other smaller development projects.

UK other income and charges

Other UK IFRS based operating loss of £1 million includes the £2 million trading profit generated by Sesame Bankhall Group ("SBG"). SBG is the UK's largest distributor of retail financial advice and operates three market leading brands. Sesame is the leading appointed representative network, Bankhall is the largest support service provider for directly regulated IFAs and PMS is the biggest mortgage club for intermediaries. In 2011 SBG retained its position as the UK's largest distributor of mortgages through intermediaries, with over £26.1 billion of mortgage applications (an increase of £1.9 billion on 2010). This represents a 13.8% share of the entire UK mortgage market (2010: 13.3%).

UK operating segment – MCEV operating profit

£m	**2011 Full year**[i]	2011 Half year[ii]	2010 Full year[iii]
Value of new business	**59**	28	19
Expected existing business contribution	**330**	167	210
Operating experience variances	**(9)**	(7)	37
Operating assumption changes	**147**	–	(41)
Other operating variances	**9**	6	96
Development costs	**(28)**	(10)	(21)
Life and pensions covered business operating profit before tax	**508**	184	300
Other income and charges	**(1)**	–	6
Operating profit before tax	**507**	184	306

(i) 2011 full year results comprise 12 months results for Friends Provident and the AXA UK Life Business, 11 months for BHA and two months for WLUK.

(ii) 2011 half year results comprise six months results for Friends Provident, six months for the AXA UK Life Business and five months for BHA.

(iii) 2010 full year results include 12 months results for Friends Provident and four months for the AXA UK Life Business.

The UK MCEV Operating Profit before tax increased to £507 million (2010: £306 million), including a full year's contribution from the AXA UK Life Business and contribution from BHA from 31 January 2011.

Value of new business

Value of new business has increased significantly from 2010, reflecting the inclusion of a full year's sales of the AXA UK Life Business, with improved profitability, and the inclusion of BHA sales from January 2011. Profitability has been improved through the realisation of cost synergies, transition of new business to the selected target platforms and the impact of the Diligenta transaction.

Expected existing business contribution

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

The expected return on the value of in-force has increased following the acquisition of the AXA UK Life Business (including WLUK) and BHA. However, the longer term rates of return applied to equities and properties have fallen since 2010. The longer term return for cash and government bonds is based on the one-year risk free rate at 31 December 2010 of 1.14%.

Expected return comprises two components:

- expected earnings on all opening assets assuming a reference rate based on the one-year swap return set at the beginning of the period, plus an illiquidity premium which is applied to annuity business only; and
- additional expected earnings consistent with management's long-term expectation of the asset returns on the business.

For assets such as cash and government bonds, management's expectation has been based on the one-year risk free rate, by reference to the swap yield curve. The rate applied for the 2011 results is based on the one-year risk free rate at 31 December 2010 of 1.14%, which is materially below the longer term rate that could be derived from the 10 year swap rate at 31 December 2010 of 3.70%.

	Rates of return	
	2011 **%**	2010 %
Reference rate (non annuity business)	**1.14**	1.01
Reference rate (annuity business)	**1.89**	1.76
Best estimate returns:		
Corporate bonds	**2.45**	2.98
Cash/Government Bonds	**1.14**	1.01
Equity	**6.70**	7.30
Property	**5.70**	6.30

Operating experience variances
Total operating experience variances in the UK amounted to a £9 million charge (31 December 2010: £37 million benefit) primarily reflecting adverse experience variances in respect of persistency, offset by favourable mortality and morbidity experience. Operating experience variances also included beneficial tax variances and adverse expense experience unrelated to the ongoing cost base.

Operating assumption changes
Operating assumption changes amount to a positive £147 million in the year (2010: negative £41 million) and comprise:

- £185 million benefit from the impact on in-force business of the outsourcing deal with Diligenta. The arrangement with Diligenta has contractualised future expense savings with this benefit reflected in the MCEV maintenance expense assumptions;
- £73 million charge resulting from strengthened persistency assumptions partially offset by the impact of favourable assumption changes for morbidity (for which more details are set out below);
- £29 million benefit from aligning mortality assumptions for protection and annuity business to reflect recent experience in these products; and
- £6 million benefit from other minor changes.

In the Group's third quarter results it was highlighted that experience in relation to persistency and morbidity was being investigated. Guidance was given amounting to a net impact of £40-£70 million on the year end MCEV operating results. These investigations have since concluded, as part of the annual basis review, and resulted in a charge of £73 million recognised in the MCEV operating result. The £73 million impact comprises the following:

- £73 million adverse impact relating to persistency across certain group and individual pension books and lapse experience in the Group's investment bond portfolio;
- £82 million provision for RDR as the Group expects market conditions in advance of RDR implementation to drive an increase in short term persistency experience reflecting the impact of continued 'churn' of new business by the commission-paying market; and
- £82 million benefit in respect of income protection morbidity assumptions, where recent experience supports a change to previous assumptions.

Other operating variances
Other operating variances of £9 million positive (2010: £96 million) primarily reflects an increase in reinsurance retention levels.

In 2010 other operating variances included one-off benefits from a change in timing of modelled tax relief on group pensions business and a review of the tax asset relating to the re-attributed inherited estate of the AXA UK Life Business.

UK Heritage

Strategic implementation

The UK Heritage business unit is fundamentally different to the Go to Market propositions, with greater in-force scale, a large set of closed products, complex legacy systems and over four million customers. Consequently the business unit (which was created during the course of 2011) is focused on different value drivers. The three key value drivers for the Heritage business are:

- Management of an efficient cost base in line with business scale
- Minimisation of capital required for the business
- Retention of in-force business

Good progress is being made in establishing a dedicated management team focused on the Heritage business, consistent with the aim to be the UK's leading legacy business manager, with the knowledge and expertise to maximise the value created from these books. This team is led by Friends Life's Chief Commercial Officer, Evelyn Bourke.

The Heritage business has set out its plans to drive value with the following strategic themes being the starting point.

Outsourcing

The Heritage business, absent further portfolio acquisitions, is not a self perpetuating business. As a result, management of the underlying cost base is critical to cash and profitability. The significant policy administration and IT outsourcing deal with Diligenta which commenced on 1 March 2012, together with the existing outsource arrangement with Capita, mean that materially all of Heritage policy administration is outsourced. The resulting certainty around administration costs reduces the risk of expense assumptions in the embedded value coming under pressure, as the cost base is now more variable and will decrease as the business runs off.

The outsourcing transaction also contractually secures and extends the synergies arising from the combination of the Friends Provident and AXA UK Life Business.

Building an in-house asset manager

Building in-house asset management capability supports the aim of running to an efficient cost base with the expectation that assets can be managed more efficiently internally in the longer term. Friends Life Investments ("FLI") is due to launch in mid 2012, with the in-house capability presenting a significant opportunity to deliver more value from the existing book through optimised investment strategies at lower cost.

As announced in November 2011, the Group has £61 billion of externally managed assets which will reach the end of their contractual terms within the next nine years and are available for recapture. The potential fee recapture associated with these assets is in the order of £100 million per annum including VAT. In Phase 1, FLI will focus on the recapture of the core non-linked and shareholder assets of the Group. These assets are principally fixed income in nature. It is expected that the Group could recapture fees of the order of £10 million per annum (including VAT) from the £12 billion assets targeted in Phase 1. The Group has currently served notice on £8 billion of assets with £6 billion expected to transfer in the middle of the year. Phase 2 principally relates to fixed income assets currently managed in the Group's with-profit and unit-linked funds.

The Group already has significant expertise in fixed income and this was augmented with the recruitment of an experienced fixed interest team in January 2012 .

To assist in minimising the additional headcount, the middle and back office support functions will be wholly outsourced. This will provide future scalability and flexibility whilst assuring cost certainty.

Capital Optimisation Programme

There is a large capital optimisation programme underway to simplify the legal structure of the business and remove capital inefficiencies. Friends Life has five UK life companies within the group and the ultimate result of the programme will be to reduce this to two, broadly aligned to the Heritage business and Go to Market business lines. The Group expects to reach this end state during 2013.

With-profits fund management

A programme to develop and implement a uniform risk management framework for the six with-profits funds within the Heritage business is currently underway. The result will be a consistent plan of management actions across the with-profits funds to mitigate the risk of volatile returns for shareholders whilst ensuring fair treatment of customers.

Customer Value Management
Friends Life aims to actively engage with its customers to minimise avoidable policy lapses. Initiatives in place include both pro-active and reactive customer communication, aimed at retaining valuable customers within their existing product, or within the group as a post-retirement annuitant.

Fund rationalisation
The Heritage business includes policies invested in a very wide universe of investment funds, as a legacy of the businesses that wrote the original policies. There are opportunities to increase efficiency and reduce risk over the medium term by significantly rationalising the number of funds and this process will begin during 2012.

Scale

Value of in-force business
The UK Heritage business represents a significant proportion of the Group's future in-force value. This is distributed across a range of products within the following broad categories.

	£bn	%
With-profits	**0.5**	21
Pensions	**0.5**	21
Investments	**0.7**	34
Protection	**0.3**	16
Annuities	**0.1**	7
Other	**–**	1
Total UK Heritage VIF 31 December 2011	**2.1**	100

By product line, the primary drivers of future profit are expected to be:

- Unit-linked Pensions and Investments: the value of charges (mostly annual management charges) less costs of administration and any renewal or trail commission. Profits are therefore sensitive to the levels of investment markets and, to a lesser extent, lapse and expense experience. Relative to other product lines, these policies require little regulatory capital on both Pillar 1 and Pillar 2 bases.
- Annuities: the value of the investment margins expected on the assets and the release of reserving margins, in particular in relation to longevity. Profits are affected by changes in long-term longevity assumptions and the return achieved on the assets. Relative to other product lines, these policies require significant regulatory capital on both Pillar 1 and Pillar 2 bases.
- Protection: the value of the margins assumed in the premiums less the best estimate expected costs of claims, expenses and renewal commission. Relative to other product lines, these policies require modest amounts of regulatory capital on a Pillar 2 basis but more significant amounts on a Pillar 1 basis.
- With-profits: typically the value of the shareholders' 10% share of the cost of bonus on 90/10 with-profits business and the value of charges less expenses on other with-profits business. Relative to other products lines, these policies require significant regulatory capital on both bases.

UK Heritage unit-linked assets under management
Unit-linked funds under management are a significant source of future revenue in the form of annual management charges less investment management fees and trail commission. In 2011, the Group has seen net outflows of both unit-linked pensions and investment business. Unit-linked pensions outflows in the year have been driven by individual pensions business whilst unit-linked investment business, primarily single premium bonds, reflects the maturing of this book with new business having been modest for some years. The Group no longer actively markets any bond products in line with the Group's announcement to withdraw from the individual bond market. Whilst net outflows are significant, the UK Heritage business expects to be able to manage these books of business within the current assumptions.

Heritage unit-linked – funds under management

Pensions – funds under management	**£bn**
31 December 2010	**18.6**
Acquisition of WLUK	2.4
Inflows	0.7
Outflows	(2.7)
Net investment return	(0.1)
31 December 2011	**18.9**

Investments – fund under management	**£bn**
31 December 2010	**17.1**
Acquisition of WLUK	0.5
Inflows	0.5
Outflows	(2.1)
Net investment return	0.3
31 December 2011	**16.3**

At 31 December 2010, total unit-linked pensions funds under management amounted to £30.6 billion. Following the creation of the UK Heritage business unit, £12.0 billion of these unit-linked pensions funds are now managed in the Corporate Benefits business unit.

UK Heritage profit emergence
During 2011 approximately £0.3 billion of VIF has monetised. In the five-year period from 2012, around £1.0 billion of UK Heritage VIF is also expected to monetise, of which unit-linked business accounts for around £0.5 billion.

The table illustrates the VIF expected to emerge in future five-year periods.

VIF run-off of Heritage business	**£bn**
Year 1–5	1.0
Year 6–10	0.5
Year 11–15	0.3
Year 16–20	0.2
Year 21+	0.1

Key drivers
Cash generation from the in-force business is sensitive to a number of key drivers, including:

- investment performance of the assets, in particular on unit-linked funds and assets held in respect of shareholder backed pension annuities;
- lapse experience, which is a function of client behaviour in response to future uncertainties around the economic outlook and their particular situations, adviser behaviour and changes in UK fiscal and regulatory regimes;
- future claims experience on the Group’s protection and annuity business which is a function of underlying mortality and morbidity trends, risk selection and claims management; and
- capital requirements as specified by the regulatory regime (e.g. Solvency II).

During 2011, cash generation was affected by the accelerated emergence of surplus on protection business through the adoption of negative reserves and operating cost savings in respect of servicing in-force business.

New business

£m (unless otherwise stated)	Heritage pensions	Heritage protection	Heritage investments	Heritage WP annuities	2011 Full year	2011 Half year
Value of new business	**(17)**	**11**	**3**	**(1)**	**(4)**	8
New business cash strain	**(31)**	**(2)**	**(23)**	**2**	**(54)**	(30)
IRR	**2.2%**	**>25%**	**7.6%**	**18.8%**	**6.0%**	6.8
APE	**108**	**7**	**34**	**8**	**157**	87

The Heritage business unit specifically focuses on those products no longer actively marketed. It does not actively drive new business, but the book delivers a significant level of ongoing incremental business written across all product types.

The Group expects new business to reduce in the medium term. In particular new business strain relating to investments business is expected to reduce in future years due to the closure of bond products to new business during 2011.

The contribution from UK Heritage new business was a loss of £4 million in the full year results with this representing an adverse movement from a first half contribution of £8 million. This change is due to a number of factors:

- DWP rebate business contributed £7 million to pensions VNB in the first half of 2011, with this benefit not repeated in the second half of the year;
- as previously announced the Group does not expect to be able to generate the required returns on the investment proposition. The closure of some investment product lines in the second half of the year has therefore reduced volumes with a corresponding reduction in contribution; and
- strengthening of lapse assumptions on bonds and individual pensions as a result of the year end investigation of experience.

Go to Market: Corporate Benefits

The Go to Market Corporate Benefits business is being built on the efficient and scalable New Generation Pension ("NGP") platform and currently administers £15.4 billion of assets on behalf of over 15,000 corporate clients. In addition to the current products focused around both trust and contract-based pensions solutions, the launch of the corporate platform in January 2012, with schemes expected to be taken on in the second quarter, will extend the reach of the business into the wider workplace savings market providing complete savings solutions for customers.

The proposition remains highly regarded in the market, retaining first place in the Greenwich 2012 DC survey of leading employee benefits consultants ("EBCs"), and also being rated first in the 2011 NMG Corporate Wealth Programme.

Market environment

Friends Life expects the corporate benefits market to grow strongly and to benefit from the ongoing structural shift from defined benefit to defined contribution schemes, auto-enrolment and demographic changes. However, although growth prospects remain good, the traditional UK industry model is structurally unattractive, delivering poor shareholder returns in a marketplace historically characterised by intense price driven competition, heavy intermediation and commission bias.

The current competitive intensity and "land grab" in advance of RDR is expected to subside post 2013 as the basis of competition switches from price and commission to a quality of proposition. As a result, the number of market competitors is expected to reduce as the competitive intensity takes its toll, particularly with providers who lack scale and who are unlikely to benefit from the uplift in volumes expected from auto-enrolment within the back book.

Strategy implementation

Friends Life expects to compete in this environment and significant progress has been made in 2011 with the execution of the Go to Market strategy. The transition to a lower cost platform is reflected in improving business performance whilst new business momentum and pipeline into 2012 are evident.

Returns in the Corporate Benefits business have historically been low and the Group is focused on improving these through the following four key levers:

Retain and develop existing schemes

Organic growth of the Corporate book will be driven through a focus on key clients and distributors, supported by a strong relationship management function already within the business. Friends Life expects to enhance this client growth with additional structural benefits from consolidation of schemes and closure of defined benefit plans, in addition to the

Group's success in the Enhanced Transfer Value market. Worksite marketing and member education activities will drive further growth. This is already evidenced in the strong levels of new business generated in 2011 against a difficult economic backdrop.

Selectively take on new schemes

The selective acquisition of new schemes will be driven by a limited number of key distribution relationships in Friends Life's target market. Within this, the focus is on mid to large schemes where Friends Life expects to be able to achieve its target returns and most efficiently deploy the new business team. The launch of the new corporate platform in 2012 will add a further strong proposition to Corporate Benefits market leading offering.

Reduce costs

Friends Life remains focused on reducing costs across the organisation. Having already restructured the distribution function, work continues on building a lean front-office business. In addition, the migration of assets from the Embassy platform on to the market leading NGP platform will reduce operational costs further. The outsourcing deal with Diligenta provides further cost savings and certainty as the market enters a period of profound change.

Position Friends Life for auto-enrolment and RDR

As the corporate market continues to develop, the Friends Life offering is moving in line with it. Friends Life recently announced a link with Tata Consultancy Services to develop an auto-enrolment hub to reduce the legislative burden on clients. This will further drive retention and growth in the existing book and the acquisition of new clients whilst taking advantage of the opportunity presented by auto-enrolment. The launch of the new corporate platform broadens the proposition from a retirement savings business into a wider workplace marketing business. Additionally, the removal of commission bias within the market with the advent of RDR in 2013 will enable the Corporate Benefits business to form relationships across the whole of the distribution landscape with minimal change to the offering.

The implementation of these elements will enhance new business IRRs and support the delivery of the 2013 new business financial targets set out early in 2011.

Financial performance

Corporate Benefits all platforms **£m (unless otherwise stated)**	2013 Full year target	**2011** **Full year**	2011 Half year
VNB	25	**15**	5
New business cash strain	(75)	**(51)**	(35)
IRR	10%+	**8.3%**	6.6%
APE	n/a	**440**	219

The contribution from Corporate Benefits new business totalled £15 million in the year and shows a strong financial performance in the second half reflecting both improved mix of business and the delivery of synergy savings.

Overall returns have been enhanced by better than expected results on the acquired AXA UK Life Business platforms, primarily driven from cost savings. These business lines are now no longer loss making and will be migrated onto the target platform in 2012, realising further efficiencies and improvements in performance.

The profitability of business written on the target NGP platform remains robust, delivering £15 million of VNB and an IRR of 9.4%. Performance in the first half of the year included £3 million VNB in respect of DWP rebates which are weighted towards the first half of the year while the full year result takes account of the revised persistency assumptions, and the benefit of the Diligenta outsourcing transaction.

2011 saw strong overall volumes with APE of £440 million principally driven by increments and new entrants to existing schemes. Market concerns around the merger with the acquired AXA UK Life Business and a restructure of the sales team in January 2011 impacted adversely on new scheme wins, although performance picked up strongly throughout the year, with a good pipeline of new business in place for 2012.

Corporate Benefits target platform **£m (unless otherwise stated)**	**2011** **Full year**	2011 Half year
VNB	**15**	11
New business cash strain	**(38)**	(23)
IRR	**9.4%**	8.8%
APE	**356**	176

This platform, which forms the core of the Go to Market business is expected to achieve the 10% target return during 2012 as the cost synergies and migration of business onto the more efficient NGP platform take effect.

Corporate Benefits funds under management

Following the changes made to the Friends Life group management structure in 2011, the Corporate Benefits business manages a total of £15.4 billion customer assets including £2.5 billion of assets in respect of the acquired WLUK business administered on the Embassy system. These Embassy assets are due to migrate onto the NGP platform in 2012.

Corporate Benefits – funds under management

	£bn
31 December 2010	**12.3**
Acquisition of WLUK	2.5
Inflows	2.3
Outflows	(1.3)
Net investment return	(0.4)
31 December 2011	**15.4**

(i) WLUK assets included from 7 November 2011 with movements included for the final two months of 2011

(ii) Corporate Benefits assets under management include £0.3 billion of unitised with-profits business managed on the NGP platform

Despite poor equity market conditions group pensions assets for the Corporate Benefits business now stand at £15.4 billion with net inflows in the year of £1.0 billion. Of this, net outflows of £0.2 billion related to the closed individual pension lines on the NGP platform, with the core Corporate Benefits business generating net inflows of £1.2 billion. This increase in assets, combined with the reduction in the cost base drives strong underlying business performance. Although overall assets have grown, there have also been significant outflows of business as a result of scheme losses. These have primarily been lost to commission paying providers and this level of outflow is not expected to continue after the RDR comes into effect. This recent experience has been recognised within the MCEV operating result with an additional provision of £82 million set up to allow for further short term adverse persistency impacts on VIF.

The outlook for 2012 is positive with a strong new business pipeline and the start of auto-enrolment for Friends Life's larger customers in the second half of the year. The development of an auto-enrolment proposition will support employers and aid further growth and client retention. The continued development towards these market changes is progressing well and the Group remains confident of achieving the 2013 financial targets.

Go to Market: Protection

The Friends Life Protection business brings together the Friends Provident individual and group protection propositions with those acquired from the AXA UK Life Business and BHA. The Group now has comprehensive market coverage with the proposition operating across a wide range of distribution channels.

The individual protection business provides life, critical illness and income protection cover to individuals and businesses. These products are distributed through IFAs, banks, estate agents and leading brands such as Tesco, Virgin and the AA.

The group protection business provides group income protection, group life and group critical illness products, which are distributed through EBCs and IFAs. In July 2011 the acquired propositions were integrated and all new business is now written on the strategic platform.

Market environment

The UK protection market is mature and concentrated, and has remained stable over the last five years generating in force premiums in the region of £6.6 billion per annum. The developments made to date have placed Friends Life well into the top five market participants with the Group having significant scale in this market. Despite this position of relative strength the focus on profitability remains paramount with a selective approach to those channels and products which offer acceptable levels of return.

The protection market will be affected by a number of significant regulatory changes over the next two years including the RDR, gender neutral pricing, life tax changes and Solvency II.

Protection products are out of scope for the RDR, and the industry consensus view expects the market to experience a short term 'bounce' as intermediaries manage their cash flow and transition their businesses. Friends Life supports this view and, supported by the breadth of the Group's distribution footprint, is well placed to benefit.

Changes regarding gender neutral pricing and life tax will have an effect on the price of protection, with this impact varying by provider. Friends Life operates a value based proposition focused on product quality, as opposed to commoditised volume players focused on price, and expects to be less sensitive to any general price increase in the market, allowing the business to communicate clearly and confidently to its target partners.

The impact of these changes has been factored into the Protection strategy from the start and the Group believes the protection business and the wider Friends Life protection proposition are well positioned to benefit from these changes.

Strategy implementation
The acquisition of BHA has transformed the Group's protection product range and platform options. The implementation of the Go to Market Protection strategy is progressing well and focuses on the proposition's following key competitive advantages.

Customer solutions
The combination of the three acquired protection businesses has enhanced the Group's range of protection products with the business retaining the best elements of these. Building on this strength the Go to Market protection business is able to offer a higher value customer offering, which enables the products to be priced at a premium. This includes:

- Market leading income protection and critical illness cover, with a breadth of illnesses covered;
- A flexible exemption based approach to underwriting, with pricing for exemptions and other innovative underwriting features such as tele-underwriting; and
- Value added benefits such as Bupa HealthLine and Best Doctors.

Operational excellence
The strategy announced earlier in 2011 confirmed the selection of the low cost and efficient BHA platform, with good progress made to date in consolidating these platforms in the market. This development enabled the integration of the Group Protection proposition in July 2011 and culminated in the launch of the Friends Life Protect+ menu proposition in October 2011 for the Individual business. This has brought together the best features of the three historic intermediary propositions. The Protection business now has market leading individual critical illness and income protection offerings, both with a Defaqto five star rating, whilst loss making former Friends Provident and AXA UK Life Business intermediary products have been closed to new business. The transition to the Group's target end state will continue into 2012 with the controlled distribution partners due to migrate to the strategic platforms over the course of the year.

Selective distribution
The business continues to build on the existing distribution partnerships whilst managing the performance of existing relationships. The active management of these relationships across the breadth of different channels de-risks the impact of changes to distribution as the market responds to the Retail Distribution Review.

Supporting this, the implementation of a new tripartite partnership between Friends Life, Sesame Bankhall Group and Connells, one of the UK's largest estate agencies and property services groups, has come into force in March 2012. The arrangement encompasses a new single tie arrangement between Friends Life and Connells as well as a long-term partnership between Sesame Bankhall Group and Connells.

Financial expertise
The business has strong technical expertise in pricing, reinsurance and claims management enabling us to deliver good profitability and efficient use of capital. Leverage of this expertise will drive strategic change and deliver improved profitability in the targeted time scales.

Regulatory requirements, such as gender neutral pricing will cause changes in pricing for Individual Protection. There is a strategic focus on analysing business mix and price points in order to optimise business performance and profitability in the market during and after the changes. Reinsurance negotiations have already given increased margin flexibility and work with reinsurers continues in order to consider other innovations. Claims management is consolidated with technical and investigative expertise that works across the Individual and Group business. This expertise enables efficient claims management as well as innovations such as early intervention and early rehabilitation for Group Protection, giving both product differentiation and cost benefits.

Financial performance

Protection all platforms £m (unless otherwise stated)	2013 Full year target	**2011 Full year**	2011 Half year
Value of new business	80	**16**	(2)
New business cash strain	(30)	**(77)**	(43)
IRR	20%	**5.5%**	3.9%
APE	n/a	**92**	50

Contribution from new business has improved significantly in the year with a total of £18 million contributed in the second half of 2011 versus a loss of £2 million in the first half of the year. The change in focus, towards the higher value critical illness and income protection products as well as the migration to the lower cost strategic platform have been the key drivers of this improvement. In addition new business contribution has also benefited from the changes made to assumptions on persistency and mortality reflecting recent favourable experience. These assumption changes are principally reflected in the business lines not yet transferred to the target platform with this level of performance expected to continue.

The new business strain continues to be reduced with strain in the second half of £34 million down on the £43 million recorded in the period to 30 June. The changes made to allow credit for negative reserves materially improved new business strain compared to 2010. New business strain is expected to continue to decrease in 2012 as profitability improves towards target.

Protection IRR has improved to 5.5% (30 June 2011: 3.9%) with the improvement in profitability expected to continue in 2012 as a full year impact from the changes made in the second half of 2011 and the migration of the controlled partners to the strategic platform during 2012 take effect.

Protection volumes in the second half of 2011 amount to £42 million APE (30 June 2011: £50 million) as the increase in pricing, launch of the "Protect+" proposition and targeted focus on critical illness and income protection marginally reduced volumes.

Individual protection target platform £m (unless otherwise stated)	**2011 Full year**	2011 Half year
VNB	**22**	9
New business cash strain	**(8)**	(2)
IRR	**20.0%**	>25.0%
APE	**22**	10

The contribution generated from the individual protection target platform has continued to improve over 2011 with £22 million VNB generated on £22 million APE in the year. Further improvement in new business contribution is expected as volumes continue to migrate to the target platform. Profitability remains above the targeted level of 20% in the period although the transition to the target platform and changes in product mix may result in some fluctuation from period to period.

Go to Market: Retirement Income

The Group has identified Retirement Income as a key strategic Go to Market business unit with this founded on the acquired elements of the Friends Provident and AXA UK Life Business. The Group expects the retirement income market to provide an excellent opportunity for the business to grow in what continues to be a growing and profitable market segment.

Historically the Group has generated sales from internal vestings with the vast majority of these reflecting the retirement of Friends Life pension policyholders. The Group's strategy for the annuity market was reviewed in 2011 and will target the creation of a more sophisticated proposition to vesting policyholders alongside the development of capabilities to support participation in the open market.

Market environment

The annuity market continues to show underlying growth with 2011 market figures expected to show growth on 2010. Expectations for future growth in this market remain strongly positive, driven by the approaching retirement of the baby boomer generation as well as the continued movement from defined benefit to defined contribution pension products in the accumulation phase.

The removal of compulsory annuitisation, previously set at age 75, is widely expected to have a limited impact. The need for individuals to meet minimum income requirements before they can take advantage of this option is likely to restrict the additional flexibility to those individuals with large retirement funds.

Growth in the open market option ("OMO") market continues to benefit from the overall regulatory and industry drive to publicise the benefits of the OMO, including access to impaired annuities. The proportion of vesting pensions using the open market option continues to rise (57% in the third quarter of 2011). The share of vestings represented by impaired annuities also continues to rise and now stands at 29% of the annuity market (50% of open market annuities).

Competition within the annuity market has reduced over recent years as the number of providers looking to compete at the top of the open market has reduced and providers have looked to reflect the impact of expected higher capital requirements under Solvency II in their pricing.

Strategy implementation

Friends Life is well placed to grow its share of the annuity market with the existing book generating £2 billion of maturing pensions each year. As previously announced, Friends Life's immediate objective is to retain a larger proportion of this vesting population with an aspiration in the longer term to become a top three provider in this segment. The improvement in retention rates is expected to be sufficient to achieve the Retirement Income new business financial targets with the potential entry into the OMO market being additive to these.

Implementation of the strategy will focus on building the enhanced range of capabilities including the following five key initiatives:

Development of sophisticated pricing and underwriting

The recruitment of an experienced Managing Director and Director of Longevity in the first half of 2011 will further advance the business's underwriting capabilities, allowing a highly targeted pricing approach.

Optimising and developing the investment strategy

The announcement in November 2011 of the creation of an internal asset management business, FLI, which will, in particular, improve the management of fixed income assets in respect of annuity business. The development of FLI is progressing well with the recruitment of an experienced team of fixed income investors in January 2012. This team will enable the Group to deliver an investment strategy aimed at optimising returns and improving capital efficiencies on its annuity portfolio.

Provision of a broader product proposition

Friends Life currently has a relatively narrow range of annuity products. The development and building of pricing and longevity capabilities will allow the proposition to extend into more complex lifestyle annuities.

Improving customer engagement

2012 plans include the launch of an enhanced annuity product and the introduction of pilot initiatives to enhance customer engagement, phased throughout the year.

Development of capabilities to support an open market offering

As a whole these developments will enhance the current vesting annuity proposition and will enable the Retirement Income business unit to achieve its financial targets. These developments will also underpin the development of an option for the business to enter the OMO market in the future.

Financial performance

£m (unless otherwise stated)	2013 Full year target	**2011 Full year**	2011 Half year
Value of new business	50	**32**	17
New business cash strain	n/a	**13**	10
IRR	15%+	**22.0%**	>25%
APE	n/a	**32**	16

Annuity new business contributed £32 million of VNB in the year with the performance in the second half of the year being broadly consistent with the performance in the first six months of 2011 despite challenging macroeconomic conditions. IRR of 22.0% remains well above target level of 15% but has been adversely affected in the second half of 2011.

Retention rates, at around 25% of vesting funds, have been maintained over the year and, whilst the implementation of the strategic initiatives is expected to improve this position towards the targeted 50% level, this improvement is not expected to be seen until later in 2012.

2011 sales volumes of £32 million are in line with the performance seen in the first half of 2011 where sales of £16 million were achieved.

International operating review

International operating review

The International segment comprises:

- Friends Provident International Limited ("FPIL"), an Isle of Man based company manufacturing unit-linked regular contribution savings and single premium bond products with a focus on high net worth expatriate individuals via distribution hubs in Hong Kong, Singapore and Dubai;
- Overseas Life Assurance Business ("OLAB"), the overseas branch business of Friends Life Limited, benefiting from EU freedom of services rules which allow regulated EU insurers to trade anywhere within its borders;
- Financial Partners Business AG ("fpb"), a German distributor of OLAB unit-linked pensions business;
- a 30% interest in AmLife Insurance Berhad ("AmLife"), a Malaysian life insurance company, majority owned by AmBank Berhad, a major Malaysian banking group; and
- a 30% interest in AmFamily Takaful Berhad ("AmFamily") which was established in December 2011 as a Malaysian family takaful business.

£m (unless otherwise stated)	**2011 Full year**	2010 Full year
IFRS based operating profit before tax	**40**	95
MCEV operating profit before tax	**29**	68
Operating free surplus generation	**(17)**	10
VNB	**40**	43
New business cash strain	**(89)**	(83)
IRR	**12.7%**	15.4%
APE (at actual exchange rates)	**252**	238

The International results for 2011 have been impacted by a number of adverse one-off items and challenging market conditions. VNB and IRR have both been adversely affected by changes in business mix, operating assumption changes and modelling improvements despite higher sales. In addition, a full review of FPIL actuarial models and assumptions has taken place during the year as part of a business-wide controls improvement project. This has resulted in one-off charges, some of which were reported at half year, to operating profit on both the IFRS and MCEV bases, and also to operating free surplus generation. A strategic review of the business is well advanced and details of this will be included in a market update in the second half of 2012.

Market environment

All core markets have delivered a resilient sales performance, in particular Asia, where demand remains strong, despite uncertainty in the International environment. The economic environment in Europe has been challenging and is expected to remain so in 2012.

The largest market is the North Asian region, predominantly Hong Kong. This is a relatively mature and competitive market, although it continues to grow strongly, with an established IFA distribution segment servicing affluent local nationals, corporate clients and expatriates. FPIL is one of the market leaders in offshore IFA distributed business with very strong distribution relationships, supported by strong service and leading propositions which include a wide choice of funds available through FPIL's range of unit-linked products. Quality of distribution relationships, service, commitment to overseas markets, systems capability and proposition development are fundamental to success in the region. The region has strong growth prospects for the future.

The South Asia region is serviced through Singapore. This region has continued to grow well although GDP growth in 2011 at 5-6% is lower than 2010. Singapore continues to evolve as a wealth management hub to rival Hong Kong and offers good growth potential.

The United Arab Emirates and the wider Middle Eastern region are relatively under-developed in terms of market penetration, but with wealthy high net worth individuals in those markets and good growth prospects.

In Germany, the business participates, through OLAB, in the unit-linked individual pensions market, a growth segment where the business has a well regarded product set. Whilst the market environment is challenging in the short term, as low investment market confidence drives consumers towards traditional with-profits business, the unit-linked sector has good medium-term prospects through demand for private sector savings and investments and the move from state to private pensions provision. This market and the product choices offered by local players are still dominated by with-profits type investment products. However, the trend towards lower guaranteed rates of return continues to reduce the attractiveness of traditional product structures, whilst the impact of Solvency II is expected to limit market participants' ability to provide traditional with-profits product offerings. OLAB is well positioned to benefit from these changes as the German unit-linked pensions market continues to evolve.

AmLife participates in the Malaysian market through both an agency and the bancassurance channel. This is a fast moving market which is currently closed to further entrants through the rationing of available licences. AmFamily was established in 2011 but is not expected to contribute materially to results in 2012.

Overall the International business is well established to take advantage of the opportunities that will arise in growth markets.

Strategy implementation

The Friends Life strategy is to grow the value of the International business and its component parts by improving its overall growth prospects and returns through diversification and focus on higher margin products. As the business grows, maintaining discipline over margins, the level of cash generation is expected to improve and the level of adverse one-off modelling impacts in this year's results is not expected to recur. The business has a target of achieving £20 million sustainable cash generation and 20% IRR by 2013.

The business has continued to invest in building capability, developing propositions and product structures to improve profitability and persistency. Investment has commenced in developing a new administration platform for the business with increased international capability and developing regional infrastructure in the core Hong Kong region. The roll-out of the new FPIL regular premium product is underway which is expected to improve profitability and IRR. It is planned to launch in Singapore and the Middle East in the second quarter of 2012, and in Hong Kong in the final quarter of this year. It will be available in all regions by the end of 2012.

The business is engaging in a strategic review and will give further details of its objectives and strategy at the International investor day in the second half of 2012.

Financial performance

New business profitability

	Value of new business	
	2011 Full year £m	2010 Full year £m
FPIL	**29**	27
OLAB	**7**	12
AmLife	**4**	4
	40	43

The International VNB has reduced from £43 million to £40 million. FPIL VNB has benefited from higher sales but margins have been impacted by operating basis changes. The OLAB VNB has reduced due to the impact of lower persistency and economic conditions on the cost of guarantees on the German pension business, in combination with slightly lower sales and higher expenses. The AmLife VNB has been maintained despite the lower sales volumes.

The International IRR has reduced from 15.4% to 12.7%. This was in part due to changes in the mix of business sold, with a larger proportion of lower margin longer term Premier business sold in 2011 compared to 2010, proportionally lower single premium OLAB sales (which are generally higher margin) and the same operating basis changes as above.

The business has a target to deliver IRR of 20% by 2013. Improvements will be driven by the roll-out of the new FPIL regular premium Premier product as mentioned above, a focus on other high IRR product lines, and a review of the cost base as part of the strategic review.

New business volumes

APE by region (£m, actual exchange rates)	2011 Full year	2010 Full year	% change
North Asia	**103**	95	9
South Asia	**26**	19	35
Middle East	**46**	46	(1)
Europe (excluding UK)	**32**	35	(11)
UK	**18**	14	29
Rest of the world	**21**	19	11
AmLife (Malaysia)	**6**	10	(38)
APE total (at actual exchange rates)	**252**	238	6
APE total (at constant exchange rates)	**257**	238	8

The International business sales volumes continued the growth seen in the first half of 2011, with sales at actual exchange rates up 6%, driven by strong North and South Asian markets. UK sales have also increased from a low base and there has been modest growth in Germany within a difficult market. Other European sales are down. Sales at constant exchange rates increased by 8%.

This performance is reflected in the underlying businesses with FPIL sales at actual exchange rates increasing by 9% whilst OLAB sales decreased by 3%.

Funds under management (£bn)	1 January 2011 restated(i)	Inflows	Outflows	Net inflows/ (outflows)	Market and other movements	31 December 2011
FPIL	**5.3**	1.1	(0.5)	0.6	(0.3)	**5.6**
OLAB	**0.5**	0.1	(0.1)	–	–	**0.5**
AmLife	**0.1**	–	–	–	–	**0.1**
International total	**5.9**	1.2	(0.6)	0.6	(0.3)	**6.2**

(i) Funds under management at 1 January 2011 have been restated to include OLAB unitised with-profit funds of £0.2bn previously accounted for within the UK business segment.

Funds under management as at 31 December 2011 total £6.2 billion and have increased by 5% during the year. As a result of record levels of new business sales, the business has generated positive net inflows of £0.6 billion but these have been offset by market falls, particularly in the Far East, of £0.3 billion, mainly in the second half of the year.

IFRS based operating profit

	2011 Full year £m	2010 Full year £m
New business strain	**(36)**	(28)
In-force surplus	**97**	120
Long term investment return	**1**	1
Principal reserving changes and one-off items	**(12)**	2
Development costs	**(7)**	(6)
Other	**(3)**	6
IFRS based operating profit before tax	**40**	95

IFRS based operating profit has reduced by £55 million to £40 million mainly because of an £8 million increase in new business strain, a £23 million reduction in in-force surplus and £12 million of adverse principal reserving and one-off items (a £14 million adverse movement from the prior year). These items are explained below.

New business strain

Reconciliation of new business cash strain to IFRS

	2011 Full year £m	2010 Full year £m
New business cash strain	**(89)**	(83)
DAC/DFF adjustments	**224**	210
Other IFRS adjustments	**(171)**	(155)
IFRS new business strain	**(36)**	(28)

DAC adjustments relate to the deferral of acquisition costs including initial commission and enhanced allocations. DFF relates to the deferral of establishment charges on portfolio bond business. Both DAC and DFF adjustments have increased in line with sales volumes.

Other IFRS adjustments include the elimination of financial reinsurance (at a higher level in 2011), which is not permitted under IFRS. This line also includes the elimination from IFRS new business strain of actuarial funding and sterling reserves on investment business.

The net increase in IFRS new business strain of £8 million mainly results from higher sales and the impact of lower interest rates, which have increased reserving requirements.

In-force surplus

Reconciliation of in-force cash surplus to IFRS

	2011 Full year £m	2010 Full year £m
In-force cash surplus	**79**	106
DAC/DFF adjustments	**1**	7
Other IFRS adjustments	**17**	7
IFRS in-force surplus	**97**	120

In-force cash surplus has reduced by £27 million due to a combination of adverse economic variances, experience variances, and repayment of financial reinsurance, which have more than offset the growth in the back book.

The DAC/DFF adjustments have decreased because of a higher DAC run off due to the larger block of post-acquisition business compared to 2010. Other IFRS adjustments include the elimination of financial reinsurance (at a higher level in 2011).

The net decrease in IFRS surplus of £23 million primarily results from the falls in investment market levels leading to higher reserving required for return of premium guarantees on German pensions largely resulting from lower interest rates, and the higher DAC run-off on the larger post-acquisition book.

Principal reserving changes and one-off items

Adverse principal reserving changes and one-off items amount to £12 million primarily comprise improved modelling of return of premium guarantee on paid-up policies in German pensions business.

Operating expenses

	2011 Full year £m	2010 Full year £m
Acquisition	**30**	28
Maintenance	**31**	22
Development	**7**	6
Other	**–**	1
Total	**68**	57

International operating expenses, which exclude commission payments and non-recurring costs, have increased to £68 million from £57 million, as follows:

- acquisition costs reflect the marketing and proposition support for the growth in sales volumes;

- maintenance costs have increased as a result of increased customer service costs to support the larger in-force book, and strengthening the controls and governance infrastructure to meet the needs of the growing business; and
- development costs are higher due to the increased investment in the business, including the development of the German business and the commencement of a project to move to a significantly improved administration platform for the business.

MCEV operating profit

	2011 Full year £m	2010 Full year £m
Value of new business	**40**	43
Expected existing business contribution	**27**	29
Operating experience variances	**(7)**	12
Operating assumption changes	**(3)**	(2)
Other operating variances	**(20)**	(7)
Development costs	**(7)**	(6)
Life and pensions covered business operating profit before tax	**30**	69
Other income and charges	**(1)**	(1)
Operating profit before tax	**29**	68

International MCEV operating profit has decreased from £68 million to £29 million principally as a result of adverse operating experience and other variances. These are explained below.

Expected existing business contribution

The expected existing business contribution has decreased from £29 million to £27 million. The effect of the larger in-force book has been offset by the following lower rates of expected return. The value of the in-force book has increased to £502 million compared to £473 million at 31 December 2010.

	Rates of return	
	2011 %	2010 %
Reference rate	**1.14**	1.01
Best estimate returns:		
Corporate bonds	**2.45**	2.98
Equity	**6.70**	7.30
Property	**5.70**	6.30

Operating experience variances

Operating experience variances were £7 million adverse. These include negative variances in respect of expenses and persistency, offset by positive mortality experience. In 2010 there were £12 million positive variances in respect of persistency, mortality and fund rebates.

Operating assumption changes

Adverse operating assumption changes of £3 million reflect the net charge in respect of revisions to the assumptions for lapses for German pensions partial surrenders from paid-up policies, and various smaller other items, offset by a positive adjustment for fund manager rebate allowances. In 2010 there was a £2 million net charge in respect of strengthening investment expense assumptions, offset by positive changes across persistency and mortality.

Other operating variances

Adverse other operating variances amounting to £20 million result from various modelling improvements mainly in respect of FPIL. The majority of these have arisen as a result of the completion of the review and validation exercise during the year of all FPIL actuarial models. In 2010 there was a charge of £7 million in respect of modelling and methodology improvements.

Lombard operating review

Lombard is the leading pan-European life assurance business specialising in compliant estate planning solutions for high and ultra-high net worth individuals ("HNWIs"). Based in Luxembourg the business offers innovative solutions and superior service, through a well-established distribution network of private banks, high-end IFAs and independent specialist financial advisers to HNWIs across Europe and selected markets in Latin America and Asia. Solutions offered by Lombard are typically based on single premium, whole of life, unit-linked life assurance structures with all but minimal levels of life exposure reinsured. The business is well placed to benefit from increasing demands for fully compliant financial solutions for HNWIs.

£m (unless otherwise stated)	**2011 Full year**	2010 Full year
IFRS based operating profit	**38**	33
MCEV operating profit	**82**	162
Operating free surplus generation	**9**	(12)
VNB	**52**	83
New business cash strain	**(20)**	(6)
IRR(i)	**>25%**	>25%
APE	**237**	302

(i) The 2011 Lombard IRR now takes account of the Luxembourg regulatory regime in which DAC is an allowable asset.

IFRS based operating profit at £38 million is 15% above 2010, benefiting from higher in-force fee income, in line with higher levels of funds under management ("FUM") during the period whilst global operating expense level have been controlled.

MCEV operating profit is lower than 2010 as a result of lower VNB and certain negative operating experience variances, despite materially increased existing business contribution. 2010 operating profit also included £32 million benefit resulting from a review of Lombard's corporate structure which had resulted in the business's intermediation service company being repatriated from Jersey to Luxembourg and the reduction in the business's effective tax rate from 28.59% to 23.5%.

2011 sales volumes (APE) were £237 million, 22% below 2010, results being affected by significantly adverse macroeconomic conditions in Europe and the lack of strong external drivers to generate new business compared to previous years. In the current context, relative to most competitors, these results are strong. The last quarter of the year saw higher sales than in the fourth quarter of 2010 with fourth quarter 2011 APE of £100 million up from £89 million in the same period of 2010.

Funds under management have continued to grow significantly in 2011, despite the material fall of equity markets. FUM at 31 December 2011 reached €20.9 billion (£17.4 billion), 4.5% (€898 million) up on 2010 year end (€20.0 billion; £17.1 billion).

Market environment

2011, and especially the second half of the year, has been characterised by significant adverse macroeconomic conditions in Europe, with falls in most equity markets, a sovereign debt crisis and uncertainties in respect of potential fiscal constraints in some European countries.

While Lombard's performance is not directly linked to investment markets this continued market uncertainty has led to clients postponing actions to structure their investments and manage intergenerational transfer of their wealth.

In contrast, 2010 was an exceptional period for the cross-border life insurance market with this being particularly evident in the first nine months of 2010, driven by significant external factors and there were no other similar event drivers in 2011.

Despite the European economic environment Lombard has performed relatively well in the year compared to its peers. New business sales performance in the Luxembourg life insurance market is down by 34% in 2011, significantly below levels achieved by Lombard. In this context, Lombard's market share increased from 16% in 2010 to 19% in 2011.

The current external environment remains highly uncertain across Europe, and there is no sign of short-term macroeconomic recovery. In these exceptional circumstances, we expect 2012 sales to remain affected. However, notwithstanding the challenging short-term market conditions, the longer term drivers of the demand for compliant "Privatbancassurance" solutions remain compelling.

Strategy implementation

There are three core elements of Lombard's strategy and these have progressed in 2011:

- Strengthening of sales force: strengthen Lombard sales force in key markets with a 20% increase in sales consultants in place during 2011. This action, together with training and development initiatives and professionalisation of sales management, enhances Lombard's presence in key geographical markets;
- Investment in marketing and deepening partner relationships: expand and enhance marketing and product development capability to enable further valuable support to existing and potential partners. Lombard is undertaking due diligence exercises with selected key partners to continue the tailoring of its service offering to suit their precise needs and those of their clients (thereby enhancing Lombard's franchise and protecting margins); and
- Operating model: consistent with the needs of Lombard's partners and clients, this initiative is seeking to further improve the maintenance and servicing of policies whilst streamlining Lombard's operating model. This will contribute to enhancing competiveness and improving profitability whilst reducing business model risk.

It is envisaged that these initiatives will contribute to the delivery of the financial outcomes (strong growth in profitable new business and cash generation) with IRR above 20% by 2013 and £30 million dividend from 2014.

Financial performance

Performance during the year has been impacted by a number of factors including:

- the absence of strong policy drivers to generate new business which Lombard experienced in the first half of 2010;
- Northern Europe primarily impacted by the negative economic environment and lower activity among IFAs especially in Belgium; and
- Market uncertainties in respect of a number of potential fiscal changes and significantly adverse macroeconomic conditions in Europe, resulting in clients delaying decisions and affecting investor confidence.

Despite these factors, five markets (Spain, Italy, Finland, France and Asia) showed volumes significantly above 2010 business levels in 2011. These improvements reflect the benefits from sales force enhancement and continued deepening of relationships with partners in these markets. The growth in these regions also highlights the strength of Lombard's geographic diversification compared with its competitors.

New business in Italy was supported by strong partnerships developed at the time of the tax amnesty ("Scudo fiscale"), combined with the increasing importance of life-assurance for long-term estate planning.

2011 has been characterised by a stronger diversification between markets and seasonality of new business is in line with 2010 with H1/H2 at 41%/59% (2010: 45%/55%).

Overall, business in 2011 is below 2010 levels, with sales volumes of £237 million APE, 22% below 2010. The lower volumes have directly affected the contribution from new business with VNB of £52 million although IRR at more than 25% remains above the target level.

APE performance per region is as follows:

APE by region (actual exchange rates)	**2011 Full year £m**	2010 Full year £m	Change %
UK and Nordic	**52**	72	(28)
Northern Europe	**42**	119	(64)
Southern Europe	**115**	94	22
Rest of world	**28**	17	66
Total including large cases	**237**	302	(22)
Of which: large cases (greater than €10 million)	**83**	90	(8)
Total excluding large cases	**154**	212	(27)

APE seasonality since 2007 is as follows:

	H1 APE £m	H2 APE £m	FY APE £m	H1/ H2 split (%)
2007	65	134	199	33/67
2008	70	176	246	28/72
2009	47	226	273	17/83
2010	135	167	302	45/55
2011	**97**	**140**	**237**	**41/59**

IFRS based operating profit

	2011 Full year £m	2010 Full year £m
New business strain	**(33)**	(28)
In-force surplus	**73**	66
Investment return and other items	**(1)**	(4)
Principal reserving changes and one-off items	**–**	–
Development costs	**(1)**	(1)
IFRS based operating profit before tax	**38**	33

Lombard generated operating profit before tax of £38 million, 15% up on 2010 supported by increased income from the in-force book. The in-force surplus has benefited from significant net fund inflows in 2010 and 2011, more than offsetting negative investment return in 2011, and compensating for increased new business strain.

New business strain and in-force surplus

Reconciliation of new business strain to IFRS

	2011 Full year £m	2010 Full year £m
New business cash strain	**(20)**	(6)
DAC/DFF adjustments	**(13)**	(21)
Other IFRS adjustments	**–**	(1)
IFRS new business strain	**(33)**	(28)

New business cash strain is higher than 2010 despite sales volumes being down on the prior year. This has been driven by a reduced benefit from year one annual management charges as lower sales volumes were written in the first nine months of the year. In addition the lower sales volumes in the year reduced the proportion of acquisition expense capitalised within cash strain.

On an IFRS basis a lower proportion of acquisition costs can be deferred. As cost deferral in 2011 new business cash strain is lower than the prior year the corresponding reversal is also reduced in arriving at the IFRS new business strain.

Reconciliation of in-force surplus to IFRS

	2011 Full year £m	2010 Full year £m
In-force cash surplus	**41**	30
DAC/DFF adjustments	**32**	36
Other IFRS adjustments	**–**	–
IFRS in-force surplus	**73**	66

In-force cash surplus is up 37% on 2010, benefiting from growth in the in-force book. Average funds under management have increased significantly between 2010 and 2011 despite negative market performance in the second half of 2011. Continued positive net fund inflows over the last two years have driven this growth with funds under management growing from £14.4 billion at the start of 2010 to £17.4 billion at the end of 2011.

Lombard funds under management

2010 and 2011

	£bn
31 December 2010	**17.1**
Inflows	**2.4**
Outflows	**(1.1)**
Net investment return	**(1.0)**
31 December 2011	**17.4**

Operating expenses

	2011 Full year £m	2010 Full year £m
Acquisition	**42**	47
Maintenance	**25**	19
Development	**1**	1
Other	**–**	2
Total	**68**	69

The operating expenses of Lombard, which exclude both commission payments and non-recurring costs, are set out in the table above.

Lombard has maintained tight control of expense levels which, despite an increase in average funds under management of 13%, have remained in line with 2010.

Acquisition expenses were lower than 2010 as a result of lower sales volume which have translated into lower sales and partner incentives costs.

Development costs consist of expenses related to new product and market development.

Lombard MCEV operating profit

	2011 Full year £m	2010 Full year £m
Value of new business	**52**	83
Expected existing business contribution	**49**	38
Operating experience variances	**(12)**	(17)
Operating assumption changes	**(4)**	20
Other operating variances	**(2)**	39
Development costs	**(1)**	(1)
Life and pensions covered business operating profit before tax	**82**	162

MCEV operating profit of £82 million is significantly below 2010, mainly driven by the lower contribution from new business whilst the result also reflects unfavourable experience variances.

Expected existing business contribution
Expected existing business contribution has increased significantly year on year. The improvement reflects the higher opening in-force book as a result of significant net fund inflows delivered in 2010, despite rates of return being below those applied in the 2010 result.

	Rates of return	
	2011 %	2010 %
Reference rate	**1.40%**	1.32%
Best estimate returns:		
Corporate bonds	**4.46%**	4.72%
Equity	**6.46%**	6.72%

Operating experience variances
Adverse operating experience variances of £12 million include a £7 million persistency charge relating to surrenders on the Belgian IFA book, as lapses deteriorated on this portfolio in the latter part of 2011. This is expected to be a short-term issue with this reflected in the revised assumptions.

Operating experience variances also include an accrual for the management long-term incentive plan (£6 million; 31 December 2010: £4 million).

Operating assumption changes
Adverse operating assumption changes totalling £4 million include a £6 million persistency provision relating to surrenders within the Spanish book as adverse economic conditions and uncertainty in the Spanish market continue. In addition a £5 million provision has been put in place for short-term expected additional lapses within the Belgium IFA book. It is anticipated that this deterioration in lapses on this particular book will not persist longer term.

The above negatives are partially offset by a wider review of other lapse experience with a £5 million benefit, as well as improved mortality assumptions for £3 million.

Changes to expense assumptions of negative £1 million are in line with lower policy volumes achieved in 2011.

Other operating variances
Other adverse operating variance amounted to £2 million in the year. In 2010 these included a £32 million benefit resulting from a review of Lombard's corporate structure which had resulted in the business's intermediation service company being repatriated from Jersey to Luxembourg and the reduction in the business's tax rate from 28.59% to 23.5%, as well as a £7 million benefit following a reassessment of the cost of non-hedgeable risk.

Corporate operating review

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

Financing and interest costs
FLG has a number of debt instruments and the operating cost of financing these for the year ended 31 December 2011 are presented below.

In April 2011, FLG issued a £500 million external LT2 debt instrument with a coupon of 8.25% and a maturity of 2022; this is guaranteed on a subordinated basis by FLL. From the proceeds of this debt, £400 million was used by FLG to partially repay the internal LT2 debt issued to RHG. A further repayment of £100 million was made in May 2011, leaving an outstanding value of £200 million at 31 December 2011.

£m	Market value of debt[i]	Finance cost[ii]	
		IFRS	MCEV
£200 million internal LT2 subordinated debt 2020	200	(33)	(33)
£162 million external LT2 subordinated debt 2021	182	(24)	(10)
£500 million external LT2 subordinated debt 2022	450	(29)	(17)
STICS 2003	142	(12)	(8)
STICS 2005	185	(14)	(11)
Total		**(112)**	**(79)**

(i) Market value is based on listed offer price, at 31 December 2011, excluding accrued interest and before tax on market valuation

(ii) Finance cost is operating profit impact, before tax

The interest cost included within operating profit differs between the two bases, reflecting the lower expected rate of return applied in the MCEV results.

In so much as these debts have been raised to support the ongoing growth and development of the life operating businesses the cash raised has been loaned to the UK operating segment. The external cost attributable to each segment is shown below.

£m	IFRS	MCEV	
		Covered	Non-covered
Corporate segment	(36)	(46)	(33)
UK operating segment	(76)	–	–
	(112)	**(46)**	**(33)**

FLG corporate IFRS based operating result

£m	**2011 Full year**	2010 Full year
Investment return and other items excluding debt	**91**	47
Expected return on debt	**(112)**	(61)
Other corporate costs	**(7)**	(11)
IFRS based operating loss before tax	**(28)**	(25)

The corporate result is primarily driven by the expected return on the debt held in the Group, offset by the investment return on shareholder assets. The increase in the expected return on debt reflects the additional £500 million external LT2 subordinated debt raised in April 2011 (followed by £500 million partial repayment of the internal LT2 subordinated debt with Resolution Holdings (Guernsey) Limited as described above). The increased investment return on other assets reflects the higher level of assets at holding company level driven by receipt of dividends from life companies in the year, partly offset by payment of dividends to RHG.

Other corporate costs of £7 million include £2 million of costs in relation to the FLG long-term incentive scheme. The current year charge reflects changes in the senior management team during the year. The additional net costs of £5 million relate primarily to corporate overhead costs, being holding company and Group costs incurred in supporting non-covered business.

FLG corporate MCEV operating results

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

	2011 Full year £m	2010 Full year £m
Expected existing business contribution on debt	**(46)**	(30)
Other operating variances	**19**	(63)
Life and pensions covered business operating loss before tax	**(27)**	(93)
Other income and charges	**(33)**	(16)
Operating loss before tax	**(60)**	(109)

The Friends Life corporate segment includes the interest on the external STICS and external LT2 subordinated debt instruments at the reference rate and expected return over reference rate.

Other operating variances comprise a release of £19 million arising from the reduction in group capital management policy from 160% of Group Capital Resource Requirements (excluding WPICC) to 150% reflecting the continued progress on integration of the UK life businesses.

The interest on the £200 million (2010: £700 million) debt issued to RHG of £33 million is included within other income and charges as well as £1 million of corporate costs and £3 million of credit facility costs fees. These costs are partially offset by expected return on the pension asset of £6 million and interest income receipts of £4 million.

Resolution corporate segment

The operating results of the Resolution holding companies are summarised in the table below. These are presented consistently in the IFRS financial statements and MCEV supplementary information.

	2011 Full year £m	2010 Full year £m
Interest on internal LT2 subordinated debt issued by FLG	**33**	18
Financing and interest costs	**(40)**	(18)
Other operating items	**(34)**	(15)
Total	**(41)**	(15)

FLG issued £700 million LT2 fixed rate unsecured loan notes to RHG in September 2010 to fund the acquisition of the AXA UK Life Business; £500 million was repaid in the first half of 2011. Interest received from FLG in the year was £33 million.

Financing and interest costs of £40 million are analysed in the following section.

Other operating items mainly comprise fees payable to ROL of £20 million, directors and professional fees and other corporate costs of £15 million, partly offset by £1 million of interest earned on cash based assets held by the Resolution holding companies.

Financing and interest costs

External financing within Resolution holding companies is summarised in the following table:

£m	**31 Dec 2011 carrying amount**	**2011 Full year finance cost**	31 Dec 2010 carrying amount	2010 Full year finance cost
Deferred consideration notes	**423**	**30**	500	10
Acquisition finance facility	**–**	**10**	400	8
Total	**423**	**40**	900	18

The deferred consideration notes were issued in September 2010 in connection with the acquisition of the AXA UK Life business. A scheduled repayment of £63 million was made in June 2011 and an additional accelerated repayment of £14 million was made in August 2011. The accelerated repayment was triggered by the incremental cash distributed to shareholders during the 2011 share buy-back programme.

The acquisition finance facility was a term loan facility agreement also issued in September 2010 to fund part of the consideration payable for the acquisition of AXA UK Life Business; this loan was repaid in April 2011.

WLUK acquisition

Completion of AXA UK Life Business acquisition

The acquisition of WLUK was completed with an effective acquisition date for accounting purposes of 7 November 2011. This marks the completion of the acquisition agreed with AXA UK, the first phase of which initiated in September 2010 with the acquisition of the AXA UK Life Business.

Due to the complex structure of the AXA UK Life Business the assets acquired included certain portfolios of insurance business (the GOF and TIP portfolios) which were to be retained by AXA UK. The terms of this transfer were agreed as part of the transaction and these portfolios were transferred back to AXA UK on 1 November 2011 via Part VII transfer for consideration, including interest, of £285 million.

Similarly the shares of WLUK, initially retained by AXA UK, were acquired by the Group for consideration of £248 million once the business lines to be retained by AXA UK had been removed. In completing this transaction, total consideration of £2,072 million (net of debt) represents 72.2% of the net acquired MCEV.

	£m
Gross MCEV of acquired AXA UK Life Business (excluding WLUK)	3,498
Acquisition financing	(900)
Net MCEV of acquired AXA UK Life Business (excluding WLUK)	2,598
WLUK MCEV	271
Total MCEV acquired	**2,869**
AXA UK Life Business consideration (net of £900 million acquisition financing)	1,824
WLUK consideration	248
Total consideration	**2,072**
Percentage of acquired MCEV	**72.2%**

The WLUK acquisition was completed following the agreed transfer, back to AXA UK, of the GOF and TIP portfolios. The net impact of these transactions on the IFRS and MCEV balance sheets was £(2) million and £23 million respectively.

Net impact of WLUK and GOF/TIP transactions

	IFRS £m	MCEV £m
Consideration received for GOF/TIP (including interest)	285	285
Less: GOF/TIP net assets (including interest)	(285)	(235)
Wrong pocket payments[(i)]	(50)	(50)
	(50)	–
Consideration paid for WLUK	(248)	(248)
WLUK net assets	296	271
	48	23
Net impact of transactions[(ii)]	**(2)**	**23**

(i) Reflects net surplus emerging in the pre-transaction companies, prior to completion of the respective acquisition and disposal.

(ii) In IFRS, the £50 million wrong pocket payment is included in administrative expenses and the gain on the WLUK acquisition is included in other income. In MCEV, the gain on the WLUK acquisition is shown as a reserves movement. These are stated before acquisition costs of £3 million.

WLUK IFRS acquisition balance sheet as at 7 November 2011 and gain on acquisition

Assets	£m	Liabilities	£m
Intangible assets	268	Insurance and investment contract liabilities	7,322
Financial assets and cash	6,955	Other liabilities	92
Other current assets	487		
Total assets	**7,710**	**Total liabilities**	**7,414**
Net identifiable assets acquired			**296**
Fair value of net assets acquired – cash paid			248
Gain on the acquisition of WLUK (excluding transaction costs)			**48**

In accordance with IFRS the Group ascribed fair values to the AVIF and other intangible assets as well as placing a fair value on the assets acquired and liabilities assumed.

The AVIF has been calculated on the basis of assumptions which are consistent with those which have been used in the preparation of the MCEV results. The AVIF and other intangibles of £239 million and £29 million, respectively, are presented gross of tax.

Acquisition of WLUK on a MCEV basis

On a MCEV basis, the amount attributable to ordinary shareholders at the acquisition date was £271 million and consideration paid was £248 million. A summarised balance sheet as at the date of acquisition is set out below.

	£m	£m
Adjusted net assets		60
Value of in-force business		
– Certainty equivalent value	241	
– Time value of options and guarantees	(7)	
– Frictional costs of required capital	(8)	
– Cost of residual non-hedgeable risks	(15)	
		211
WLUK MCEV		**271**

Cash and capital

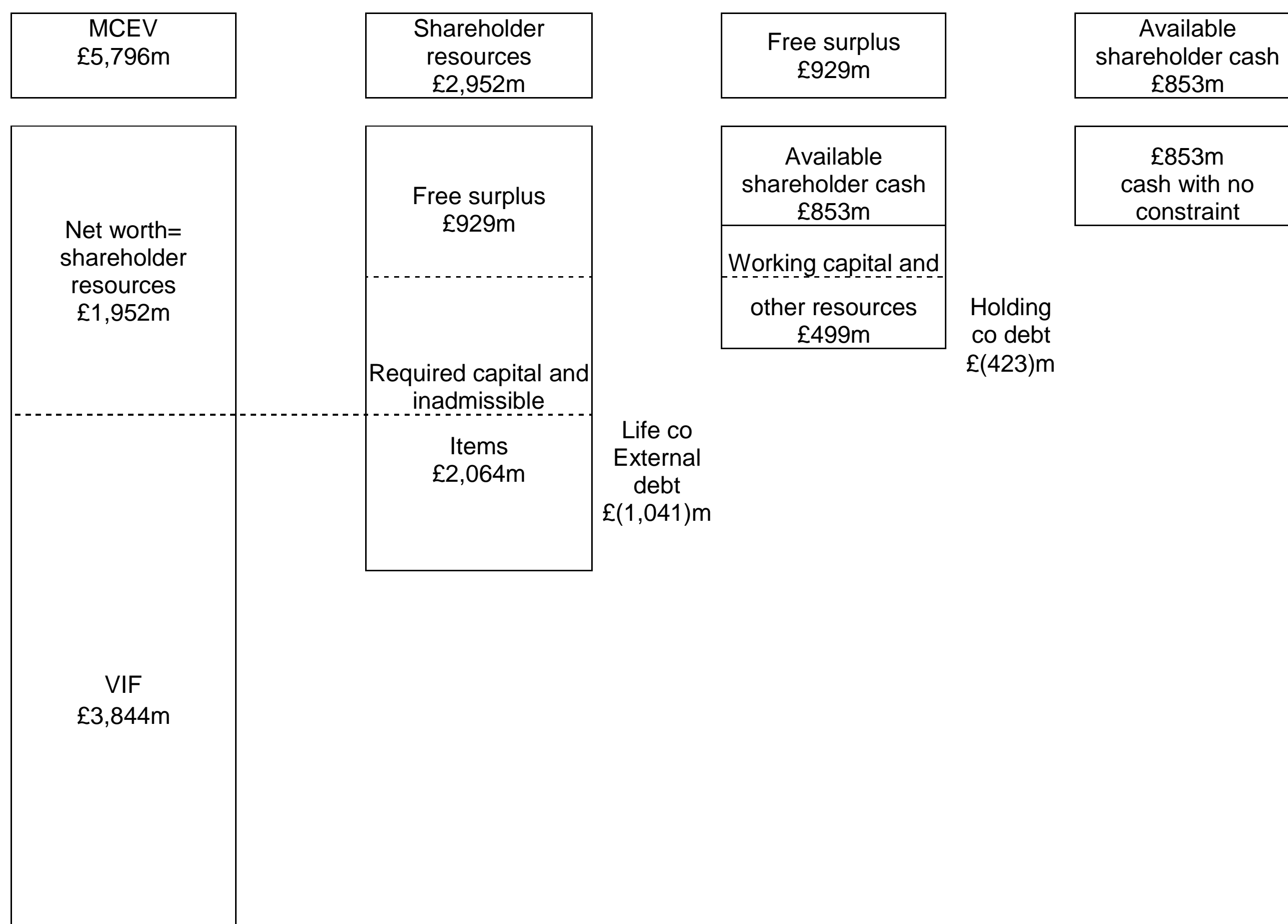
Group cash delivery

Available shareholder cash ("ASC") at 31 December 2011 was £853 million, comprising £752 million in FLG and £101 million in Resolution holding companies. The contribution from FLG to the distributable cash target ("DCT") was £393 million, reflecting the free surplus generated in the period, £100 million of capital raised and retained in the life companies, net of other amounts retained for working capital and FLG holding company costs. DCT is defined as the increase in FLG ASC after interest and before dividends to Resolution holding companies and is the amount that could be paid to Resolution holding companies without reducing the MCEV of FLG, excluding investment variances and non-recurring items.

The sustainable free surplus generated in the period was £291 million, based on underlying free surplus of £395 million offset by development costs, finance costs and other operating activities and excluding the GOF and TIP results and the impact of one-off capital optimisation activities. Total free surplus generated in the year of £413 million included £161 million arising from the implementation of certain elements of PS06/14 and £181 million from the capital optimisation programme, giving total benefits of £342 million. £61 million of the benefit arising from the implementation of certain elements of PS06/14 in BHA was already assumed in the Group's valuation of BHA (for capital purposes); excluding this amount, capital synergies delivered were £281 million exceeded the target of £235 million announced previously. The Group continues to maintain a prudent buffer within ASC, in addition to working capital, of £400 million to cover the external dividend, financing and corporate costs at Resolution holding companies level.

Cash management framework

The Group's cash management framework is based on the movement in MCEV, reflecting the basis of MCEV as the discounted value of expected future cash flows on a market consistent basis. The chart below shows how the core components of MCEV within this framework, and their respective values as at 31 December 2011, reconcile to ASC.



The total MCEV is split between the net worth, or shareholder resources, and the VIF. Shareholder resources comprise the free surplus, required capital and inadmissible assets of the business. Required capital is based on the Group's capital management policy of maintaining 150% (formerly 160%) of Group Capital Resource Requirements ("CRR") excluding WPICC, and at life company level, the higher of 150% of Pillar 1 CRR excluding WPICC and 125% of Pillar 2

CRR including Individual Capital Guidance. For other operating businesses and Friends Life holding companies, free surplus is defined as IFRS net assets less required capital and inadmissible assets on an IGCA basis (for MCEV, where these assets relate to non-covered business, they are all included within free surplus). VIF comprises the value of the future cash flows arising from the policies currently in-force.

External debt issued by FLG is offset against required capital in the life businesses as this debt has been guaranteed by life operating companies and has been used to support their activities. This debt comprises STICS of £373 million, LT2 subordinated debt 2021 of £185 million and LT2 subordinated debt 2022 of £483 million. Deferred consideration notes ("DCNs") issued by the Company to AXA UK as part of the acquisition of the AXA UK Life Business are offset against free surplus.

ASC is stated after the deduction of regulatory and other restrictions on the availability of cash resources. ASC represents cash available to cover corporate costs, to service debt issued by Resolution holding companies and, subject to shareholder approval, to pay dividends, fund future acquisitions, or return to shareholders. The Group intends to maintain a prudence buffer, within ASC, of £400 million to cover the Company's dividend cost, DCN repayments and interest and Resolution holding companies corporate costs.

The key components and drivers of ASC for 2011 are detailed in the following sections.

a) Value of in-force business and shareholder resources

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

Analysis of movement in MCEV

		Shareholder resources		
£m	**Value in-force**	**Required capital**	**Free surplus**	**Total MCEV**
Opening MCEV at 1 January 2011	4,202	1,585	728	6,515
MCEV (loss)/profit after tax	(493)	(215)	413	(295)
Impact of acquisition of BHA	132	91	(165)	58
Impact of acquisition of WLUK	211	102	(290)	23
Impact of sale of GOF/TIP	(196)	–	196	–
Other movements in net equity	–	(32)	13	(19)
Foreign exchange variances	(11)	(3)	(1)	(15)
Transfers to shareholders	–	–	(476)	(476)
Other capital flows	(1)	(9)	15	5
External LT2 subordinated debt issuance (net of issue costs)	–	(496)	496	–
Closing MCEV at 31 December 2011	**3,844**	**1,023**	**929**	**5,796**

MCEV loss after tax for the period of £295 million comprises £413 million of free surplus generation offset by £215 million reduction in required capital and £493 million reduction in VIF. These movements are set out in more detail in the following section.

The value of BHA at acquisition was £226 million, comprising VIF of £132 million, required capital of £91 million and free surplus of £3 million. The consideration paid by FLG was £168 million, resulting in a gain on acquisition of £58 million. The net impact on free surplus was a reduction of £165 million reflecting the consideration paid net of the free surplus acquired.

The value of WLUK at acquisition was £271 million, comprising VIF of £211 million, required capital of £102 million and free surplus of negative £42 million. The consideration paid by Friends Life was £248 million, resulting in a gain on acquisition of £23 million. The net impact on free surplus was a reduction of £290 million reflecting the consideration paid net of the free surplus acquired.

The impact of the sale of the GOF and TIP portfolios was to reduce VIF by £196 million and generate £196 million of free surplus. Consideration of £285 million, including interest, increased free surplus but was partially offset by the disposal of £39 million of GOF and TIP free surplus and the £50 million payment from FLG to AXA UK, reflecting the surplus arising in the Group's period of ownership which was due to AXA UK. The reduction in VIF of £196 million represents the value of the VIF asset disposed of.

In aggregate, the impact of transaction activity on free surplus comprised £27 million outflow from Friends Life holding companies (comprising deferred consideration for the AXA UK Life Business acquisition in line with expectations) and £232 million funded by the life companies.

Other movements in net equity comprise actuarial losses on defined benefit pension schemes (£32 million) offset by the reduction in the adjustment to exclude intra-group holdings in the Company's shares (£13 million).

Transfers to shareholders comprise the cash dividends of £226 million and the impact of the share buy-back programme of £250 million. Other capital flows includes £5 million inflow reflecting the change in value of the Lombard share option scheme (as this is an equity settled scheme, changes in value are shown as movements in equity) with other, offsetting, minor items.

The proceeds of the £500 million external LT2 subordinated debt issued by FLG (net of £4 million costs) were used to repay (via repayment of internal loans) the £400 million acquisition finance facility taken out by RHG to part fund the acquisition of the AXA UK Life Business and to inject £100 million into the life companies. A further £100 million of the internal loan between FLG and RHG was also repaid in the year. The external LT2 subordinated debt is offset against required capital as it supports the activities of the life businesses whereas the internal debt was, for FLG, offset against free surplus. Consequently the issue of the external LT2 subordinated debt and repayment of the internal debt results in an increase in free surplus and an offsetting reduction in required capital.

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

The table below sets out the impact of the MCEV profits generated in the period on the VIF, required capital and free surplus of the business. The analysis identifies the impact of underlying surplus generation, operating variances, including the implementation of certain aspects of PS06/14, and non-recurring and other non-operating items.

The analysis is shown on a net of tax basis.

		Shareholder resources		
£m	**Value in-force**	**Required capital**	**Free surplus**	**Total MCEV**
Expected return from in-force business net of finance costs	(333)	(57)	662	272
Add back coupon on FLG external debt(i)	–	(24)	58	34
Investment in new business	364	80	(325)	119
Underlying MCEV generation	**31**	**(1)**	**395**	**425**
Development costs	–	–	(28)	(28)
Financing costs	–	24	(91)	(67)
Operating assumption changes	(86)	(16)	204	102
Impact of PS06/14	(146)	(13)	161	2
FLG other operating items	(27)	(55)	56	(26)
FLG operating result	**(228)**	**(61)**	**697**	**408**
RSL income and charges	–	–	(41)	(41)
Group operating result	**(228)**	**(61)**	**656**	**367**
Economic variances	(300)	199	(352)	(453)
Capital optimisation programme	–	(181)	181	–
Non-recurring and non-operating variances	35	(172)	(72)	(209)
Result after tax	**(493)**	**(215)**	**413**	**(295)**

(i) The expected return from in-force business is shown net of the expected return on FLG external LT2 subordinated debt. As the coupon on this debt of £58 million is included within the financing costs of £91 million, it has been added back to underlying MCEV generation to provide greater clarity on the impact of debt on free surplus generation.

The key driver of underlying MCEV generation is expected return from in-force business net of investment in new business; this is explained in more detail below. The underlying free surplus generation of £395 million and £365 million impact on free surplus of assumption changes and the adoption of certain elements of PS06/14 underpin the £697 million FLG operating free surplus generation in the period.

The impact on free surplus of FLG financing costs of £91 million, net of tax, comprises £23 million in respect of the external STICS issued by FLG, £35 million in respect of the existing external LT2 subordinated debt 2021 and new external LT2 subordinated debt 2022 issued by FLG and £33 million in respect of the internal LT2 debt issued by FLG to

RHG. The receipt of the £33 million internal interest is included in the operating result for the Resolution holding companies.

Operating assumption changes relate to changes to expense assumptions following the implementation of the Diligenta outsourcing deal, and changes to persistency and morbidity assumptions.

The implementation of certain elements of PS06/14 resulted in accelerated recognition of free surplus; this has been largely offset by a reduction in future profits that were present in the VIF; the £2 million net MCEV profit represents the release of the associated cost of capital.

Other operating items relate to the impact of persistency and modelling changes on VIF and the positive impact on free surplus of mortality and morbidity experience variances, offset by FLG corporate costs.

Economic variances include £72 million for an increase in the market value of corporate debt within required capital. Adverse investment variances have reduced the VIF for unit-linked business in all operating segments, and reduced gilt yields have led to a corresponding increase in required capital for annuity and conventional business.

Non-recurring and non-operating items include the impact on VIF of the reduction in corporation tax (£26 million) offset by the impact on free surplus of separation and integration and Solvency II costs. In addition the change in Group capital policy has released £172 million of required capital, with an offsetting increase in free surplus.

c) Free surplus – £929 million

The generation of free surplus, net of movements in required capital, underpins the declaration of future dividends. The table below expands the free surplus result after tax shown above and sets out the reserve movements.

Movement in free surplus	£m
1 January 2011	**728**
In-force surplus[(i)]	**720**
New business	**(325)**
Development costs and other operational items	**28**
Finance costs	**(91)**
Operating assumption changes	**204**
PS06/14 impact	**161**
FLG operating free surplus generated in the period	**697**
RSL income and charges	**(41)**
Operating free surplus generated in the period	**656**
Economic variances	**(352)**
Capital optimisation programme	**181**
Change in Group capital policy	**172**
Other non-operating items	**(244)**
Total free surplus generated in the period	**413**
Capital/dividend flows	
BHA acquisition	**(165)**
WLUK acquisition	**(290)**
GOF/TIP disposal	**196**
Debt raising	**496**
Transfers to shareholders	**(476)**
Other capital movements	**27**
31 December 2011	**929**

(i) Before deduction of coupon on FLG external LT2 subordinated debt of £58 million

Total free surplus of the Group amounts to £929 million at 31 December 2011 up from £728 million at the end of 2010. This reflects the free surplus generated in the period of £413 million, the impact of the acquisitions of BHA and WLUK in January 2011 and November 2011 respectively, the disposal of the GOF and TIP portfolios, debt raising and the return of capital to shareholders.

The transfers to shareholders of £476 million comprise £226 million of cash dividend and £250 million in respect of the share buy-back programme. Other capital movements reflect the favourable impact of £13 million reduction in the Company's shares held by subsidiaries, £5 million favourable movement in respect of the Lombard long-term incentive scheme and other minor movements arising from internal reorganisations.

Further information on in-force surplus and new business strain are shown below.

In-force business expected return and investment in new business

At product level, in-force surplus and new business drivers are monitored on a "cash strain" and "cash surplus" basis which excludes movements in required capital and is stated before tax and other adjustments. Tax and other items include the cumulative adjustments for tax and long-term investment return which use different assumptions across the MCEV, regulatory (or "cash") and IFRS bases. The reconciliation of MCEV free surplus to cash strain/surplus is set out below.

£m	MCEV free surplus	Movement in required capital	Tax and other items	Cash (strain)/ surplus
New business strain	(325)	80	(33)	(278)
In-force surplus[(i)]	720	(81)	(165)	474
	395	(1)	(198)	196

(i) Movement in required capital for in-force surplus is shown before the impact of the £58 million coupon on FLG external LT2 subordinated debt

The following table provides a segmental analysis of in-force surplus and new business strain on both the MCEV free surplus and cash bases.

£m	MCEV free surplus	Movement in required capital, tax and other items	Cash strain/ surplus
New business strain			
UK	(218)	49	(169)
International	(88)	(1)	(89)
Lombard	(19)	(1)	(20)
Total strain	**(325)**	**47**	**(278)**
In-force surplus			
UK	568	(214)	354
International	116	(37)	79
Lombard	36	5	41
Total surplus	**720**	**(246)**	**474**
Net strain/surplus	**395**	**(199)**	**196**

The Group has set a target for the UK business to reduce cash strain, the measure used to manage individual products, by £200 million, by the end of 2013. This target is set from a full year baseline of £392 million, of which the UK accounted for £303 million. The UK new business cash strain of £169 million for the year therefore represents a reduction of £134 million compared to this baseline. The targeted reduction of £200 million is expected to be achieved for the UK business through moving to target platforms, utilising negative reserves and other initiatives set out in the UK operating section. International and Lombard have not been set specific targets for reductions in new business strain, but are expected to deliver annual dividends of £30 million by the end of 2014 for Lombard and £20 million by the end of 2013 for International. Continued improvement in business performance, focused on managing new business strain in comparison to in-force surplus emergence is expected to deliver the dividend targets, subject to economic conditions.

Analysis of FLG operating free surplus generation and sustainable DCT contribution by segment

£m	UK	Int'l	Lombard	Corporate covered	Non-covered	Total
Expected return from in-force business net of finance costs	568	116	36	(58)	–	662
Add back coupon on FLG external debt	–	–	–	58	–	58
Investment in new business	(218)	(88)	(19)	–	–	(325)
Underlying free surplus generation	**350**	**28**	**17**	**–**	**–**	**395**
Development costs	(21)	(6)	(1)	–	–	(28)
Deduct coupon on external debt	–	–	–	(58)	–	(58)
Deduct GOF/ TIP result	(41)	–	–	–	–	(41)
Operating experience variances	(8)	(8)	(7)	–	–	(23)
Other operating variances (excluding PS06/14)	95	(14)	–	–	–	81
Other income and charges	–	–	–	–	(35)	(35)
Sustainable DCT contribution	**375**	**–**	**9**	**(58)**	**(35)**	**291**
Add back GOF/TIP result	41	–	–	–	–	41
Operating assumption changes	221	(17)	–	–	–	204
Impact of PS06/14	161	–	–	–	–	161
FLG operating free surplus generation	**798**	**(17)**	**9**	**(58)**	**(35)**	**697**

Sustainable DCT contribution of £291 million excludes £41 million generated from the GOF and TIP portfolios which is in the operating result for the period but which will not recur following the sale of these businesses.

d) Working capital and other assets and liabilities

The £929 million of free surplus at 31 December 2011 comprises £853 million available shareholder cash and £499 million of working capital, illiquid and restricted assets, net of the deferred consideration notes of £423 million.

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

The Group does not include free surplus within ASC until it is paid-up to group holding companies or declared as a dividend.

An analysis of the movement in gross working capital in the period is shown below.

£m	Working capital (gross)	RSL holding company debt	Net working capital
Opening position at 1 January 2011	561	(900)	(339)
FLG free surplus for the period, net of transaction activity	222	–	222
Injection into life businesses from LT2 debt raise	100	–	100
Contribution from life companies to ASC	(415)	–	(415)
FLG corporate cash flows offset with working capital movements	18	–	18
Other movements	13	–	13
Repayment of acquisition finance facility	–	400	400
DCN repayment	–	77	77
Group closing position at 31 December 2011	**499**	**(423)**	**76**

The movements in working capital primarily comprise the retention of FLG free surplus generated in the period of £454 million, offset by life company funding of transaction activity of £232 million, injection of £100 million from the FLG external LT2 subordinated debt issue, offset by £415 million contribution to ASC. The contribution to ASC comprises £350 million of dividends and £65 million of working capital set aside in the life companies to fund integration and

separation activities. FLG corporate cash flows offset with working capital movements primarily relates to interest on the internal debt less tax relief payments from life companies to holding companies. Other movements comprise items impacting on free surplus in relation to foreign exchange, LTIP schemes and other minor items.

As at 31 December 2011, the key components of working capital are:

£m	2011 Full year	2010 Full year
Amounts retained to support separation integration and service company costs	**233**	175
Amounts retained to facilitate BHA acquisition	**–**	77
Long-term fund surplus currently unavailable to shareholders and restricted assets	**26**	129
Life company amounts retained for flexibility	**265**	125
Other operating businesses working capital	**(25)**	55
Total working capital (gross of debt)	**499**	561

Working capital held by other operating businesses includes the net current liabilities of the Resolution holding companies.

e) Available shareholder cash – £853 million

Available shareholder cash comprises £752 million of shareholder cash at Friends Life holding company level (including £350 million dividends proposed by FLL), together with £101 million held by Resolution holding companies.

£m	
Friends Life holding companies cash	402
Proposed dividend from FLL	350
Friends Life available shareholder cash	**752**
Resolution holding companies cash	101
Group available shareholder cash	**853**

The movements in ASC are summarised below:

£m	
1 January 2011	**1,067**
Dividends and share buy-back settlements	**(476)**
Debt payments and servicing	**(115)**
Resolution holding companies corporate cash flows	**7**
FLG corporate cash flows offset with working capital movements	**(18)**
Impact of acquisitions and disposals	**(27)**
Contribution from life companies to ASC	**415**
31 December 2011	**853**

The £476 million outflow in respect of dividends and share buy-back comprises £141 million cash in respect of the final 2010 dividend, £85 million cash in respect of the interim 2011 dividend and £250 million cash paid to corporate brokers in respect of the shares bought back in the period.

Debt payment and servicing costs comprise £77 million capital repayment on the DCNs, £34 million of finance costs and £4 million issue costs for the £500 million FLG external LT2 subordinated debt. The DCN repayment comprises £63 million scheduled repayment and an accelerated repayment of £14 million triggered by the incremental cash distributed to shareholders during the 2011 share repurchase programme. Finance costs of £34 million relates to interest on the DCNs and, prior to its repayment, the £400 million acquisition finance facility held in Resolution holding companies. Part of the £500 million LT2 subordinated debt issued by FLG in April was used to finance the repayment of the acquisition finance facility with the remaining £100 million injected into life companies as explained above.

Resolution holding companies cash flows comprise corporate costs offset by interest on the internal LT2 debt with FLG. The payment of this interest is included within working capital movements.

The movement in ASC in respect of acquisitions and disposals represents the cash flows from Friends Life holding companies for the WLUK and GOF/ TIP transactions; this is in line with the deferred consideration for the acquisition of the AXA UK Life Business.

The contribution from life companies to ASC and FLG corporate cash flows offset with working capital movements are as explained in the working capital analysis above.

Distributable cash target

The Company has set a DCT of £400 million per annum at Friends Life group level for 2011 and onwards, after interest costs and without reducing the MCEV of Friends Life group (excluding investment variances and non-recurring items). The DCT is satisfied by the payment of dividends from the life operating companies to the Friends Life holding companies. DCT generation in the year is given in the table below.

£m		
FLG ASC at 1 January 2011		**836**
Capital raised		500
Internal transfers (i)		(950)
Contribution from life companies	415	
FLG corporate cash costs	(18)	
Debt issue costs	(4)	
DCT contribution		**393**
Deferred transaction costs		(27)
FLG ASC at 31 December 2011		**752**

(i) Internal transfers comprise £500 million debt repayments to RHG, £100 million injection into life companies and £350 million dividends to RHG

The DCT contribution shown above of £393 million exceeds the sustainable DCT contribution of £291 million primarily reflecting the inclusion of the £100 million debt raised externally and retained in the life companies. This DCT contribution includes the benefits of capital synergies offset by the net adverse impact of non operating items (including negative economic variances of £352 million and acquisition activity) as well as the increase in working capital held in the life companies. Movement in ASC qualifies as DCT to the extent that it is not greater than the change in MCEV excluding economic impacts and one-off items. FLG MCEV operating profit, net of tax, was £408 million for the period, so DCT contribution is unrestricted at £393 million.

As announced in February 2011, the Group expects to reduce cash new business strain by £200 million by the end of 2013, and in addition to this, has targeted the delivery of £50 million of dividends from the overseas businesses by the end of 2014. The Group therefore expects the £400 million DCT to be met predominantly from operational cash flows and related releases of required capital, but until such time as this is achieved the delivery of the target will be dependent, in part, on the release of working capital and capital synergies. In 2011 the Group targeted a further £235 million of capital synergies, in addition to the £400 million DCT. Of the £161 million of free surplus generated in the period through the implementation of certain elements of PS06/14, £100 million relates to the AXA UK Life Business and contributed towards the £235 million to be generated from capital synergies. The additional capital synergies generated in BHA were already assumed in the Group's valuation of BHA (for capital purposes) and do not form part of the incremental capital synergies targeted. The remaining element of the capital synergies were achieved on completion of the Part VII transfers in November 2011.These moved business from smaller life companies into FLL and generated £181 million of excess capital over capital policies, £46 million above expectation. This takes the total impact of capital synergies on free surplus to £281 million in the year.

Targeted cash return

As announced on 7 June 2011, the Group is targeting a return of £500 million of excess capital to shareholders. The first £250 million of this return was started on 8 June 2011 and successfully completed on 26 October 2011. During this period, the Company purchased 93 million of its own ordinary shares at prices between 229 pence per share and 313 pence per share; all of these shares have been cancelled.

The Company has concluded that it would have been inappropriate to commence an immediate return of the second tranche of £250 million based on the year end cash and capital position which was significantly impacted by weak investment markets during the year. The potential to do so in the future will be kept under review, taking into account the ongoing performance of markets and the impact of planned management actions. The Company will update the market

no later than the interim 2012 results announcement on its intentions with respect to the second stage of the capital return programme announced in June 2011.

Group capital management

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

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

The Group's capital policy has been to maintain sufficient Group capital resources to cover 160% of Group CRR. This coverage ratio was put in place at the time of the AXA UK Life Business acquisition and has now been reduced to 150%, reflecting the good progress made towards integrating these businesses.

As part of the integration of the AXA UK Life Business, a number of initiatives have been undertaken including fund mergers and the optimisation of the corporate structure, to ensure capital efficiency and to maximise the fungibility of capital resources. Further activities are being implemented in 2012 in order to create additional efficiencies in the Group's capital structure.

In 2010, the Group undertook the five yearly test of the FLC re-attributed inherited estate ("RIE") with this resulting in a transfer of £1,010 million to the shareholders' fund. As at 31 December 2011, a further £484 million has been transferred to the shareholders' fund, in line with the results of the end 2010 test and the surplus arising in the non profit fund over the period. These assets will remain in the shareholders' fund to provide capital support to the with-profits funds to the extent required by the scheme, and to support with-profits and non-profit funds to the extent required by FLC's capital policy.

Solvency II

The implementation of the EU Solvency II Directive, the proposed new EU insurance regulatory requirements, continues to be a key focus of attention for the Group. The aim of the new regulation is to place the management of risk at the heart of running a successful and sustainable insurance company. The Group has been closely following the emerging regulations and monitoring their potential impact on the Group balance sheet. There is still a lack of clarity over certain key issues, particularly in respect of the treatment of matching premium and contract boundaries, which could have a material impact on future capital requirements. The Group continues to be closely involved with the industry in lobbying on key areas where uncertainty remains.

Friends Life has established a Solvency II programme to manage the implementation of the new regulatory requirements. It is progressing well and the Group is well placed for the implementation of Solvency II. A key deliverable of the programme is an integrated financial reporting platform across acquired businesses.

Insurance Groups Capital Adequacy

In addition to individual company requirements FLG, as the ultimate European Economic Area ("EEA") parent insurance undertaking, is required to meet the IGCA requirements of the Insurance Groups Directive. IGCA is monitored at FLG level and does not include the assets of the Resolution holding companies. The Group's capital policy is to maintain sufficient Group capital resources to cover 150% of Group CRR (excluding WPICC). This policy was changed at the end of 2011 from 160% of Group CRR (excluding WPICC) reflecting progress on the integration of the UK Life businesses.

The balance sheet remained strong at the Friends Life group level, with an IGCA surplus of £2.1 billion at 31 December 2011, with Group capital resources being 219% of Group CRR (excluding WPICC). Group capital resources were £1.2

billion in excess of the amount required to satisfy the Friends Life group capital policy of holding 150% of Group CRR (excluding WPICC).

The IGCA surplus would reduce by around £0.2 billion for a 40% fall in equity markets from 31 December 2011 levels and would reduce by slightly less if interest rates were to fall by 200bps across the yield curve. The IGCA surplus would reduce by approximately £0.5 billion if credit spreads were to rise by 200bps.

The movement in IGCA surplus over the period largely reflects the surplus emerging in the period of £403 million. This includes a £103 million benefit from the 2011 capital optimisation project ("COP"), £157 million benefit (on an IGCA basis) of negative reserves released for FLC and BHA business and is after adverse economic variances of £316 million.

The acquisition of BHA and WLUK less the disposal of the GOF and TIP portfolios has decreased the IGCA surplus by £154 million. The acquisition of BHA reduced IGCA surplus by £132 million (£169 million cost of investment offset by a £37 million IGCA surplus at the respective acquisition date). The acquisition of WLUK reduced IGCA surplus by £237 million (£248 million cost of investment offset by a £11 million IGCA surplus at the respective acquisition date) which is offset by £215 million increase from the disposal of the GOF and TIP portfolios.

The surplus is also impacted by financing and dividend costs, which include the £350 million of dividends paid to Resolution holding companies in the period. £500 million of the internal LT2 subordinated debt issued to RHG has been repaid during the period, following an external debt raising by FLG of £500 million LT2 subordinated debt, with £4 million of associated costs.

Finance costs and other movements include £58 million of interest costs on the external LT2 subordinated debt and £33 million of interest due on the internal LT2 debt with RHG, partially offset by the reduction in restricted intangible assets of £16 million and £2 million of other movements.

Management initiatives in the year to optimise the IGCA surplus position delivered a benefit of £157 million. This relates to the recognition of negative reserves in the acquired BHA and AXA UK Life businesses. This benefit applies to the base IGCA position with release of capital requirements at 100% whereas the free surplus impact of £161 million includes the release of FLG level required capital at 150%. The Part VII transfers implemented in 2011 moved business from some of the smaller life companies into FLL which has reduced aggregate Pillar 1 capital requirements by £113 million, thereby increasing excess capital over capital policies by around £181 million. Further Part VII transfers are planned for 2012.

Movement in IGCA surplus	£m
1 January 2011	**2,317**
Surplus emerging	**143**
COP 2011	**103**
PS06/14	**157**
BHA acquisition	**(132)**
WLUK acquisition/GOF TIP disposal	**(22)**
Dividend to RSL	**(350)**
External LT2 subordinated debt	**496**
Repay RSL debt	**(500)**
Finance costs and other movements	**(73)**
31 December 2011	**2,139**

At 31 December 2011 the capital held to meet FLG capital policies was £902 million (1 January 2011: £1,085 million) and the excess over the capital policies was £1,237 million (1 January 2011: £1,232 million). The change in group capital policy from 160% of Group CRR to 150% of Group CRR increased capital in excess of capital policies by £172 million.

The IGCA surplus is a prudent measure and excludes surplus capital not immediately available to shareholders, such as surplus capital held in long-term funds to the extent that this is not needed to cover the capital resource requirements of the long-term fund concerned. Following actions taken in 2011 to transfer surplus long-term fund assets to shareholders, there are no remaining restrictions to the IGCA surplus in respect of surpluses in the non-profit funds (2010: £39 million restriction). The IGCA surplus excludes £385 million of UK with-profits funds surpluses. As the calculation is prepared to include the subsidiaries of the highest EEA parent company, the net assets of the Resolution holding companies are excluded.

Management of the with-profits funds

Friends Life Limited

Asset allocation within the With-Profits Fund is actively managed. For the first half of 2011 the strategic proportion of equities and property backing asset shares (equity backing ratio or "EBR") for the whole fund was set at 50%. Management actions allowed for within the risk management framework were revised and with effect from 30 June 2011 the strategic EBR was increased to 55% for the post-demutualisation business and was maintained at 50% for the pre-demutualisation business.

At 31 December 2011, the EBR was 48% for pre-demutualisation business (31 December 2010: 49%) and 53% for post-demutualisation business (31 December 2010: 49%).

There are no Market Value Reductions ("MVRs") currently in place for the fund.

The risk appetite and risk management framework of the With-Profits Fund are in line with FLL's commitment to fair treatment of all its customers and the published Principles and Practices of Financial Management underlying the Fund.

Non-profit business in the FLL With-Profits Fund, the majority of which is annuities, is backed by a mix of gilts and corporate bonds.

Friends Life Company Limited

Asset allocation within the With-Profits Fund is actively managed. During 2011 the Group was able to continue to reduce MVRs on single premium bonds, and in early 2012 these were removed.

At 31 December 2011 the EBR was close to 66% (31 December 2010: 68%).

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

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

Friends Life Assurance Society Limited

Asset allocation within the With-Profits Fund is actively managed. During 2011 the Group was able to continue to reduce MVRs on single premium bonds, and in early 2012 these were removed.

At 31 December 2011 the EBR was close to 52% (31 December 2010: 54%).

The investment policy of FLAS was reviewed in 2010. The strategy now is to target a stable EBR of 50% for assets backing policy asset shares. The allocation for assets backing guarantees and options comprises gilts and hedging derivatives (equity put options, sold equity futures, interest rate swaps and swaptions). The target allocation for assets backing the realistic with-profits estate is gilts only, although currently some property and corporate bond holdings still remain.

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

Winterthur Life UK Limited

Asset allocation within the With-Profits Fund is actively managed. MVRs may apply to certain products on a case by case basis.

At 31 December 2011 the EBR was close to 50%.

The investment policy of WLUK is to target a stable EBR of 50% for assets backing policy asset shares. The allocation for assets backing guarantees and options comprises gilts, corporate bonds and hedging derivatives (equity put and call options, sold equity futures, interest rate swaps and swaptions). The target allocation for assets backing the realistic with-profits estate is gilts only.

Non-profit business in the With-Profits Fund, the majority of which is annuities, is backed by a mix of gilts and corporate bonds.

Certain of the with-profit deferred annuity business in the Fund is backed by gilts and corporate bonds only.

Asset quality and exposure

The Group's financial assets as at 31 December 2011, excluding cash, are summarised as follows:

	Unit-linked £bn	With-profit £bn	Non-profit £bn	Shareholder £bn	31 December 2011 Total £bn	31 December 2010 Total £bn
Shares, unit trusts and OEICs	**53.4**	**7.1**	**0.1**	**–**	**60.6**	60.4
Government securities	**8.5**	**8.5**	**2.2**	**0.3**	**19.5**	16.1
Corporate bonds and asset-backed securities	**5.7**	**9.0**	**7.2**	**0.3**	**22.2**	21.5
Derivatives	**–**	**0.8**	**0.1**	**–**	**0.9**	0.4
Deposits	**0.4**	**–**	**–**	**–**	**0.4**	0.4
Loans	**–**	**–**	**–**	**–**	**–**	0.7
Total 31 December 2011	**68.0**	**25.4**	**9.6**	**0.6**	**103.6**	–
Total 31 December 2010	**65.5**	**24.3**	**8.3**	**1.4**	**–**	99.5

The vast majority of the Group's exposure to sovereign debt holdings is to UK gilts. The Group has £6 million shareholder exposure (including shareholder fund exposure to non-profit and with-profit funds) to the higher risk government debts of Spain, Portugal, Italy, Ireland and Greece (31 December 2010: £7 million).

In addition the Group's shareholder exposure to various corporate securities issued by companies domiciled in Spain, Portugal, Italy, and Ireland is £370 million (31 December 2010: £444 million). The Group's shareholder exposure to Greek corporate securities is less than £1 million. 64% by value of these corporate securities are issued by non-financial companies, which are in many cases less exposed to their domicile economy than to other countries. Where the Group holds securities issued by financial companies, 44% of these are not linked to the institution's domestic economy. In all cases the company's financial strength and the ability of the domicile government to provide financial support in the event of stress has been considered.

	Total £m	Spain £m	Portugal £m	Italy £m	Ireland £m	Greece £m
Sovereign debt	**6**	–	–	6	–	–
Corporate exposure						
– Domestic banks	**65**	29	–	33	3	–
– Domestic non-bank financials	**26**	–	–	13	13	–
– Non-domestic banks	**40**	40	–	–	–	–
– Domestic non-financials	**205**	64	10	108	23	–
– Non-domestic non-financials	**34**	34	–	–	–	–
Total 31 December 2011	**376**	167	10	160	39	–
Total 31 December 2010[(i)]	**451**	159	14	228	50	–

(i) Restated to include two non-domestic financials totalling £39 million

The Group's shareholder exposure to bank debt securities across the various geographic regions is shown below.

£m Seniority	Rating	UK	Euro	USA	France	PIIGS[(i)]	ROW	Shareholder Total
Senior	AAA	28	561	18	17	–	6	630
	AA	19	57	–	–	–	29	105
	A	129	5	268	7	21	22	452
	BBB	–	–	14	–	3	–	17
	Below BBB/NR	–	3	–	–	–	–	3
	Senior Total	**176**	**626**	**300**	**24**	**24**	**57**	**1,207**
Secured	AAA	270	–	–	35	24	–	329
	AA	3	–	–	–	–	–	3
	A	5	–	10	–	–	–	15
	BBB	1	–	8	–	–	–	9
	Below BBB/NR	–	–	–	–	–	2	2
	Secured Total	**279**	**–**	**18**	**35**	**24**	**2**	**358**
Subordinated	AA	–	9	–	–	–	–	9
	A	194	30	33	16	36	84	393
	BBB	191	1	29	23	21	43	308
	Below BBB/NR	69	–	–	–	–	–	69
	Subordinated Total	**454**	**40**	**62**	**39**	**57**	**127**	**779**
Cash	**Cash Total**	**669**	**267**	**324**	**235**	**39**	**207**	**1,741**
Grand Total		**1,578**	**933**	**704**	**333**	**144**	**393**	**4,085**

(i) Portugal, Ireland, Italy, Greece, Spain

Shareholder exposure to corporate bonds and asset-backed securities is analysed by fund and credit rating as follows:

£bn	Unit-linked funds	With-profit funds	Non-profit funds	Shareholder funds	31-Dec-11 Total	31-Dec-10 Total
Corporate bonds and asset-backed securities	**5.7**	**9.0**	**7.2**	**0.3**	**22.2**	21.5
less: policyholder exposure	5.7	7.9	–	–	**13.6**	13.3
Shareholder exposure	**–**	**1.1**	**7.2**	**0.3**	**8.6**	8.2
AAA	–	0.2	0.8	0.1	**1.1**	1.3
AA	–	0.2	2.8	–	**3.0**	2.8
A	–	0.4	2.5	0.1	**3.0**	2.7
BBB	–	0.2	1.0	0.1	**1.3**	1.0
Sub-BBB or rating not available	–	0.1	0.1	–	**0.2**	0.4
% Investment Grade					**96.9%**	95.1%

Over 96% of the corporate bond and asset-backed securities to which the shareholder funds are exposed are investment grade. The Group controls its exposures to corporate issuers by rating, type of instrument and type of issuer. The sub-investment grade bonds held in investment portfolios are monitored closely in order to maximise exit values. Where asset-backed securities and other complex securities are held, the Group monitors closely its exposures to ensure that the relevant structure, liquidity and tail credit risks are well understood and controlled.

There has been one default in the period, Titan ABS, with a market value loss of £1.7 million in 2011. No other defaults have been experienced in the year. The Group holds default reserves to cover the risk of defaults and credit rating downgrades on corporate bonds that back all annuity business within Friends Life group. The reserves reflect assumed defaults over the outstanding terms to maturity of the bonds. The shareholder share of default reserves at 31 December 2011 was £0.6 billion (31 December 2010: £0.4 billion). This represents a haircut of 35% of the overall corporate bond spreads over gilts of equivalent term (31 December 2010: 46%).

Liquidity

The liquidity of the Group remains strong.
FLG has an undrawn £500 million funding facility with a consortium of banks. This facility is due to run until June 2013 but can be extended at the option of FLG for a further two years.

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

	Fitch	Moody's	Standard & Poor's
Friends Life Limited	A+ (strong)	A3 (strong)	A-(strong)
Friends Life Company Limited	A+ (strong)	A2 (strong)	A-(strong)
Friends Life Assurance Society Limited	A+ (strong)	A2 (strong)	NR

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

Principal risk and uncertainties

The Group actively manages its risk profile and the risk management framework drives the identification and mitigation of strategic, financial and operational risks to support the achievement of its objectives.

Following is a list of the principal inherent risks and uncertainties the Group was exposed to during 2011 and an overview of its approach to managing these exposures:

Economic conditions

The Group is exposed to volatile and uncertain economic conditions as these will give rise to changes in the values of the assets and liabilities of its insurance businesses. Adverse or uncertain economic conditions also impact the willingness of consumers to buy and continue to hold the Group's products. The Group is particularly impacted by conditions in the UK and other European countries as a result of its operations and investment assets being focused in these countries.

During 2011 there has been considerable instability within the Eurozone and this has impacted economic confidence in Europe, including the UK. The UK and a number of other countries face a significant risk of a double dip recession as both their governments and consumers attempt to substantially reduce their indebtedness. The UK housing market, the main driver for sales of protection business, has remained relatively depressed due to the economic uncertainty, insecure labour markets and limited availability of credit to potential purchasers. The UK market for pensions has generally been more resilient than other life assurance products due to the need for consumers to save for their retirement, but even this is not immune to market confidence factors. The Group's international businesses focus on the sale of savings and investment products to high net worth individuals and these are impacted by consumers having reduced funds for investment and reduced investment confidence. Economic conditions are expected to remain challenging and uncertain for some years, with extremely low levels of interest rates, volatile economic growth and insecure labour markets expected to continue at least in the short term.

The Group's business model is designed to mitigate the impact of market conditions through measures including the matching of assets and liabilities, the use of financial instruments to reduce the volatility of returns on assets, diversification in the product portfolio, and ensuring the operating companies within the Group are robustly capitalised. The Group also actively monitors changes in the economic environment to enable proactive management of impacts to relevant markets. Its exposure to sovereign debt from all but the strongest countries in the Eurozone is modest and in line with the Group's risk appetite has been managed down further in recent years. The Group faces significant credit risk exposure (both from credit default and credit spread widening) as a result of its use of corporate bonds to back non-profit business and for the investment of shareholder funds. However it seeks to mitigate these risks by adopting a conservative investment policy with investment skewed towards bonds with high credit ratings.

Integration and restructuring

The Group is exposed to the risk of failing to integrate and successfully restructure the financial services businesses that it acquires, and to achieve project specific objectives. As expected, the AXA UK Life Business acquisition, and to a lesser extent the BHA acquisition, led to a step change in this inherent risk and the focus of the Group's activity to manage the risk.

Substantial progress has been made in integrating the three acquired businesses with strategic decision-making now being driven by business plans, capital management, business performance and risk data produced on an integrated basis. There remains considerable work to be done to complete separation of the AXA UK Life Business from its previous parent group at operation level but this work is substantially on track.

Restructuring plans have been developed and are in the process of being implemented; these are based around bringing together in separate companies the UK Heritage business (within FLL) and the UK Go to Market propositions (within FLPL). The first phase of this work was completed in 2011 with a series of Part VII transfers used to transfer all of the BHA and FPLAL business and part of the FLPL business to FLL and leave the currently marketed corporate pension business within FLPL. Further business transfers and restructuring are expected in 2012 and 2013 to optimise the capital structure of the Group and prepare FLG for the "exit" stage of the UK Life Project.

The scale of the separation, integration and restructuring agenda, particularly when taken with the substantial regulatory change agenda faced by the Group (see below) poses particular challenges. Through the business planning process the Group determines the volume of change initiatives that can be delivered and prioritises initiatives for inclusion. The Group operates robust project management disciplines to identify and manage the interdependencies between initiatives, to set and monitor budgets, to manage the deployment of resources and to monitor delivery of outputs. In this way the Group aims to manage the risks of the change programme within its appetite.

Completion of the UK Life Project

The Group's business model is founded on delivering the UK Life Project. The project is expected to have three phases – acquisition, restructuring and exit. The acquisition phase is considered to be substantially complete and the restructuring phase is ongoing. The Company is now seeking to develop options for its exit from the UK Life Project.

The Company intends to look for exit options involving M&A as these would be expected to allow shareholders to benefit from the synergies arising from further consolidation at exit. A key inherent risk in any such M&A is the ability to identify suitable target companies and to execute any transactions at a price consistent with delivering shareholder value. The Company also expects to develop a "self-managed" exit plan which is not reliant on M&A opportunities and could be implemented on a stand-alone basis.

The value achieved on exit will be subject to a number of factors, in particular the performance and expected future performance of the acquired and restructured businesses, the exit option pursued, the timing of exit and economic conditions and other factors affecting market values within the life insurance sector at the time of exit.

Regulatory change and compliance

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

The current framework of regulation in the UK and throughout the world continues to evolve due to national and, from a UK perspective, European requirements and in response to the ongoing turmoil in global financial markets. It is impossible to fully predict the nature of the regulatory changes which may occur in the future or the impact that such changes may have on the Group and its strategic objectives. The burden of regulatory change facing the Group's insurance businesses continues to grow with preparation being required for compliance with UK government initiatives for auto-enrolment of employees in work-based pensions and reform of financial regulation, requirements for gender neutral pricing, proposals for Solvency II and IFRS Phase II and implementation of the Retail Distribution Review. In addition the FSA's consultation paper on changes to the listing rules for "externally managed companies" could, if implemented, require some change in the Company's governance model in order to enable it to maintain its UK premium listing. This could require negotiation with ROL regarding amendments to, or termination of, the Company's Operating Agreement. The alternative option proposed by the FSA would be for the Company to redesignate as a standard listed company (which would make the Company ineligible for inclusion in the FTSE index).

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

Changes in taxation law

The Group may be affected by changes in tax legislation and interpretation of tax law. In addition to relevant corporation taxes, life insurance companies within the Group are subject to specific rules governing the taxation of policyholders, and amendment to these rules may impact the business. To mitigate the risk of taxation changes on its business, the Group engages with the relevant tax and legislative authorities and supports lobbying activity undertaken by industry groups.

From 1 January 2013, there is expected to be a major change in the UK corporate tax regime applicable to life insurance companies. Draft legislation was issued for consultation in December 2011 and is expected to be included in the Finance Bill due to be published on 29 March 2012. The Group's assessment is that the draft legislation proposed in the December consultation paper would not have a material adverse impact on the corporate tax position of the Group. However, until the legalisation is finalised, there remains a risk that changes to it could affect this assessment.

The Group's insurance businesses currently benefit from the exemption from VAT of certain costs incurred under outsourcing contracts into which they have entered. The VAT exemption is subject to possible change following a decision in 2005 by the European Court of Justice ("ECJ") to narrow the scope of the insurance intermediaries' exemption. The European Commission has made detailed proposals for change, but the proposals have not yet been accepted by the EU Council and it is not known when any changes might become law, what form those changes might take and what the impact, if any, will be on the Group. If agreement cannot be reached at EU level, the UK and other Member States that have not already changed their national laws to give effect to the ECJ decision may need to do so.

Mortality and other assumption uncertainties

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

The continued economic uncertainty and FSA's Retail Distribution Review in the UK act to increase the risk of lapses of life and pensions business as intermediaries look to re-broke existing business ahead of the impending ban in the UK on the payment of commission and in the face of a scarcity of new business. The Group has in place customer value management activities to mitigate this risk, but expects that lapse rates during 2012 will remain at similar levels to those experienced in 2011. The Group takes a prudent approach to evaluating the appropriate level of provisions and capital for these risks and the assumptions are subject to rigorous and ongoing review. However events causing a substantial change in mortality/morbidity experience, lapse rates or other reserving assumptions could require assumptions to be recalibrated and impact the profitability, earnings and capital position of the Group. Stress and scenario testing is used to validate the appropriateness of key assumptions to single events and combinations of extreme events including economic conditions, investment performance, lapse and mortality/morbidity events. The management of these risks is covered further in the full financial statements.

FLG reliance on outsourcing

As part of the Group's strategy for increasing operational efficiency, opportunities are considered for outsourcing the administration of its insurance businesses. During 2011 the Friends Life group investigated extension of its current outsource model to the enlarged group (post the acquisition of the AXA UK Life Business and BHA). In November 2011 the Friends Life group materially extended its existing outsource arrangements in respect of IT and customer services by entering into a long term contract with Diligenta. This had the effect of substantially increasing the reliance of the Friends Life group on outsource service providers.

The Group has comprehensive service level agreements in place with all its outsource partners and actively monitors the standards of delivery against these agreements in order to mitigate the operational risks posed by the outsourcing. A dedicated team is overseeing Diligenta's delivery of a Service Improvement Plan in accordance with its contractual obligations. In addition, the financial strength and strategic position of the Group's major outsource partners are actively monitored in order to manage the potential counterparty credit and continuity of service risks they pose.

Reliance on ROL

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

The resources of ROL were increased in 2010 to reflect the growth in the Group's business and increased requirement for oversight of the acquired businesses. There was minimal change in the size and composition of the ROL team during 2011 in line with the stability in the scale of the Group's operational businesses and ongoing restructuring agenda.

The Company has sought to mitigate the risk of reliance on ROL by aligning the interest of the key members of the ROL team through an incentive structure which rewards the founders and staff for the capital value created by the UK Life Project. At the general meeting on 13 January 2012 it was decided that the Company would focus solely on the UK Life Project and changes to the Operating Agreement between the Company and ROL were approved to remove the prohibition on ROL providing services to any organisation other than the Company. There is a formal process of evaluating the performance of ROL against the services it has contracted to provide and this process will continue consistent with ROL's revised obligations under the Operating Agreement. The amendment to the Operating Agreement has extended the protections the Company has against termination of ROL's contract – now ROL may not terminate the agreement under which it provides services to the Company until completion of the UK Life Project (previously 10 December 2013) and then only subject to providing the Company with 12 months' written notice (except that the agreement may be terminated by ROL prior to completion of the UK Life Project (and on shorter notice) upon a change of control of the Company and in certain other limited circumstances). Conversely, the Company is not able to remove ROL in the absence of negligence or material default or similar until completion of the UK Life Project (previously 10 December 2013).

Directors' responsibility statement pursuant to Disclosure and Transparency Rule 4 (extracted from the 2011 Annual Report and Accounts)

The Annual Report and Accounts contains the following statements regarding responsibility for the financial statements and the business review included in the Annual Report and Accounts.

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

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

IFRS financial information

Consolidated income statement

For the year ended 31 December 2011

	Notes	**2011[ii]** **£m**	2010[iii] £m
Revenue			
Gross earned premiums	2	**2,128**	1,288
Premiums ceded to reinsurers	2	**(599)**	(241)
Net earned premiums	2	**1,529**	1,047
Fee and commission income and income from service activities		**771**	751
Investment return		**1,804**	8,426
Total revenue		**4,104**	10,224
Other income	2	**134**	891
Claims, benefits and expenses			
Gross claims and benefits paid		**(3,859)**	(2,004)
Amounts receivable from reinsurers		**643**	322
Net claims and benefits paid		**(3,216)**	(1,682)
Change in insurance contracts liabilities		**216**	(891)
Change in investment contracts liabilities		**495**	(5,863)
Transfer from/(to) unallocated surplus		**484**	(4)
Movement in net asset value attributable to unit-holders		**48**	(139)
Movement in policyholder liabilities		**1,243**	(6,897)
Acquisition expenses		**(591)**	(392)
Administrative and other expenses		**(1,776)**	(1,061)
Finance costs		**(165)**	(127)
Total claims, benefits and expenses		**(4,505)**	(10,159)
Share of loss of associates and joint venture		**(1)**	–
(Loss)/profit before tax from continuing operations		**(268)**	956
Policyholder tax	3	**(220)**	(244)
(Loss)/profit before shareholder tax from continuing operations		**(488)**	712
Total tax credit/(charge)	3	**237**	(136)
Policyholder tax	3	**220**	244
Shareholder tax	3	**457**	108
(Loss)/profit for the year		**(31)**	820
Attributable to:			
Equity holders of the parent[i]		**(62)**	765
Non-controlling interests		**31**	55
(Loss)/profit for the year		**(31)**	820

Earnings per share from continuing operations		**2011** **pence**	2010 pence
Basic earnings per share	5	**(4.35)**	81.10
Diluted earnings per share	5	**(4.35)**	80.47

(i) All profit attributable to equity holders of the Company is from continuing operations.

(ii) The consolidated income statement for the year ended 31 December 2011 includes the results of BHA from 31 January 2011 and the results of WLUK from 7 November 2011.

(iii) The consolidated income statement for the year ended 31 December 2010 includes the results of the acquired AXA UK Life Business from 3 September 2010.

Consolidated statement of comprehensive income

For the year ended 31 December 2011

For the year ended 31 December 2011	Equity holders of the parent £m	Non-controlling interests £m	Total £m
(Loss)/profit for the year	**(62)**	**31**	**(31)**
Actuarial losses on defined benefit schemes	**(34)**	**–**	**(34)**
Foreign exchange adjustments[(i)]	**(10)**	**–**	**(10)**
Shadow accounting[(ii)]	**(1)**	**–**	**(1)**
Aggregate tax effect of above items	**2**	**–**	**2**
Other comprehensive loss, net of tax	**(43)**	**–**	**(43)**
Total comprehensive (loss)/income, net of tax	**(105)**	**31**	**(74)**

For the year ended 31 December 2010	Equity holders of the parent £m	Non-controlling interests £m	Total £m
Profit for the year	765	55	820
Actuarial losses on defined benefit schemes	(46)	–	(46)
Foreign exchange adjustments[(i)]	(6)	–	(6)
Shadow accounting[(ii)]	(3)	–	(3)
Aggregate tax effect of above items	25	–	25
Other comprehensive loss, net of tax	(30)	–	(30)
Total comprehensive income, net of tax	735	55	790

(i) Foreign exchange adjustments relate to the translation of overseas subsidiaries.

(ii) Shadow accounting relates to £2 million (2010: £3 million loss) in respect of foreign exchange adjustments on translation of overseas subsidiaries held by the with-profits fund of FLL and £3 million loss (2010: nil) in respect of revaluation of owner-occupied properties.

Consolidated statement of IFRS based operating profit

For the year ended 31 December 2011

	Notes	**2011 £m**	2010 £m
(Loss)/profit before tax from continuing operations	2	**(268)**	956
Policyholder tax	3	**(220)**	(244)
Returns on Group-controlled funds attributable to third parties		**–**	(23)
(Loss)/profit before tax excluding returns generated within policyholder funds		**(488)**	689
Non-recurring items	2	**180**	(787)
Amortisation and impairment of acquired value of in-force business	6	**675**	364
Amortisation of other acquired intangible assets	6	**84**	64
Interest payable on STICS		**(31)**	(31)
Short-term fluctuations in investment return		**261**	(24)
IFRS based operating profit before tax		**681**	275
Tax on operating profit		**38**	16
IFRS based operating profit after tax attributable to equity holders of the parent[(i)]		**719**	291

Earnings per share		**2011 pence**	2010 pence
Operating earnings per share	5	**50.43**	30.85

(i) IFRS based operating profit excludes: (a) investment variances from expected investment return for non-linked business which is calculated on a long-term rate of return; (b) returns attributable to non-controlling interests in policyholder funds; (c) significant non-recurring items; and (d) amortisation and impairment of present value of acquired in-force business and other intangible assets and is stated after policyholder tax and the deduction of interest payable on STICS. Given the long-term nature of the Group's operations, IFRS based operating profit is considered to be a better measure of the performance of the Group and this measure of profit is used internally to monitor the Group's IFRS results.

Consolidated statement of financial position

At 31 December 2011

As at 31 December	Notes	**2011 £m**	2010 £m
Assets			
Pension scheme surplus	8	**20**	22
Intangible assets	6	**4,847**	5,140
Property and equipment		**58**	46
Investment properties		**3,015**	3,189
Investments in associates and joint venture		**37**	32
Deferred tax assets		**–**	4
Financial assets		**103,636**	99,445
Deferred acquisition costs		**643**	358
Reinsurance assets		**3,213**	2,637
Current tax assets		**6**	22
Insurance and other receivables		**1,140**	976
Cash and cash equivalents		**8,791**	9,288
Assets of operations classified as held for sale		**–**	1,206
Total assets		**125,406**	122,365
Liabilities			
Insurance contracts		**37,264**	35,081
Unallocated surplus		**652**	1,098
Financial liabilities:			
– investment contracts		**75,191**	72,411
– loans and borrowings		**1,195**	1,212
– amounts due to reinsurers		**1,800**	1,666
Net asset value attributable to unit-holders		**1,173**	1,173
Provisions		**228**	221
Deferred tax liabilities		**872**	1,115
Current tax liabilities		**20**	11
Insurance payables, other payables and deferred income		**1,016**	903
Liabilities of operations classified as held for sale	11	**–**	925
Total liabilities		**119,411**	115,816
Equity attributable to equity holders of the parent			
– Share capital		**4,128**	4,317
– Other reserves		**1,544**	1,910
		5,672	6,227
Attributable to non-controlling interests		**323**	322
Total equity		**5,995**	6,549
Total equity and liabilities		**125,406**	122,365

The financial statements were approved by the Board of directors on 26 March 2012.

Consolidated statement of changes in equity

At 31 December 2011

For the year ended 31 December 2011	Attributable to equity holders of the parent				
	Share capital £m	Other reserves £m	Total £m	Non-controlling interests £m	Total £m
At 1 January 2011	**4,317**	**1,910**	**6,227**	**322**	**6,549**
(Loss)/profit for the year	**–**	**(62)**	**(62)**	**31**	**(31)**
Other comprehensive loss	**–**	**(43)**	**(43)**	**–**	**(43)**
Total comprehensive (loss)/income	**–**	**(105)**	**(105)**	**31**	**(74)**
Dividends paid	**–**	**(274)**	**(274)**	**–**	**(274)**
Interest paid on STICS	**–**	**–**	**–**	**(31)**	**(31)**
Appropriations of profit	**–**	**(274)**	**(274)**	**(31)**	**(305)**
Tax relief on STICS interest	**–**	**7**	**7**	**–**	**7**
Shares issued in lieu of dividend	**48**	**–**	**48**	**–**	**48**
Reduction in own shares held by the Group	**13**	**–**	**13**	**–**	**13**
Share repurchase	**(250)**	**–**	**(250)**	**–**	**(250)**
Shares issued during the year	**–**	**–**	**–**	**1**	**1**
Share-based payments	**–**	**6**	**6**	**–**	**6**
At 31 December 2011	**4,128**	**1,544**	**5,672**	**323**	**5,995**

For the year ended 31 December 2010	Attributable to equity holders of the parent				
	Share capital £m	Other reserves £m	Total £m	Non-controlling interests £m	Total £m
At 1 January 2010	2,349	1,306	3,655	615	4,270
Profit for the year	–	765	765	55	820
Other comprehensive loss	–	(30)	(30)	–	(30)
Total comprehensive income	–	735	735	55	790
Dividends paid		(144)	(144)	(7)	(151)
Interest paid on STICS	–	–	–	(31)	(31)
Appropriations of profit	–	(144)	(144)	(38)	(182)
Tax relief on STICS interest	–	9	9	–	9
Shares issued in lieu of dividend	9	–	9	–	9
Disposals of businesses	–	–	–	(310)	(310)
Issue of share capital	1,979	–	1,979	–	1,979
Share-based payments	–	4	4	–	4
Own shares held by the Group	(20)	–	(20)	–	(20)
At 31 December 2010	4,317	1,910	6,227	322	6,549

Consolidated statement of cash flows

For the year ended 31 December 2011

For the year ended 31 December	Notes	2011 £m	2010 £m
Operating activities			
(Loss)/profit for the year		**(31)**	820
Adjusted for:			
– other income		**(116)**	(891)
– net realised and unrealised losses/(gains) on assets at fair value		**1,595**	(6,379)
– finance costs		**165**	127
– amortisation and impairment of intangible assets		**759**	428
– depreciation of property and equipment		**4**	4
– movement in deferred acquisition costs		**(285)**	(312)
– total tax (credit)/charge		**(237)**	136
– purchase of shares and other variable yield securities		**(22,585)**	(21,985)
– sale of shares and other variable yield securities		**22,705**	19,029
– purchase of loans, debt securities and other fixed income securities		**(33,973)**	(33,869)
– sale of loans, debt securities and other fixed income securities		**34,380**	34,880
– purchase of investment properties		**(43)**	(67)
– sale of investment properties		**305**	81
– (decrease)/increase in insurance contract liabilities		**(101)**	925
– (decrease)/increase in investment contract liabilities		**(2,057)**	7,372
– (decrease)/increase in unallocated surplus		**(484)**	2
– decrease in provisions		**(1)**	(3)
– net movement in receivables and payables		**(51)**	667
Pre-tax cash (outflow)/inflow from operating activities		**(51)**	965
Tax (paid)/received		**(25)**	15
Net cash (outflow)/inflow from operating activities		**(76)**	980
Investing activities			
Acquisition of subsidiaries, net of cash acquired		**12**	969
Disposal of held for sale assets, net of cash transferred		**285**	–
Investment in associate		**(6)**	–
Additions to internally generated intangible assets		**(4)**	(4)
Net additions of property and equipment		**(17)**	(1)
Net cash inflow from investing activities		**270**	964
Financing activities			
Proceeds from issue of ordinary share capital		**–**	1,979
Share repurchase		**(250)**	–
Proceeds from issue of long-term debt		**496**	428
Repayment of long-term debt		**(477)**	(123)
Finance costs		**(131)**	(113)
STICS interest		**(31)**	(31)
Net movement in other borrowings, net of expenses		**(36)**	15
Dividends paid to equity holders of the parent		**(226)**	(135)
Proceeds from increase in non-controlling interests		**1**	–
Dividends paid to non-controlling interests		**–**	(7)

Net cash (outflow)/inflow from financing activities	**(654)**	2,013
(Decrease)/increase in cash and cash equivalents	**(460)**	3,957
Balance at beginning of year	**9,288**	5,386
Exchange adjustments on the translation of foreign operations	**(37)**	(55)
Balance at end of year	**8,791**	9,288

Notes to the consolidated accounts

1. Basis of preparation

The financial statements of the Company as at and for the year ended 31 December 2011 comprise the consolidated financial statements of the Company and its subsidiaries (together referred to as "the Group") and the Group's interests in associates and jointly controlled entities.

On 31 January 2011, the Group, through its subsidiary FLL, acquired all of the share capital of BHA. The consolidated income statement therefore includes the results of BHA from that date.

On 7 November 2011, the Group, through its subsidiary FLG, acquired control of WLUK. The consolidated income statement therefore includes the results of WLUK from that date. The acquisition of WLUK was agreed with AXA UK in 2010 at the same time as the acquisition of FASLH was negotiated. However, the share capital of WLUK was not legally acquired by the Group until 2011 as the purchase was contingent upon a transfer under Part VII of FSMA of AXA UK's retained business out of WLUK and approval for the change of control in WLUK being received. These substantive conditions for the acquisition were fulfilled in November 2011 enabling the Group to acquire WLUK's share capital.

Under the terms of the FASLH acquisition in 2010, certain portfolios of business legally owned by the Group as a result of the acquisition were transferred back to AXA UK under Part VII of FSMA. These portfolios were therefore classified as held for sale for the year ended 31 December 2010. In October 2011 the Part VII transfers were successfully completed.

The 2010 comparatives include the results of the acquired AXA UK Life Business from 3 September 2010.

During November 2011, all of the business of FPLAL and BHA and certain portfolios of the business of FLPL were transferred into FLL, their immediate parent company, under Part VII of FSMA. The purpose of this internal group re-organisation was to realise capital and operating synergies for the Friends Life group. Prior to the Part VII transfers, the with-profit liabilities of FPLAL, which were less than £500 million, were reported in the consolidated financial statements of the Group on a non realistic basis. Subsequent to the transfer, these with-profit liabilities have become liabilities of FLL and are required to be reported on a realistic basis. This change does not impact equity attributable to equity holders of the parent in the consolidated financial statements of the Group but does impact the split of the with-profit liabilities between insurance contracts, investment contracts and unallocated surplus. Aside from this change, the Part VII transfers have not generated any other significant impacts on the consolidated financial statements.

The results for the year ended 31 December 2011 have been prepared in accordance with IFRS as adopted by the European Union ("IFRS"). The preliminary announcement for the year ended 31 December 2011 does not constitute the Company's statutory accounts for 2010 or 2011 but has been derived from those accounts. The auditor has reported on the 2011 and 2010 financial statements, and the reports were unqualified and did not include any reference to any matters by way of emphasis. The Group's 2010 consolidated financial statements have been filed with the company registrar.

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

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

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

The International Accounting Standards Board ("IASB") issued the following interpretation which is effective for annual periods beginning on or after 1 July 2010:

- IFRIC 19: Extinguishing financial liabilities with equity instruments. This interpretation does not have a material impact on the Group.

The IASB issued the following changes to standards and interpretations which are effective for accounting periods beginning on or after 1 January 2011:

- IAS 24 (revised): Related party disclosures. The revised standard clarifies and simplifies the definition of a related party and does not have a material impact on the Group; and
- Annual improvements to IFRSs (May 2010). In accordance with the improvement to IFRS 7: Financial Instruments: Disclosures, the Group has disclosed details of collateral held by the Group to mitigate credit risk.

The IASB issued the following change to IFRS 7 which is effective for accounting periods beginning on or after 1 July 2011 and has been early adopted by the Group:

- IFRS 7: Financial Instruments: Disclosures. The amendment enhances the disclosure requirements in relation to transferred financial assets to require information as to any residual risks that remain from an entity's continuing involvement with such assets. Adoption of this amendment has not had a material impact on the Group.

Below is a list of new standards and changes to existing standards that have been issued by the IASB with effective dates for accounting periods beginning on or after 1 January 2012, but where earlier adoption is permitted. They have not been early adopted by the Group in 2011 as they are yet to be endorsed by the European Union ("EU"). The impact of these new requirements is currently being assessed by the Group.

New standards:

- IFRS 9: Financial instruments: classification and measurement. This IFRS reflects the first phase of the IASB's work on the replacement of IAS 39: Financial Instruments: Recognition and Measurement, and relates to the classification and measurement of financial assets as defined in IAS 39. The adoption of IFRS 9 will have a material impact on the classification and measurement of the Group's financial assets;
- IFRS 10: Consolidated Financial Statements. This IFRS provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. It replaces the requirements in IAS 27: Consolidated and Separate Financial Statements and SIC 12: Consolidation – Special Purpose Entities. IFRS 10 is effective for annual periods beginning on or after 1 January 2013;
- IFRS 11: Joint Arrangements. This IFRS establishes principles for the financial reporting by parties to a joint arrangement. It supersedes the requirements in IAS 31: Interests in Joint Ventures and SIC 13: Jointly Controlled Entities – Non Monetary Contributions by Venturers. IFRS 11 is effective for annual periods beginning on or after 1 January 2013;
- IFRS 12: Disclosure of Interests in Other Entities. This IFRS combines, enhances and replaces disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after 1 January 2013; and
- IFRS 13: Fair Value Measurement. This IFRS defines fair value and sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 is effective for annual periods beginning on or after 1 January 2013.

Amendments to existing standards:

- IAS 1: Presentation of Financial Statements. The amendments require companies to group together items within other comprehensive income ("OCI") that may be reclassified to the profit or loss section of the income statement and reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. These amendments are effective for annual periods beginning on or after 1 July 2012;
- IAS 12: Income Taxes. This amendment introduces a rebuttable assumption that where certain assets (including investment property and intangible assets) are measured at either fair value or under a revaluation model, deferred tax should be calculated on the assumption that the asset will be sold at its carrying amount. This amendment is effective for annual periods beginning on or after 1 January 2012; and
- IAS 19: Employee Benefits. The amendment eliminates the option to defer the recognition of gains and losses, known as the "corridor method". This amendment is effective for accounting periods beginning on or after 1 January 2013.

The financial statements comply with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005 (as amended in December 2006) insofar as these requirements do not contradict the requirements of IFRS.

The Group presents its balance sheet in order of liquidity. Where applicable, for each asset and liability line item that combines amounts expected to be recovered or settled both within and beyond 12 months after the balance sheet date, disclosure of the amount due beyond 12 months is made in the respective note.

Financial assets and financial liabilities are not offset, unless there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by an accounting standard or interpretation, as specifically disclosed in the accounting policies of the Group.

2. Segmental information

(a) Summary

Segmental information is presented on the same basis as internal financial information used by the Group to evaluate operating performance. Segmental information relating to revenue, net income, products and services for the year ended 31 December 2011 includes BHA from 31 January and WLUK from 7 November. The segmental information for the year ended 31 December 2010 includes twelve months for the acquired Friends Provident business and four months for the acquired AXA UK Life Business.

The Group's management and internal reporting structure is based on the following operating segments which all meet the definition of a reportable segment under IFRS 8: *Operating segments*:

- UK comprising the former Friends Provident UK life and pensions business, the acquired AXA UK Life Business (including WLUK), BHA, Sesame Bankhall and, for the period prior to 19 March 2010 when it was disposed, Pantheon Financial Limited;
- International comprising FPIL, the overseas life assurance business within the UK life and pensions subsidiaries and the Group's share of AmLife and AmFamily; and
- Lombard.

Corporate functions are not strictly an operating segment, but are reported to management and are provided in the analysis below to reconcile the Group's reportable segments to total profit.

(b) Operating segment information

(i) IFRS based operating profit

Year ended 31 December 2011	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Total £m
Life and pensions operating profit	**706**	**49**	**40**	**–**	**–**	**795**
Longer-term shareholder investment return	**(5)**	**1**	**(1)**	**(21)**	**–**	**(26)**
Other expense	**(1)**	**(3)**	**–**	**(7)**	**(41)**	**(52)**
Development costs	**(28)**	**(7)**	**(1)**	**–**	**–**	**(36)**
IFRS based operating profit/(loss) before tax	**672**	**40**	**38**	**(28)**	**(41)**	**681**
Tax on operating profit						**38**
IFRS based operating profit after tax attributable to ordinary shareholders						**719**
Operating earnings per share (pence)						**50.43**

Year ended 31 December 2010	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Total £m
Life and pensions operating profit	176	94	38	–	–	308
Longer-term shareholder investment return	30	1	(4)	(14)	–	13
Other income/(expense)	2	6	–	(11)	(15)	(18)
Development costs	(21)	(6)	(1)	–	–	(28)
IFRS based operating profit/(loss) before tax	187	95	33	(25)	(15)	275
Tax on operating profit						16
IFRS based operating profit after tax attributable to ordinary shareholders						291
Operating earnings per share (pence)						30.85

(ii) Reconciliation of IFRS based operating result before tax to profit before tax from continuing operations

Year ended 31 December 2011	**UK £m**	**Int'l £m**	**Lombard £m**	**FLG corporate £m**	**RSL corporate £m**	**Total £m**
IFRS based operating profit/(loss) before tax	**672**	**40**	**38**	**(28)**	**(41)**	**681**
Non-recurring items[(i)]	**(178)**	**(1)**	**(1)**	**–**	**–**	**(180)**
Amortisation and impairment of acquired value of in-force business	**(483)**	**(126)**	**(66)**	**–**	**–**	**(675)**
Amortisation of other acquired intangible assets	**(45)**	**(8)**	**(30)**	**(1)**	**–**	**(84)**
Interest payable on STICS	**31**	**–**	**–**	**–**	**–**	**31**
Short-term fluctuations in investment return[(iii)]	**(247)**	**(10)**	**(1)**	**(3)**	**–**	**(261)**
Loss before policyholder and shareholder tax	**(250)**	**(105)**	**(60)**	**(32)**	**(41)**	**(488)**
Policyholder tax	**220**	**–**	**–**	**–**	**–**	**220**
Loss before tax from continuing operations	**(30)**	**(105)**	**(60)**	**(32)**	**(41)**	**(268)**

Year ended 31 December 2010	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Total £m
IFRS based operating profit/(loss) before tax	187	95	33	(25)	(15)	275
Non-recurring items(ii)	(121)	(6)	–	928	(14)	787
Amortisation of acquired present value of in-force business	(169)	(123)	(72)	–	–	(364)
Amortisation of other acquired intangible assets	(27)	(8)	(28)	(1)	–	(64)
Interest payable on STICS	31	–	–	–	–	31
Short-term fluctuations in investment return(iii)	28	2	1	(7)	–	24
Profit/(loss) before tax excluding returns generated within policyholder funds	(71)	(40)	(66)	895	(29)	689
Policyholder tax	244	–	–	–	–	244
Returns on Group-controlled funds attributable to third parties	23	–	–	–	–	23
Profit/(loss) before tax from continuing operations	196	(40)	(66)	895	(29)	956

(i) UK non-recurring items include £68 million (£67 million net of stamp duty expenses) in respect of the gain on acquisition of BHA and £48 million (£46 million net of stamp duty expenses) in respect of the gain on acquisition of WLUK. Further details are set out in note 11. This is offset by £293 million of non-recurring costs comprising £128 million of separation and integration costs in respect of the UK Life Project, £55 million in respect of Solvency II and finance system developments, £84 million of reserve impacts in respect of the outsourcing arrangement with Diligenta and £26 million of other costs.

(ii) Corporate non-recurring items include £883 million in respect of the gain on acquisition of AXA UK Life Business. Further details are set out in note 11. Non-recurring costs of £96 million comprise £34 million of separation and integration costs in respect of the acquired AXA UK Life Business, £28 million in respect of expensed acquisition costs, £24 million in respect of Solvency II and other finance transformation costs and £10 million of other items. Segment results also include £80 million of non-recurring items comprising recharges to the life companies for pension scheme contributions. The net impact of the recharge for the Group is nil.

(iii) Includes shareholder investment return short-term fluctuations and investment variances arising from the mismatching of fixed-interest assets and the liabilities they are backing as well as the impact of credit default assumptions. This latter variance reflects profits or losses in excess of the expected investment return on the assets and the impact of the corresponding economic assumption changes on the liabilities.

(iii) Revenue and expenses

For the year ended 31 December 2011	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Elimination of inter-segment amounts[(ii)] £m	Total £m
Gross earned premiums on insurance and investment contracts	**5,270**	**1,260**	**2,373**	**–**	**–**	**–**	**8,903**
Investment contract premiums[(i)]	**(3,225)**	**(1,177)**	**(2,373)**	**–**	**–**	**–**	**(6,775)**
Gross earned premiums	**2,045**	**83**	**–**	**–**	**–**	**–**	**2,128**
Premiums ceded to reinsurers	**(598)**	**(1)**	**–**	**–**	**–**	**–**	**(599)**
Net earned premiums	**1,447**	**82**	**–**	**–**	**–**	**–**	**1,529**
Fee and commission income	**546**	**114**	**110**	**1**	**–**	**–**	**771**
Investment return	**2,657**	**(400)**	**(461)**	**57**	**34**	**(83)**	**1,804**
Total revenue	**4,650**	**(204)**	**(351)**	**58**	**34**	**(83)**	**4,104**
Inter-segment revenue	**2**	**1**	**–**	**47**	**33**	**(83)**	**–**
Total external revenue	**4,648**	**(205)**	**(351)**	**11**	**1**	**–**	**4,104**
Other income[(iii)]	**134**	**–**	**–**	**–**	**–**	**–**	**134**
Net claims and benefits paid	**(3,209)**	**(7)**	**–**	**–**	**–**	**–**	**(3,216)**
Movement in insurance and investment contract liabilities	**(183)**	**346**	**548**	**–**	**–**	**–**	**711**
Transfer to unallocated surplus	**490**	**(6)**	**–**	**–**	**–**	**–**	**484**
Movement in net assets attributable to unit-holders	**48**	**–**	**–**	**–**	**–**	**–**	**48**
Acquisition expenses	**(497)**	**(47)**	**(47)**	**–**	**–**	**–**	**(591)**
Administrative and other expenses	**(1,348)**	**(177)**	**(208)**	**(8)**	**(35)**	**–**	**(1,776)**
Finance costs	**(115)**	**(9)**	**(2)**	**(82)**	**(40)**	**83**	**(165)**
Total claims, benefits and expenses	**(4,814)**	**100**	**291**	**(90)**	**(75)**	**83**	**(4,505)**
Inter-segment expenses	**(47)**	**(3)**	**–**	**(33)**	**–**	**83**	**–**
Total external claims, benefits and expenses	**(4,767)**	**103**	**291**	**(57)**	**(75)**	**–**	**(4,505)**
Share of loss of associates and joint venture	**–**	**(1)**	**–**	**–**	**–**	**–**	**(1)**
Loss before tax from continuing operations	**(30)**	**(105)**	**(60)**	**(32)**	**(41)**	**–**	**(268)**
Policyholder tax	**(220)**	**–**	**–**	**–**	**–**	**–**	**(220)**
Shareholder tax	**437**	**(4)**	**29**	**(5)**	**–**	**–**	**457**
Segmental result after tax	**187**	**(109)**	**(31)**	**(37)**	**(41)**	**–**	**(31)**

(i) Accounted for as deposits under IFRS.

(ii) Eliminations include inter-segment fee income and loan interest. Inter-segment transactions are undertaken on an arm's length basis.

(iii) Includes gains on acquisitions of BHA (£68 million) and WLUK (£48 million).

For the year ended 31 December 2010	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Elimination of inter-segment amounts[(ii)] £m	Total £m
Gross earned premiums on insurance and investment contracts	3,457	1,063	3,021	–	–	–	7,541
Investment contract premiums[(i)]	(2,181)	(1,051)	(3,021)	–	–	–	(6,253)
Gross earned premiums	1,276	12	–	–	–	–	1,288
Premiums ceded to reinsurers	(240)	(1)	–	–	–	–	(241)
Net earned premiums	1,036	11	–	–	–	–	1,047
Fee and commission income	373	266	111	1	–	–	751
Investment return	6,477	569	1,374	22	20	(36)	8,426
Total revenue	7,886	846	1,485	23	20	(36)	10,224
Inter-segment revenue	3	1	–	14	18	(36)	–
Total external revenue	7,883	845	1,485	9	2	–	10,224
Other income[(iii)]	8	–	–	883	–	–	891
Net claims and benefits paid	(1,678)	(4)	–	–	–	–	(1,682)
Movement in insurance and investment contract liabilities	(4,768)	(694)	(1,292)	–	–	–	(6,754)
Transfer to unallocated surplus	(2)	(2)	–	–	–	–	(4)
Movement in net assets attributable to unit-holders	(139)	–	–	–	–	–	(139)
Acquisition expenses	(329)	(15)	(48)	–	–	–	(392)
Administrative and other expenses	(670)	(169)	(208)	18	(32)	–	(1,061)
Finance costs	(108)	(6)	(3)	(29)	(17)	36	(127)
Total claims, benefits and expenses	(7,694)	(890)	(1,551)	(11)	(49)	36	(10,159)
Inter-segment expenses	(3)	(1)	–	(32)	–	36	–
Total external claims, benefits and expenses	(7,691)	(889)	(1,551)	21	(49)	–	(10,159)
Share of profits of associate and joint venture	(4)	4	–	–	–	–	–
Profit/(loss) before tax from continuing operations	196	(40)	(66)	895	(29)	–	956
Policyholder tax	(244)	–	–	–	–	–	(244)
Shareholder tax	99	7	21	(19)	–	–	108
Segmental result after tax	51	(33)	(45)	876	(29)	–	820

(i) Accounted for as deposits under IFRS.

(ii) Eliminations include inter-segment fee income and loan interest. Inter-segment transactions are undertaken on an arm's length basis.

(iii) Includes £883 million in respect of the gain on acquisition of the AXA UK Life Business.

(iv) Products and services

For the year ended 31 December 2011	Protection £m	Investment £m	Annuities £m	Individual pensions £m	Group pensions £m	Other[(i)] £m	Total £m
Gross earned premiums	1,109	491	407	63	58	–	2,128
Net earned premiums	876	489	46	61	57	–	1,529
Fee and commission income	3	294	–	246	19	209	771
Total external revenue	879	783	46	307	76	209	2,300

For the year ended 31 December 2010	Protection £m	Investment £m	Annuities £m	Individual pensions £m	Group pensions £m	Other[(i)] £m	Total £m
Gross earned premiums	598	312	327	42	9	–	1,288
Net earned premiums	480	310	207	41	9	–	1,047
Fee and commission income	(3)	423	–	145	6	180	751
Total external revenue	477	733	207	186	15	180	1,798

(i) Other includes revenue streams from Sesame Bankhall and Pantheon (for the period prior to its disposal on 19 March 2010).

(v) Assets and liabilities

As at 31 December 2011	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Elimination of inter-segment amounts[(i)] £m	Total £m
Segment assets	**99,262**	**7,450**	**18,190**	**1,725**	**294**	**(1,552)**	**125,369**
Investments in associates and joint venture	**5**	**32**	**–**	**–**	**–**	**–**	**37**
Total assets	**99,267**	**7,482**	**18,190**	**1,725**	**294**	**(1,552)**	**125,406**
Total liabilities	**94,551**	**7,189**	**17,773**	**1,003**	**447**	**(1,552)**	**119,411**
Other segment information:							
– Capital expenditure	**7**	**–**	**4**	**9**	**–**	**–**	**20**
– Depreciation	**1**	**–**	**1**	**2**	**–**	**–**	**4**
– Amortisation	**458**	**134**	**95**	**1**	**–**	**–**	**688**
– Impairment	**71**	**–**	**–**	**–**	**–**	**–**	**71**

As at 31 December 2010	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Elimination of inter-segment amounts[(i)] £m	Total £m
Segment assets	96,551	7,184	17,930	1,325	911	(1,568)	122,333
Investments in associate and joint venture	5	27	–	–	–	–	32
Total assets	96,556	7,211	17,930	1,325	911	(1,568)	122,365
Total liabilities	91,237	6,814	17,487	936	910	(1,568)	115,816
Other segment information:							
– Capital expenditure	1	–	4	1	–	–	6
– Depreciation	1	–	1	2	–	–	4
– Amortisation	196	131	100	1	–	–	428

(i) Eliminations mainly comprise intercompany loans.

(c) Geographical segmental information

In presenting geographical segment information, segment revenue is based on the geographical location of customers. The Group has defined two geographical areas: UK and the rest of the world.

For the year ended 31 December 2011	**UK £m**	**Rest of the world £m**	**Total £m**
Gross earned premiums	**2,042**	**86**	**2,128**
Fee and commission income	**566**	**205**	**771**
Revenue from external customers	**2,608**	**291**	**2,899**
Investment return			**1,804**
Premiums ceded to reinsurers			**(599)**
Total revenue			**4,104**

For the year ended 31 December 2010	UK £m	Rest of the world £m	Total £m
Gross earned premiums	1,276	12	1,288
Fee and commission income	398	353	751
Revenue from external customers	1,674	365	2,039
Investment return			8,426
Premiums ceded to reinsurers			(241)
Total revenue			10,224

3. Taxation

(a) Tax recognised in the income statement

For the year ended 31 December	**2011 £m**	2010 £m
Current tax		
UK corporation tax at 26.5% (2010: 28%)	**52**	16
Adjustments in respect of prior periods	**(11)**	(15)
Overseas taxation	**18**	6
Total current tax charge	**59**	7
Deferred tax		
Origination and reversal of temporary differences	**(322)**	121
Adjustments in respect of prior periods	**26**	8
Total deferred tax (credit)/charge	**(296)**	129
Total tax (credit)/charge	**(237)**	136
Analysis:		
– policyholder tax	**220**	244
– shareholder tax	**(457)**	(108)
Total tax (credit)/charge	**(237)**	136

Policyholder tax is tax on the income and investment returns charged to policyholders of linked and with-profits funds. Shareholders' tax is tax charged to shareholders on the profits of the Group. During the year legislation was enacted to bring in a phased decrease in the rate of corporation tax to 26% on 1 April 2011 and 25% on 1 April 2012. Under IFRS, deferred tax is calculated using rates substantively enacted by the balance sheet date and as such the reduction to a 25% rate has been taken into account in deferred tax balances. Further incremental rate reductions have been announced but not substantively enacted by the balance sheet date. For further information please refer to note 13.

(b) Factors affecting tax charge for period

For the year ended 31 December	**2011 £m**	2010 £m
(Loss)/profit before tax from continuing operations	**(268)**	956
(Loss)/profit before tax from continuing operations determined with reference to the standard rate of corporation tax in the UK of 26.5% (2010: 28%)	**(71)**	268
Effects of:		
– non-taxable income	**(232)**	(115)
– deductions not allowable for tax purposes	**22**	46
– tax on reserving adjustments	**41**	7
– overseas tax	**(6)**	–
– utilisation of excess expenses brought forward	**–**	(8)
– valuation of tax losses	**(123)**	(43)
– with-profits minority interest(i)	**–**	(8)
– adjustments in respect of prior periods	**(8)**	(7)
– non-taxable gain on acquisition	**(31)**	(247)
– reduction in corporation tax rate from 27% to 25% (2010: 28% to 27%)	**(60)**	(8)
– non-taxable result of Resolution Holding Companies	**11**	7
– policyholder tax	**220**	244
Total tax (credit)/charge	**(237)**	136

(i) The effect of with-profits minority interest in 2010 related to tax on F&C Commercial Property Trust prior to deconsolidation.

4. Appropriations of profit

a) Dividends paid on ordinary shares

A final dividend in respect of 2010 of 12.57 pence per ordinary share was paid on 28 May 2011 comprising £141 million of cash and £41 million of shares issued in lieu of dividends. An interim dividend of 6.47 pence per ordinary share was paid on 7 October 2011 comprising £85 million of cash and £7 million of shares issued in lieu of dividends.

As required by IAS 10: *Events after the balance sheet date*, dividends declared after the balance sheet date are not accrued in these accounts. Also as required by IFRS, the costs of these dividends are taken directly to reserves. Subject to the approval of shareholders at the annual general meeting on 17 May 2012, a dividend of 13.42 pence per share will be paid on 21 May 2012 amounting to £185 million. Accordingly, this amount is not reflected in these financial statements.

b) Step-up Tier 1 Insurance Capital Securities interest

The Step-up Tier 1 Insurance Capital Securities ("STICS") are accounted for as equity instruments under IFRS and consequently the interest on the STICS is recorded in the financial statements as though it were a dividend.

Interest on the 2003 STICS is paid in equal instalments in May and November each year at a rate of 6.875%. During the year ended 31 December 2011, interest of £14 million (2010: £14 million) was paid to the 2003 STICS holders.

Interest on the 2005 STICS is paid annually in June at a rate of 6.292%, and interest of £17 million (2010: £17 million) was paid on 30 June 2011.

These interest payments are shown as movements in reserves in these financial statements together with the related tax relief.

5. Earnings per share

a) Basic and operating earnings per share from continuing operations

Earnings per share have been calculated based on the profit after tax and on the operating profit after tax, attributable to ordinary shareholders of the parent and the weighted number of shares in issue. The directors consider that underlying earnings per share provides a better indication of operating performance.

For the year ended 31 December	**2011 Earnings £m**	2011 Pence per share	2010 Earnings £m	2010 Pence per share
(Loss)/profit after tax attributable to equity holders of the parent	**(62)**	(4.35)	765	81.10
Short-term fluctuations in investment return	**261**	18.31	(24)	(2.54)
Non-recurring items	**180**	12.62	(787)	(83.43)
Amortisation and impairment of acquired intangible assets	**759**	53.23	428	45.37
Tax credit on items excluded from operating profit	**(419)**	(29.38)	(91)	(9.65)
IFRS based operating profit after tax attributable to equity holders of the parent	**719**	50.43	291	30.85

b) Diluted basic earnings per share from continuing operations

There were no dilutive factors for the year ended 31 December 2011.

For the year ended 31 December 2010	Earnings £m	Weighted average number of shares number	Pence per share
Profit after tax attributable to ordinary shareholders of the parent	765	943,284,481	81.10
Dilution	–	7,347,287	(0.63)
Diluted profit after tax attributable to ordinary shareholders of the parent	765	950,631,768	80.47

c) Weighted average number of ordinary shares

For the year ended 31 December 2011	**Actual**	**Weighted**
Issued ordinary shares at beginning of period	**1,452,564,371**	**1,452,564,371**
Own shares held by the Group	**(8,579,292)**	**(8,579,292)**
	1,443,985,079	**1,443,985,079**
Effect of:		
– scrip dividend (final 2010)	**13,639,313**	**8,183,588**
– share repurchase	**(92,990,516)**	**(31,044,327)**
– scrip dividend (interim 2011)	**2,975,821**	**717,458**
– reduction in own shares held	**8,579,292**	**4,324,903**
– own shares held through acquisition	**(2,661,384)**	**(393,739)**
Number of ordinary shares at end of period	**1,373,527,605**	**1,425,772,962**

c) Weighted average number of ordinary shares

For the year ended 31 December 2010	Actual	Weighted
Issued ordinary shares at beginning of period	2,412,451,145	2,412,451,145
Effect of:		
– scrip dividend (final 2009)	5,753,268	3,436,198
– share consolidation	(2,337,597,599)	(2,335,357,765)
– rights issue	1,370,315,835	865,193,173
– scrip dividend (interim 2010)	1,641,722	382,319
– own shares held by the Group	(8,579,292)	(2,820,589)
Number of ordinary shares at end of period	1,443,985,079	943,284,481

6. Intangible assets

Movements in intangible assets are as follows:

For the year ended 31 December 2011	AVIF £m	Other £m	Total £m
Cost			
At 1 January 2011	**5,107**	**528**	**5,635**
Acquisition of subsidiaries [(i)]	**411**	**37**	**448**
Other additions	**–**	**4**	**4**
Disposals	**–**	**(5)**	**(5)**
Foreign exchange adjustments	**3**	**(4)**	**(1)**
At 31 December 2011	**5,521**	**560**	**6,081**
Amortisation and impairment			
At 1 January 2011	**422**	**73**	**495**
Amortisation charge for the period[(ii)]	**604**	**84**	**688**
Impairment charge[(ii)]	**71**	**–**	**71**
Disposals	**–**	**(5)**	**(5)**
Foreign exchange adjustments	**(13)**	**(2)**	**(15)**
At 31 December 2011	**1,084**	**150**	**1,234**
Carrying amounts at 31 December 2011	**4,437**	**410**	**4,847**

For the year ended 31 December 2010	AVIF £m	Other £m	Total £m
Cost			
At 1 January 2010	2,938	382	3,320
Acquisition of AXA UK Life Business	2,192	150	2,342
Other additions	–	4	4
Foreign exchange adjustments	(23)	(8)	(31)
At 31 December 2010	5,107	528	5,635
Amortisation			
At 1 January 2010	59	10	69
Amortisation charge for the period	364	64	428
Foreign exchange adjustments	(1)	(1)	(2)
At 31 December 2010	422	73	495
Carrying amounts at 31 December 2010	4,685	455	5,140

(i) Acquisitions in 2011 related to BHA and WLUK, see note 11.

(ii) Amortisation and impairment charges are included within administrative and other expenses in the consolidated income statement.

A detailed exercise was undertaken to identify intangible assets as part of the acquisition of BHA on 31 January 2011 and WLUK on 7 November 2011. As a result of the BHA review it was decided that the acquired business represented an additional cash generation unit ("CGU"). Intangible assets identified within BHA related to acquired value of in-force business ("AVIF") and software totalling £180 million. Intangible assets identified within WLUK related to AVIF and distribution channels and customer relationships totalling £268 million and are included in the UK – AXA UK Life Business CGU.

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.

For each type of asset, the useful economic life was determined, being the period over which the asset is expected to contribute directly or indirectly to future cash flows. The value of the assets will be amortised over their respective useful economic lives.

The "AXA" and "BUPA" brands and associated brands that existed within the acquired businesses have been retained by AXA UK plc and Bupa Finance plc respectively and as such no value has been attributed to them.

The "Friends" brand has been retained by the Group and during the course of the year, a rebranding exercise was carried out to change all inherited brands to "Friends Life".

(a) AVIF

On acquisition of a portfolio of insurance contracts and/or investment contracts, either directly or through the acquisition of a subsidiary undertaking, the net present value of the Group's interest in the expected pre-tax cash flows of the in-force business is capitalised in the balance sheet as the AVIF. AVIF is shown gross of policyholder and shareholder tax of £995 million (2010: £1,076 million), with the offsetting balance included in deferred taxation. The AVIF is based on the value of in-force business calculated on a market consistent embedded value basis.

AVIF is allocated to CGUs, which represent the lowest level within the Group at which AVIF is monitored for internal management purposes. An analysis of AVIF by operating segments used for segmental reporting (see note 2) is set out below:

As at 31 December 2011	Cost £m	Impairment £m	Amortisation £m	Net book value £m
UK	**3,907**	**(71)**	**(608)**	**3,228**
International	**1,014**	**–**	**(250)**	**764**
Lombard	**600**	**–**	**(155)**	**445**
Total	**5,521**	**(71)**	**(1,013)**	**4,437**

As at 31 December 2010	Cost £m	Amortisation £m	Net book value £m
UK	3,496	(196)	3,300
International	995	(132)	863
Lombard	616	(94)	522
Total	5,107	(422)	4,685

(b) Other intangibles

Other intangibles are made up of the following:

As at 31 December 2011	Cost £m	Amortisation £m	Net book value £m
Distribution channels and customer relationships	**444**	**(112)**	**332**
Brand	**49**	**(19)**	**30**
Software	**54**	**(19)**	**35**
Goodwill	**13**	**–**	**13**
Total	**560**	**(150)**	**410**

As at 31 December 2010	Cost £m	Amortisation £m	Net book value £m
Distribution channels and customer relationships	419	(54)	365
Brand	49	(10)	39
Software	47	(9)	38
Goodwill	13	-	13
Total	528	(73)	455

(c) Impairment

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 income statement. As at 31 December 2011, based on an impairment review of each of the CGUs, the directors are satisfied that none of the Group’s intangible assets are impaired, except as stated below.

Impact of negative reserves

During the period, FLC and the acquired BHA business revised their reserving methodology by allowing for negative reserves on protection business as allowed for in the FSA Policy Statement 06/14. The benefit of negative reserving has been offset by an acceleration of AVIF amortisation of £130 million in the AXA UK Life Business CGU and by an impairment charge against AVIF of £71 million in the BHA CGU. This is included within administrative and other expenses in the consolidated income statement.

The impairment arose from the implementation of negative reserves, which resulted in an earlier recognition of surplus and the recoverable amount of the AVIF being assessed to be lower than the carrying value. The AVIF asset which has been impaired is included in the UK segment (disclosed in note 2).

For the purpose of the AVIF impairment test, the calculation of the recoverable amount is consistent with its measurement at initial recognition and is based on a current adjusted MCEV VIF balance for pre-acquisition business only, which represents a reasonable basis for determining future profits generated by the asset acquired.

6. Financial assets

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

As at 31 December	**2011 £m**	2010 £m
Fair value through profit or loss (note 7(a))		
Designated on initial recognition	**102,756**	98,312
Held for trading	**875**	456
Loans at amortised cost (note 7 (f))	**5**	677
Total financial assets	**103,636**	99,445

Derivative financial instruments are classified as held for trading in accordance with IAS 39: *Financial instruments: Recognition and measurement*. All other financial assets recognised at fair value through profit and loss are designated as such on initial recognition.

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

As at 31 December 2011	**With-profits £m**	**Unit-linked £m**	**Non-linked annuities £m**	**Non-linked other £m**	**Shareholder £m**	**Total £m**
Shares and other variable yield securities	**7,106**	**53,487**	**–**	**108**	**9**	**60,710**
Debt securities and other fixed income securities:						
– Government securities:						
– Loaned government securities	**–**	**–**	**–**	**198**	**–**	**198**
– Other government securities	**8,469**	**8,507**	**1,069**	**993**	**274**	**19,312**
– Corporate bonds	**9,020**	**5,665**	**5,969**	**1,214**	**287**	**22,155**
Derivative financial instruments	**762**	**7**	**97**	**9**	**–**	**875**
Deposits with credit institutions	**–**	**381**	**–**	**–**	**–**	**381**
Total financial assets held at fair value	**25,357**	**68,047**	**7,135**	**2,522**	**570**	**103,631**

(i) On 11 May 2011, the Group provided a £200 million collateralised loan to Barclays Bank plc which matures on 31 July 2012. UK government securities were loaned and the assets remain on balance sheet as substantially all the risks and rewards of ownership are retained by the Group. The Group holds collateral in respect of these arrangements.

As at 31 December 2010	With-profits £m	Unit-linked £m	Non-linked annuities £m	Non-linked other £m	Shareholder £m	Total £m
Shares and other variable yield securities	8,108	52,003	–	241	8	60,360
Debt securities and other fixed income securities:						
– Government securities	6,937	7,644	659	716	189	16,145
– Corporate bonds	8,885	5,445	5,634	922	569	21,455
Derivative financial instruments	393	24	39	5	(5)	456
Deposits with credit institutions	3	349	–	–	–	352
Total financial assets held at fair value	24,326	65,465	6,332	1,884	761	98,768

As at 31 December 2011, the fair value of the collateral received from counterparties was £850 million (2010: £306 million). No collateral received from the counterparties has been sold or re-pledged. The fair value of loans is considered to be the same as their carrying value

The above unit-linked column and with-profits column include £1,129 million (2010: £964 million) of financial assets (£818 million of shares, £219 million of government securities and £92 million of corporate bonds) relating to the minority interests in the OEICs that have been consolidated as the Group holding is 50% or more.

For unit-linked funds, the policyholders bear the investment risk and any change in asset values is matched by a broadly equivalent change in the liability.

The majority of financial assets held are readily realisable. However, amounts of £93,863 million (2010: £87,707 million) are not expected to be realised for more than 12 months after the balance sheet date in line with the expected maturity of insurance/investment contract liabilities.

Asset-backed securities (excluding those held by the linked funds) amount to £3,060 million (2010: £2,505 million) and 94% (2010: 92%) of these are at investment grade.

b) Determination of fair value hierarchy

In accordance with the requirements of IFRS 7: *Financial Instruments: Disclosures*, financial assets at fair value have been classified into three categories as set out below. Financial assets at fair value include shares and other variable yield securities, government securities, corporate bonds (including asset-backed securities), derivative financial instruments and deposits with credit institutions.

Level 1 – quoted prices (unadjusted) in active markets for identical assets. An active market is one in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Examples include listed equities and bonds in active markets and quoted unit trusts/OEICs.

Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category generally includes assets that are priced based on models using market observable inputs. Examples include certain corporate bonds, certificates of deposit and derivatives.

Level 3 – inputs that are not based on observable market data. Assets with single price feeds and/or limited trading activity are included in this category. Examples include unlisted equities and private equity investments.

The majority of the Group's assets held at fair value are valued based on quoted market information or market observable data. Approximately 4% (5% excluding unit-linked assets) are based on valuation techniques where significant observable market data are not available or the price is not observable from current market transactions. However, the fair value measurement objective of these assets remains the same, that is, an exit price from the perspective of the Group.

The fair values of these assets are generally provided by external parties. During the year, the Group has performed independent reviews of pricing models to ensure that appropriate methodologies have been applied. The approach taken for each class of specific unlisted investment is as follows:

The valuation of the holdings in private equity limited partnerships and companies is based on the most recent underlying valuations available at the reporting date as adjusted for contributions, distributions and known diminutions in value of individual underlying investments in the period since valuations were performed. The valuation technique is not supported by observable market values. Valuation of private equity holdings are prepared in accordance with International Private Equity and Venture Capital Board ("IPEV") guidelines.

The fair value of the investments in property limited partnerships is taken as the Group's appropriate share of the net asset value of the partnerships. The net asset value is based on the latest external market valuation of the underlying property investments, which is updated at least every six months. The valuation would be adjusted in the event of a significant market movement in the period between the last market valuation and the reporting date.

Private loans are valued using discounted cash flows, which are carried out by investment managers and reviewed by management. The interest rate used when calculating the present value is derived from the UK Gilts Curve, adjusting the spread by the movement in the most appropriate IBoxx GBP Corp Curve associated with the loan rating, where available. All spreads are reviewed on a quarterly basis and any spreads that appear inappropriate taking into consideration loan details (loan sector, maturity and rating), available market proxies, comparable instruments and underlying securities are recalibrated accordingly.

The Group has invested in a mortgage loan issued by AXA Equitable in the US. The mortgage loan is secured against the property. The loan is valued by external real estate advisors using discounted cash flows. The discount rate used in the calculation is determined by adding an appropriate spread (based on property type, prevailing interest rates and the current mortgage spread over US treasuries) to the yield of an appropriate US Treasury Bond with the maturity closest to the maturity of the loan. The loan is denominated in US dollars.

The requirements of IFRS 7 also require financial liabilities at fair value to be categorised into Level 1, 2 or 3 hierarchies. Financial liabilities at fair value include unit-linked contracts, amounts due to reinsurers, net asset value attributable to unit-holders (non-controlling interests in the OEICs that are consolidated) and derivative financial instruments. The classifications take into account the types of inputs used to determine the fair value measurements. For unit-linked funds

this has been undertaken on a fund-by-fund basis. For the net asset value attributable to unit-holders, this has been analysed in the same proportion as the underlying consolidated investments categorisation.

The Group has financial liabilities which contain discretionary participation features of £9,426 million (2010: £9,123 million) that form part of its with-profits funds. Products giving rise to these liabilities are mainly investment or pension contracts with a unitised with-profits element. The Group is unable to measure the fair value of these financial liabilities reliably due to the lack of a robust basis to measure the supplemental discretionary returns arising on with-profits contracts and because there is not an active market for such instruments. These liabilities have therefore been excluded from the fair value hierarchy analysis below.

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. The table shows both the total financial assets and liabilities and the total excluding unit-linked assets and liabilities, as shareholders have no direct exposure to profits or losses on unit-linked assets (other than through investment management fees).

	Including unit-linked				Excluding unit-linked			
As at 31 December 2011	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets held at fair value								
Shares and other variable yield securities	**47,801**	**9,699**	**3,210**	**60,710**	**5,827**	**272**	**1,124**	**7,223**
Debt securities and other fixed income securities:								
– government securities	**19,220**	**285**	**5**	**19,510**	**10,913**	**85**	**5**	**11,003**
– corporate bonds (including ABS)	**11,952**	**8,944**	**1,259**	**22,155**	**9,420**	**6,560**	**510**	**16,490**
Derivative financial instruments	**67**	**808**	**–**	**875**	**60**	**808**	**–**	**868**
Deposits with credit institutions	**366**	**15**	**–**	**381**	**–**	**–**	**–**	**–**
Total financial assets held at fair value	**79,406**	**19,751**	**4,474**	**103,631**	**26,220**	**7,725**	**1,639**	**35,584**
Financial liabilities held at fair value								
Unit-linked investment contracts	**–**	**65,259**	**–**	**65,259**	**–**	**–**	**–**	**–**
Amounts due to reinsurers	**–**	**1,800**	**–**	**1,800**	**–**	**1,800**	**–**	**1,800**
Net asset value attributable to unit-holders	**1,173**	**–**	**–**	**1,173**	**36**	**–**	**–**	**36**
Derivative financial instruments	**44**	**243**	**–**	**287**	**26**	**239**	**–**	**265**
Total financial liabilities held at fair value	**1,217**	**67,302**	**–**	**68,519**	**62**	**2,039**	**–**	**2,101**

As at 31 December 2010	Including unit-linked Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Excluding unit-linked Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets held at fair value								
Shares and other variable yield securities	48,119	8,892	3,349	60,360	7,103	271	983	8,357
Debt securities and other fixed income securities:								
– government securities	16,094	51	–	16,145	8,500	1	–	8,501
– corporate bonds (including ABS)	12,317	8,035	1,103	21,455	9,601	6,051	358	16,010
Derivative financial instruments	54	402	–	456	51	381	–	432
Deposits with credit institutions	351	1	–	352	3	–	–	3
Total financial assets held at fair value	76,935	17,381	4,452	98,768	25,258	6,704	1,341	33,303
Financial liabilities held at fair value								
Unit-linked investment contracts	–	62,492	–	62,492	–	–	–	–
Amounts due to reinsurers	–	1,666	–	1,666	–	1,666	–	1,666
Net asset value attributable to unit-holders	1,173	–	–	1,173	11	–	–	11
Derivative financial instruments	27	138	–	165	27	127	–	154
Total financial liabilities held at fair value	1,200	64,296	–	65,496	38	1,793	–	1,831

c) Transfers between Level 1 and Level 2

During the year, £452 million (2010: £958 million) of shares and other variable yield securities were transferred from Level 1 to Level 2 and £1,413 million (2010: £735 million) of corporate bonds, shares and other variable yield securities were transferred from Level 2 to Level 1. These movements arose from changes in the availability of current quoted prices and market activity. There were no significant transfers between Level 1 and Level 2 for other financial assets.

d) Financial instruments

The following table shows a reconciliation of Level 3 financial assets which are recorded at fair value. Transfers out of Level 3 arise due to availability of prices in an active market and the refinement of methodology that took place during 2010.

	Shares and other variable yield securities £m	**Government bonds £m**	**Corporate bonds (including ABS) £m**	**Total financial assets held at fair value £m**
At 1 January 2011	**3,349**	**–**	**1,103**	**4,452**
Acquisition through business combinations	**3**	**–**	**26**	**29**
Total (losses)/gains in income statement	**(82)**	**–**	**11**	**(71)**
Purchases	**557**	**4**	**120**	**681**
Sales	**(582)**	**–**	**(86)**	**(668)**
Net transfer (to)/from Level 1 and Level 2	**(4)**	**1**	**104**	**101**
Foreign exchange adjustments	**(31)**	**–**	**(19)**	**(50)**
At 31 December 2011	**3,210**	**5**	**1,259**	**4,474**
Total (losses)/gains for the year included in profit or loss for assets held at 31 December 2011	**(158)**	**–**	**11**	**(147)**

Transfers out of Level 3 arise due to availability of prices in an active market.

	Shares and other variable yield securities £m	Government bonds £m	Corporate bonds (including ABS) £m	Total financial assets held at fair value £m
At 1 January 2010	4,720	–	688	5,408
Acquisition through business combinations	529	–	213	742
Total gains in income statement	394	–	180	574
Purchases	1,100	–	216	1,316
Sales	(889)	–	(99)	(988)
Net transfer to Level 1 and Level 2	(2,477)	–	(58)	(2,535)
Foreign exchange adjustments	(28)	–	(37)	(65)
At 31 December 2010	3,349	–	1,103	4,452
Total gains or losses for the year included in profit or loss for assets held at 31 December 2010	184	–	139	323

e) Level 3 sensitivity analysis

	2011		2010	
As at 31 December	**Carrying amount £m**	**Effect of reasonably possible alternative assumptions £m**	Carrying amount £m	Effect of reasonably possible alternative assumptions £m
Unit-linked investments	**2,835**	**–**	3,111	–
Shares and other variable yield securities	**1,124**	**224**	983	196
Government bonds	**5**	**1**	–	–
Corporate bonds (including ABS)	**510**	**51**	358	36
Total Level 3 financial assets	**4,474**	**276**	4,452	232

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 government bonds and corporate bonds, it could reasonably be expected that the current prices could be higher or lower by approximately 10% to reflect changes in the credit ratings of the underlying bonds.

f) Loans

As at 31 December	**2011 £m**	2010 £m
Mortgage loans	**2**	61
Other loans	**3**	616
Total loans	**5**	677

Loan assets of £600 million which were held at 31 December 2010 were repaid in March 2011.

g) Assets backing unit-linked liabilities

The net assets backing the insurance and investment contract liabilities relating to unit-linked business are included within the relevant balances in the consolidated statement of financial position and are analysed as follows:

As at 31 December	**2011 £m**	2010 £m
Shares and other variable yield securities	**53,487**	52,003
Debt securities and other fixed-income securities	**14,172**	13,089
Derivative financial instruments	**7**	24
Deposits with credit institutions	**381**	349
Total financial assets held at fair value	**68,047**	65,465
Investment properties	**1,688**	1,831
Insurance and other receivables	**875**	268
Cash and cash equivalents	**4,779**	4,991
Total assets	**75,389**	72,555
Other payables	**(124)**	(194)
Net asset value attributable to unit-holders[i]	**(1,137)**	(1,097)
Total unit-linked net assets	**74,128**	71,264

(i) This removes the impact, for the purposes of this analysis, of consolidation adjustments in respect of OEICs which the Group is deemed to control.

8. Staff pension schemes

a) Introduction

The Friends Life group operates a defined benefit scheme: the Friends Provident Pension Scheme ("FPPS"). In addition, defined contribution schemes are operated by Friends Provident Management Services Limited ("FPMS"), Friends Provident International Limited ("FPIL") and Sesame Bankhall Group. Lombard does not operate a pension scheme.

On an IAS 19 basis, a gross surplus of £52 million has been recognised in respect of the FPPS at 31 December 2011 (£66 million surplus at 31 December 2010). The latest funding agreement was entered into in June 2010. This agreement was based on an actuarial valuation as at 30 September 2008, which showed a deficit on a funding basis of £65 million. Deficit reduction contributions of £20 million per annum for the next four years were subsequently agreed with the Trustee, and commenced in July 2010. An updated triennial valuation has been carried out as at 30 September 2011 and the results of this are currently being considered by the Trustee. The valuation, once approved, will serve to assist the Trustee and the Group in determining future levels of funding.

Under IFRIC 14, deficit reduction contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available after they are paid into the scheme, a liability is recognised when the obligation arises. An additional liability of £32 million has been recognised (£44 million at 31 December 2010), reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £92 million (£40 million deficit reduction contributions plus the current surplus of £52 million). A deferred tax asset of £10 million (2010: £16 million) has also been recognised to reflect tax relief at a rate of 25% (2010: 27%) that is expected to be available on the deficit reduction contributions, once paid into the scheme.

Employees of the acquired AXA UK Life Business (including WLUK) and BHA have been placed into new defined contribution arrangements for service accruing after the acquisition date. The pension obligation for service accruing up to the date of the acquisition is not borne by the Group, as these obligations have remained with AXA UK plc and Bupa Finance plc respectively.

b) FPPS defined benefit scheme overview

The FPPS is a UK defined benefit scheme to which some of the Group's UK life and pensions employees from the acquired Friends Provident business belong. The scheme's assets, which are administered by three external investment managers, are held under the control of the Trustee and used to secure benefits for the members of the scheme and their dependants in accordance with the Trust Deed and Rules.

The Trustee board consists of a chairman who is appointed by the employer and six additional directors of which three are employer-appointed directors, two member-selected directors and one pensioner-selected director.

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

As at 31 December	**2011 £m**	2010 £m
Amounts recognised in the consolidated statement of financial position		
IAS 19 pension surplus (excluding deficit reduction contribution)	**52**	66
Authorised payments surplus charge at 35% of available surplus following deficit reduction contributions	**(32)**	(44)
Net pension scheme surplus (excluding deficit reduction contribution)	**20**	22

Movement in IAS 19 pension surplus

For the year ended 31 December	**2011 £m**	2010 £m
Pension surplus at 1 January	66	59
Current service cost(i)	(7)	(13)
Interest cost(i)	(57)	(55)
Expected return on pension assets(i) (ii)	63	60
Augmentations and termination benefits(i)	–	(3)
Employer contributions	33	41
Actuarial losses	(46)	(23)
Pension surplus at 31 December (excluding authorised payments surplus charge)	52	66
Deficit reduction contributions	40	60
Available surplus subject to authorised payments surplus charge	92	126

(i) Recognised in the consolidated income statement. The total loss recognised in the income statement for the year ended 31 December 2011 is £1 million (2010: loss of £11 million).

(ii) The actual return on plan assets was £185 million (2010: £104 million).

Analysis of net pension surplus and related deferred tax asset

As at 31 December 2011	**Pension surplus £m**	**Deferred tax £m**
Gross IAS 19 pension surplus and related deferred tax liability	**52**	**(13)**
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	**(32)**	**–**
Restriction of liability to authorised payments surplus charge	**–**	**13**
Tax relief available on deficit reduction contributions	**–**	**10**
Net pension surplus and related deferred tax asset	**20**	**10**

As at 31 December 2010	Pension surplus £m	Deferred tax £m
Gross IAS 19 pension surplus and related deferred tax liability	66	(18)
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	(44)	–
Restriction of liability to authorised payments surplus charge	–	18
Tax relief available on deficit reduction contributions	–	16
Net pension surplus and related deferred tax asset	22	16

Amounts recognised in the consolidated statement of comprehensive income

For the year ended 31 December	**2011 £m**	2010 £m
Actuarial losses	**(46)**	(23)
Reverse authorised payments surplus charge on opening surplus	**44**	21
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	**(32)**	(44)
Actuarial losses on defined benefit schemes	**(34)**	(46)
Taxation	**2**	25
Actuarial losses on defined benefit schemes after tax	**(32)**	(21)

A tax charge of £6 million (2010: £16 million credit) in respect of deficit reduction contributions and credits of £8 million (2010: £9 million) in respect of other movements in the pension scheme are included in the aggregate tax line of the consolidated statement of comprehensive income.

9. Loans and borrowings

The Group's loans and borrowings are as follows:

	Coupon %	**2011 £m**	2010 £m
Subordinated liabilities:			
Lombard undated subordinated loans	Various	**2**	3
£162 million LT2 subordinated debt 2021	12.00	**183**	186
£500 million LT2 subordinated debt 2022	8.25	**496**	–
Deferred consideration notes			
Series A deferred consideration notes	6.00	**232**	300
Series B deferred consideration notes	7.25–6.50	**191**	200
Reinsurance:			
Lombard financial reinsurance treaties	Various	**8**	15
Friends Provident International financial reinsurance treaties	Various	**64**	29
Other:			
Acquisition finance facility	Various	**–**	400
Amounts owed to credit institutions (overdrafts)		**19**	79
Total loans and borrowings		**1,195**	1,212

Unless otherwise stated below, the carrying values of interest bearing loans and borrowings closely approximate fair value.

Subordinated liabilities

The FLG 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 FLG. The fair value of this subordinated debt is £182 million.

On 21 April 2011, FLG issued a £500 million LT2 subordinated debt instrument with a coupon of 8.25% and a maturity of 2022, which is guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being £500 million principal less capitalised issue costs of £4 million. The fair value of this subordinated debt is £450 million.

Deferred consideration notes

On 15 September 2010, the Company issued fixed rate, unsecured deferred consideration notes with an aggregate principal amount of £500 million to AXA UK in connection with the acquisition of the AXA UK Life Business. These DCNs constitute senior, unsecured and unsubordinated obligations of the Company.

The original terms of the Series A DCNs were that they be redeemed by payment of £60 million on 30 September each year from 2011 to 2015. A deed of amendment was made on 2 June 2011 changing the annual payment date from 30 September to 31 May each year from 2011 to 2015. The Series A coupon rate remains at 6% throughout the loan period.

The original terms of the Series B DCNs were that they be redeemed by payment of £2.5 million on 30 September each year from 2011 to 2015, followed by payments of £62.5 million on each of the subsequent three anniversaries to 2018. The Series B coupon rate commenced at 7.25% and was to reduce in incremental amounts annually on 30 September each year to a rate of 6.50% on September 2015. Thereafter, the rate remains fixed at 6.50% for the three years to the final repayment date of 30 September 2018. A deed of amendment was made on 2 June 2011 changing the annual payment date (and annual date for reducing the rate of interest) from 30 September to 31 May each year. The final repayment will be made on 31 May 2018.

In addition to the scheduled repayments of principal described above, the Company may at any time redeem the DCNs in full or in part and is required to repay the DCNs in full or in part on occurrence of certain specified events.

The DCN agreements provide that if the Company pays cash distributions to its shareholders above a prescribed threshold in any calendar year, this will trigger an acceleration in the repayment of the outstanding principal. This accelerated repayment will then be deducted proportionately from all future scheduled principal repayments. During the year, in addition to the scheduled repayment of £62.5 million, an accelerated repayment of £14.4 million was made. The accelerated repayment was triggered by the incremental cash distributed to shareholders during the 2011 share repurchase programme therefore, the scheduled future repayments in the Series A DCNs are reduced to £58 million per annum for the next four years; on the Series B DCNs, they are reduced to £2.4 million per annum until 2015, and to £60.5 million per annum for the following three years to 2018.

Financial reinsurance

FLL has two financial reinsurance contracts with Munich Reinsurance Company UK Limited ("Munich Re") to finance new German unit-linked pensions business written in the years ended 31 December 2010 and 2011 respectively. The total amount owed to Munich Re under these financial reinsurance arrangements as at 31 December 2011 was £40 million (31 December 2010: £29 million).

On 30 June 2011, FPIL entered into a financial reinsurance agreement with Munich Re to finance new Hong Kong Premier regular premium savings business written since 1 January 2011. The amount owed to Munich Re as at 31 December 2011 was £24 million.

Other

On 24 June 2010, RHG and the Company entered into an acquisition finance term loan facility agreement with Barclays Bank plc and Royal Bank of Canada to fund part of the consideration payable for the AXA UK Life Business. The acquisition finance facility was issued on 13 September 2010 with a maturity date extendable to 30 June 2012. On 21 April 2011, the loan was fully repaid with funds provided by the £500 million LT2 subordinated debt 2022 referred to above.

Amounts owed to credit institutions (overdrafts) includes £7 million (2010: £23 million) relating to credit balances held within OEICS that have been consolidated as the Group holding is 50% or more. Such overdrafts are fully repayable out of the assets of the OEICS.

FLG benefits from a £500 million (2010: £500 million) multi-currency revolving credit facility with Barclays Bank plc, Royal Bank of Canada, HSBC Bank plc and The Royal Bank of Scotland plc, with Barclays Bank plc as agent, entered into on 24 June 2010. The facility is guaranteed by FLL. If a third party, who does not presently have control of the Group, acquires such control, the Group must notify the agent immediately. In this circumstance, the lenders are not obliged to fund utilisation and may notify the agent to cancel their commitments under the facility. This would have the effect of rendering all of their loans repayable within ten business days from the date of notice. As at the date of this report, the facility remains undrawn.

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

As at 31 December	**2011 £m**	2010 £m
Within one year or on demand	**123**	586
Between one and two years	**79**	63
Between two and three years	**67**	63
Between three and four years	**63**	63
Between four and five years	**61**	63
In more than five years	**802**	374
Total loans and borrowings	**1,195**	1,212

Included in the carrying amount above, £1,072 million (2010: £626 million) is expected to be settled more than 12 months after the balance sheet date.

Total interest expense for financial liabilities not measured at fair value through profit or loss, which arises solely from interest-bearing loans and borrowings, is £105 million (2010: £59 million).

10. Contingent liabilities and commitments

a) Contingent liabilities

In the normal course of its business, the Group is subject to matters of litigation or dispute. While there can be no assurances, at this time the directors believe, based on the information currently available to them, that it is not probable that the ultimate outcome of any of these matters will have a material adverse effect on the financial condition of the Group.

b) Commitments

Operating leases where the Group is lessee

The Group leases a number of properties under operating leases. These leases typically run for a period of 50 years, with an option of renewal at the end of the lease. Lease terms include annual escalation clauses to reflect current market conditions.

The future minimum rentals payable under non-cancellable leases are as follows:

	2011			2010		
	Land and buildings £m	**Other £m**	**Total £m**	Land and buildings £m	Other £m	Total £m
Within one year	**6**	**1**	**7**	7	1	8
Between one and five years	**15**	**1**	**16**	17	1	18
In more than five years	**19**	**–**	**19**	26	–	26
Total operating lease payables	**40**	**2**	**42**	50	2	52

Other commitments

The Group has investment property commitments of £20 million (2010: £24 million) relating to ongoing construction, renovation costs and costs of acquiring existing properties.

The Group has potential commitments of £335 million (2010: £517 million) to venture capital vehicles (partnerships and similar vehicles) that allow exposure to private equity investments in UK, US and European markets. All investments are held under agreements between the private equity managers and the Group which have committed the Group to providing an agreed maximum level of funding to the managers to invest. As at 31 December 2011 there are still funds that have yet to be utilised that, under the agreements, are still available to the private equity managers and hence classify as potential commitments.

The Group has entered into a number of outsourcing arrangements which have resulted in financial commitments amounting to £1,798 million as at 31 December 2011 (31 December 2010: £510 million). The average weighted years remaining on these outsourcing contracts is 15 years as at 31 December 2011 (31 December 2010: 15 years). Included within these amounts is the £1.3 billion outsourcing arrangement with Diligenta announced in November 2011.

11. Business combinations

During the year the Group made two acquisitions. For both acquisitions, the values of assets acquired and liabilities assumed, recognised on acquisition are their estimated fair values. No contingent liabilities have been recognised on acquisition.

In determining the fair value of AVIF, the Group applied pre-tax discount rates to the associated cash flows for each acquired business of 6.7% for BHA and 9.0% for WLUK.

In determining the fair value of distribution and customer relationships acquired the Group applied pre-tax discount rates of 6.7% for BHA and 10.0% for WLUK to the associated cash flows for each intangible asset.

The gain of £116 million recognised as a result of the two acquisitions is attributable to the purchase price being at a discount to the fair value of the net assets acquired which is based on the market consistent embedded value of WLUK and BHA. The gain is reported within other income in the consolidated income statement.

a) Acquisition of Bupa Health Assurance Limited

In January 2011, the Group through its subsidiary, FLL, acquired 100% of the shares in BHA, a life insurance company, from Bupa Investment Limited and its parent Bupa Finance plc. The Group acquired control of BHA on 31 January 2011, the date at which the last substantive condition to legal completion was satisfied, and has consolidated it from that point. The gross consideration paid in cash was £168 million compared to an announced price in October 2010 of £165 million. The increase in price reflects an additional £3 million of capital injected into BHA in December 2010 by British United Provident Association Limited.

In the period from the acquisition to 31 December 2011, BHA contributed revenue of £96 million and made a loss after tax of £11 million. If the acquisition had occurred on 1 January 2011, management estimate that consolidated revenue would have been £104 million, and the consolidated loss after tax for the year would have been £12 million. In determining these amounts, management has assumed that the fair value adjustments which arose on the date of acquisition would have been the same if the acquisition had occurred on 1 January 2011.

The following summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date:

	£m
Cash paid	**168**
Fair value of purchase consideration	**168**
Fair value of net assets acquired	**(236)**
Excess of the interest in the fair value of assets acquired over cost	**(68)**

The consolidated income statement includes £1 million within administrative and other expenses in relation to stamp duty payable on the shares acquired.

Identifiable assets acquired and liabilities assumed	**Recognised values on acquisition £m**
Intangible assets:	
Acquired value of in-force business	**172**
Other intangible assets	**8**
Financial assets	**83**
Reinsurance assets	**83**
Cash and cash equivalents	**90**
Current assets	**30**
Total identifiable assets	**466**
Insurance liabilities	**157**
Deferred tax liability	**48**
Other liabilities	**25**
Total identifiable liabilities	**230**
Net identifiable assets acquired and liabilities assumed	**236**
Attributable to equity holders of the parent	**236**

b) Acquisition of Winterthur Life UK Limited

In November 2011, the Company acquired 100% of the shares in WLUK, a life insurance company, from AXA UK. The acquisition of WLUK was agreed with AXA UK in 2010 at the same time as the acquisition of FASLH was negotiated. However, the share capital of WLUK was not legally acquired by the Group until 2011 as the purchase was contingent upon a transfer under Part VII of FSMA of AXA UK's retained business out of WLUK and FSA approval for the change of control of WLUK being received. The Group acquired control of WLUK on 7 November 2011, the date at which the last substantive condition to legal completion was satisfied, and has consolidated it from that point.

In the period from the acquisition to 31 December 2011, WLUK contributed revenue of £(1) million (reflecting a negative investment return of £22 million) and made a loss after tax of £1 million. If the acquisition had occurred on 1 January 2011, management estimate that consolidated revenue would have been £(32)million, and the consolidated loss after tax for the year would have been £7 million. In determining these amounts, management has assumed that the fair value adjustments which arose on the date of acquisition would have been the same if the acquisition had occurred on 1 January 2011.

The following summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date:

	£m
Cash paid	**248**
Fair value of purchase consideration	**248**
Fair value of net assets acquired	**(296)**
Excess of the interest in the fair value of assets acquired over cost	**(48)**

The consolidated income statement includes £2 million within administrative and other expenses in relation to stamp duty payable on the shares acquired.

Identifiable assets acquired and liabilities assumed	**Recognised values on acquisition £m**
Intangible assets:	
Acquired value of in-force business	**239**
Distribution and customer relationships	**29**
Property and equipment	**3**
Investment properties	**43**
Financial assets	**6,617**
Reinsurance assets	**402**
Current tax assets	**1**
Insurance and other receivables	**38**
Cash and cash equivalents	**338**
Total identifiable assets	**7,710**
Insurance liabilities	**2,127**
Investment contracts	**5,195**
Unallocated surplus	**38**
Provision for other risks and charges	**8**
Deferred tax liabilities	**23**
Insurance payables, other payables and deferred income	**23**
Total identifiable liabilities	**7,414**
Net identifiable assets acquired and liabilities assumed	**296**
Attributable to equity holders of the parent	**296**

c) Acquisition of AXA UK Life Business in the prior year

On 3 September 2010, the FSA approved the change of control to the Group of FASLH, the AXA UK Life Business. As the sale and purchase agreement in relation to FASLH became unconditional upon obtaining the FSA approval, the Group acquired control of FASLH on 3 September 2010 and has consolidated it from that point. On 15 September 2010, the Group legally completed the purchase of 100% of the shares and voting rights of FASLH.

In the period from the acquisition to 31 December 2010, FASLH contributed revenue of £3,339 million and a profit after tax of £1 million. If the acquisition had occurred on 1 January 2010, management estimate that consolidated revenue would have been £6,670 million, and consolidated profit after tax for the year would have been £109 million. In determining these amounts, management has assumed that the fair value adjustments which arose on the date of acquisition would have been the same if the acquisition had occurred on 1 January 2010.

The following summarises the major classes of consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date:

	£m
Cash paid	**2,224**
Deferred consideration notes	**500**
Fair value of consideration excluding acquisition expenses incurred at acquisition	**2,724**
Fair value of net assets acquired	**3,607**
Excess of the interest in the fair value of assets acquired over cost	**883**

The gain of £883 million recognised as a result of the acquisition was attributable to the purchase price being at a discount to the fair value of the net assets acquired which was based on the MCEV of the AXA UK Life Business plus the value of customer and distribution intangibles relating to future business with existing customers and distribution channels at the acquisition date.

d) Disposal of operations

Under the terms of the agreement to acquire the AXA UK Life Business in 2010, two acquired portfolios of business, the Guaranteed Over Fifties ("GOF") and Trustee Investment Plan ("TIP") portfolios, were required to be transferred back to AXA at a future date following completion of a transfer under Part VII of the FSMA. Accordingly the assets and liabilities related to these portfolios were classified as held for sale as at 31 December 2010.

The major classes of assets and liabilities of the GOF and TIP portfolios as at 31 December 2010 are disclosed in the table below:

	£m
Intangible assets – AVIF	269
Deferred tax assets	20
Financial assets	904
Cash and cash equivalents	13
Assets of operations classified as held for sale	1,206
Insurance contracts	21
Investment contracts	904
Liabilities of operations classified as held for sale	925
Net assets of operations classified as held for sale	281

The transfer of the GOF and TIP portfolios was completed on 1 November 2011. Disposal proceeds received relating to this transaction were £285 million. The difference between the proceeds received and the net assets classified as held for sale at 31 December 2010 was £4 million, and has been recognised as income in the consolidated income statement for the year. It can be summarised as follows:

	2011 **£m**
Net assets classified as held for sale at 31 December 2010	**281**
Accrued interest received on disposal proceeds	**4**
Proceeds received as above	**285**

The income statement of the GOF and TIP portfolios has been consolidated on a line by line basis up to the date of disposal in the financial statements. The table below shows the income statement of the held for sale business:

	2011 £m	2010 £m
Gross earned premiums	**71**	29
Gross claims and benefits paid	**(15)**	(5)
Change in insurance contracts liabilities	**2**	7
Acquisition expenses	**–**	(19)
Administrative and other expenses	**(51)**	(15)
Profit before tax	**7**	(3)

e) Disposal of subsidiaries in the prior year

i) Disposal of Pantheon Financial Limited

On 19 March 2010 the Group disposed of 100% of the share capital of Pantheon Financial Limited which formed part of the UK operating segment.

Details of the transaction are as follows:

Assets and liabilities in disposal	£m
Cash and cash equivalents	3
Other net assets and liabilities	(3)
Net assets on disposal:	–
Gain included in profit from continuing operations	–
Consideration received	–
Cash and cash equivalents in disposal	(3)
Cash flow from disposal of subsidiary, net of cash disposed	(3)

ii) Reduction of holding in F&C Commercial Property Trust plc ("F&C CPT")

On 23 April 2010 the Group reduced its holding in F&C CPT from 50.3% to 34.16%. The retained holding has been recognised as a financial asset at fair value through the income statement. Until 23 April 2010, F&C CPT was treated as a subsidiary of the Group and all its assets and liabilities were consolidated on a line-by-line basis. Loss of control arose when the holding was reduced resulting in de-recognition of assets and liabilities. The carrying amounts de-recognised are set out in the table below. As at 31 December 2010, F&C CPT was not treated as an associate as the Group had ceased to have significant influence over this trust.

Assets and liabilities in disposal	£m
Investment properties	767
Financial assets	6
Cash and cash equivalents	97
Insurance and other receivables	(4)
Interest-bearing loans and borrowings	(219)
Insurance payables, other payables and deferred income	(23)
Net assets on disposal:	624
Non-controlling interest in assets and liabilities in disposal	(309)
Fair value of investment retained	(214)
Gain included in profit from continuing operations	–
Consideration received (cash)	101
Cash and cash equivalents in disposal	(97)
Cash flow from disposal of subsidiary, net of cash disposed	4

12. Related parties

In the ordinary course of business, the Group and its subsidiary undertakings carry out transactions with related parties, as defined by IAS 24: *Related party disclosures*. Material transactions for the year are set out below.

a) Key management personnel compensation

Key management personnel consists of directors of Resolution Limited, executive directors of FLG, and Resolution Operations LLP ("ROL") as a body corporate.

The Company does not employ any staff. Each of the directors, who are treated as key management personnel for the purpose of IFRS, receive directors' fees under a service agreement. The Company has also appointed ROL as its investment advisor and to provide it with certain head office functions.

In aggregate the compensation paid to key management, excluding the fee paid to ROL, is as set out below:

	2011 Number	**2011 £m**	2010 Number	2010 £m
Short-term employee benefits	**16**	**6**	11	1
Post-employment benefits (excluding defined benefit scheme)	**–**	**–**	–	–
Share-based payments	**–**	**–**	–	–
Total key management personnel compensation charged to the income statement	**16**	**6**	11	1
Post-employment benefits: defined benefit schemes	**–**	**–**	–	–
Total key management personnel compensation	**16**	**6**	11	1

The compensation paid to ROL is disclosed in note 12 (b) below.

b) Other related parties

Details of the Group's pension schemes are provided in note 8.

Transactions made between the Group and related parties were made in the normal course of business. Loans from related parties are made on normal arm's length commercial terms.

The Company has entered into certain contracts with related parties as described below:

- an Operating Agreement with ROL, as a result of which the Company has outsourced most of its operating functions to ROL. Under this agreement, the Company pays an annual fee to ROL based on 0.5% of the value of the Company (subject to a minimum payment of £10 million), plus amounts for additional accounting services and, with effect from 1 October 2011, certain company secretarial services. The total fee charged for the year was £20 million, of which £2 million has been incurred by the Company, with the balance incurred by its direct subsidiary, Resolution Holdco No.1 L.P. An accrual of £0.2 million in respect of ROL fees payable has been recognised in the Company's statement of financial position as at 31 December 2011. The Operating Agreement remains in force until terminated by written notice by either party. Certain changes to the Operating Agreement took effect following shareholder approval on 13 January 2012. Under the terms of the revised agreement, subject to certain exceptions, notice to terminate may not expire until the later of 1 December 2013 and the date 12 months after the Company has publicly declared the UK Life Project complete. The amounts payable to ROL by the Company in any year will be reduced by a maximum of £2 million where ROL provides advisory and operating services to other entities in that year. Subject to certain conditions, ROL is also entitled under the new agreement to receive up to an aggregate of £20 million from the Company to fund development work for certain projects undertaken outside the Company. Amounts advanced by the Company are reimbursable by ROL, together with an appropriate investment return (which, subject to the Company's agreement may be paid in cash or take the form of another benefit to the Company or all its shareholders) if ROL successfully launches a new project. Any project costs which are repaid to the Company will replenish the amount of Company funding that may be available to ROL to fund other project costs. The Company has advanced £1 million to ROL for development work for non-UK life projects over the course of 2011. The funding was advanced on the basis that, following the amendments to the Operating Agreement, these amounts will count towards the aggregate £20 million project funding cap, reducing the amount available and that the funding plus a cash return of 100% on such funding will be payable to the Company in the event that the relevant projects are successfully launched. Further amendments and/or the termination of the operating agreement may be required if the FSA proposals for "externally managed companies" set out in consultation paper CP12/2 are implemented. See note 13 for details.
- RCAP Guernsey LP, a limited partnership in which members of ROL are limited partners, acquired shares in the Company for a consideration of £20 million in its initial public offering. At the time of the initial public offering the Company entered into a lock-up deed with RCAP GP Limited, acting in its capacity as general partner of RCAP

Guernsey LP, restricting the sale of the shares held by RCAP Guernsey LP for a period of three years. Following the Company's acquisition of the AXA UK Life Business, a further £8 million was invested in the company's shares by RCAP Guernsey LP as part of the rights issue. The sale of these shares was not restricted by the lock-up deed. The lock-up deed expired on 10 December 2011. With effect from 13 January 2012, the provisions of a new lock-up deed between the Company, RCAP GP Limited, acting in its capacity of general partner of RCAP Guernsey LP, and Resolution Capital Limited, a limited partner of RCAP Guernsey LP and member of ROL, took effect. Under the new lock-up deed, members of the Resolution Group (which includes ROL, RCAP Guernsey LP, Resolution Capital Limited and their respective undertakings – for the avoidance of doubt, it does not include the Company or any of its subsidiaries) are restricted from selling or providing as security for a loan any of their shares in the Company (including the shares acquired as part of the AXA UK Life Business acquisition-related rights issue) until completion of the UK Life Project. This restriction is subject to customary exceptions. In addition, some of the shares may be sold or provided as security for a loan for the purpose of the Resolution Group co-investing in any new entity which it may advise provided that, immediately thereafter, the remaining shares are not less in value than the largest investment made by the Resolution Group (using the proceeds of the sold or secured shares) in such entities.

- as shown in note 17, the Company has a 99.99% interest in, and is the general partner in, Resolution Holdco No. LP, a Guernsey limited partnership. RCAP Guernsey LP, a member of the Resolution Group, is a limited partner in Resolution Holdco No.1 LP. RCAP Investments SARL, another member of the Resolution Group, was previously also a limited partner of Resolution Holdco No.1 LP but transferred its interest to RCAP Guernsey LP in November 2011 with the consent of the Company (acting in its capacity of general partner of Resolution Holdco No.1 LP). The Company entered into the limited partnership for the purpose of making acquisitions for the UK Life Project and rewarding the Resolution Group for value created in the limited partnership from those acquisitions;
- a trade mark licence agreement with Resolution (Brands) Limited, a company wholly owned by Clive Cowdery, a member of ROL and RCAP Guernsey LP, under which the Group has paid a fee of £110,143 for the use of the " Resolution" brand in respect of the year commencing 4 December 2011 (2010: £104,500). The fee payable under the trade mark license agreement increases annually in line with the retail price index from a base fee of £100,000 in respect of the year commencing 4 December 2008;
- ROL was involved in the provision of certain capital raising services to the Group in connection with the financing of the AXA UK Life Business acquisition in 2010. In consideration for these services, Resolution Holdco No.1 LP paid an aggregate fee of £4.5 million, of which £3.75 million was paid-upon completion of the acquisition in 2010 and the remaining £0.75 million was paid in April 2011 following the issue by FLG of the external lower tier 2 subordinated debt 2022. Independent financial advice was provided to the Board in connection with the terms of the appointment of ROL in respect of the financing of the acquisition and confirmation was provided to the UK Listing Authority by the advisor that it considered that the terms of such appointment were fair and reasonable as far as shareholders are concerned; and
- Own shares held by subsidiary undertakings of the Company with a fair value of £20 million have been acquired as part of the share repurchase programme.

13. Post balance sheet events

The following matters occurring after the statement of financial position date have been identified as of significance to the financial reporting of the Group. No amendments have been made to balances reported in these financial statements as a result of the matters identified.

- **Changes in the UK tax regime:** HMRC have stated that draft legislation in respect of the new UK tax regime applicable to life insurance business is to be published in the Finance Bill on 29 March 2012. This follows the significant announcements previously made in the 2011 Budget and initial draft legislation published for consultation on 6 December 2011. The legislation is expected to take effect from 1 January 2013.

  The Group has made a preliminary analysis of the impact of the new legislation on the deferred tax assets and liabilities as at 31 December 2011. The net overall impact is an additional deferred tax asset of £10 million, arising from the items described below.

  Under the new tax regime, losses in respect of the Group's pension business will be measured at the full corporation tax rate (currently measured at the basic rate of income tax). The tax value of losses would increase by £34 million (based on the latest substantively enacted corporation tax rate of 25%). This is offset by the loss of the deferred tax asset of £7 million in respect of life assurance trade losses to the extent that these do not exceed pension business losses in the same entity.

Application of the draft transitional provisions would result in a further deferred tax liability of £17 million, which would unwind over 10 years, in accordance with the transitional provisions. This relates to the with-profits fund deficit in FLL which arose in 2002.

Other deferred tax assets and liabilities of the group as at 31 December 2011 are not expected to be materially affected by the new legislation.

- **Changes in the rate of corporation tax:** The Chancellor delivered his Budget on 21 March 2012, which announced a further 1% reduction in the rate of corporation tax, effective from 1 April 2012, in addition to the incremental 1% rate reductions previously announced which will take effect on 1 April 2013 and 1 April 2014. The corporation tax rate is therefore expected to be 24% from 1 April 2012, 23% from 1 April 2013 and 22% from 1 April 2014. The benefit to the Group's net assets from the further 3% decrease in the rate is estimated to be approximately £94 million in total and will be recognised when the legislation is substantively enacted.

- **CP12/2:** The FSA issued a consultation paper (CP12/2) in January 2012. One of the proposals included in the consultation paper is that premium listed companies such as the Company, which have appointed an investment adviser to provide a wide range of services to the Company would cease to be eligible for premium listing unless their arrangements with the investment adviser are unwound. This proposal, if implemented, may require the Company to terminate early or substantially amend its arrangements with ROL and may, in turn, lead the Company to incur significant costs if its premium listing were to be maintained.

MCEV financial information

Consolidated income statement – MCEV basis

For the year ended 31 December 2011

	Notes	**RSL 2011[(ii)] £m**	RSL 2010[(ii)] £m	FLG 2011[(ii)] £m	FLG 2010[(ii)] £m
Life and pensions					
Value of new business	6	**151**	145	151	145
Expected existing business contribution		**360**	247	360	247
Operating experience variances		**(28)**	32	(28)	32
Operating assumption changes		**140**	(23)	140	(23)
Other operating variances		**6**	65	6	65
Development costs	10	**(36)**	(28)	(36)	(28)
Life and pensions covered business operating profit before tax	3	**593**	438	593	438
Other income and charges		**(35)**	(11)	(35)	(11)
Life and pensions operating profit before tax		**558**	427	558	427
Corporate income and charges		**(41)**	(15)	–	–
Operating profit before tax		**517**	412	558	427
Economic variances	3	**(600)**	229	(600)	229
Amortisation of non-covered business acquired intangible assets	3	**(3)**	(3)	(3)	(3)
Non-recurring items and non-operating variances	3	**(282)**	(22)	(282)	(8)
(Loss)/profit from continuing operations before tax		**(368)**	616	(327)	645
Tax on operating profit		**(150)**	(96)	(150)	(96)
Tax on other activities		**223**	(60)	223	(60)
(Loss)/profit for the year[(i)]		**(295)**	460	(254)	489

(i) (Loss)/profit for the year is attributable to equity holders of the parent.

(ii) The consolidated income statement for the year ended 31 December 2011 includes the results of BHA from 31 January 2011 and the results of WLUK from 7 November 2011. The results for the year ended 31 December 2010 include the results of the acquired AXA UK Life Business from 3 September 2010.

Earnings per share – MCEV basis

For the year ended 31 December 2011

	Notes	**RSL 2011 Pence**	RSL 2010 Pence
Earnings per share			
Operating earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**25.74**	33.50
– Diluted		**25.74**	33.24
Earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**(20.69)**	48.77
– Diluted	4	**(20.69)**	48.39

MCEV operating profit arises from continuing operations, incorporates an expected investment return and excludes:

(i) amortisation and impairment of non-covered business acquired intangible assets;

(ii) the effect of economic variances (including the impact of economic assumption changes); and

(iii) significant non-recurring items and non-operating items.

Given the long-term nature of the Group's operations, operating profit is considered to be a better measure of the performance of the Group and this measure of profit is used internally to monitor the Group's MCEV results.

Consolidated statement of comprehensive income – MCEV basis

For the year ended 31 December 2011

	RSL 2011 £m	RSL 2010 £m	FLG 2011 £m	FLG 2010 £m
(Loss)/profit for the year	**(295)**	460	(254)	489
Actuarial losses on defined benefit pension schemes, net of tax	**(32)**	(22)	(32)	(22)
Foreign exchange adjustments	**(15)**	(11)	(15)	(11)
Other comprehensive loss for the year, net of tax	**(47)**	(33)	(47)	(33)
Total comprehensive (loss)/income for the year(i)	**(342)**	427	(301)	456

(i) Total comprehensive (loss)/income for the year is attributable to equity holders of the parent.

Consolidated statement of changes in equity – MCEV basis

For the year ended 31 December 2011

	RSL	RSL	FLG	FLG
	2011 £m	2010 £m	2011 £m	2010 £m
Opening ordinary shareholders' equity	**6,515**	3,488	6,514	3,181
Acquired value of BHA as at 31 January 2011	**226**	–	226	–
Cost of acquisition of BHA(i)	**(168)**	–	(168)	–
Acquired value of WLUK as at 7 November 2011	**271**	–	271	–
Cost of acquisition of WLUK(i)	**(248)**	–	(248)	–
Acquired value of AXA UK Life Business as at 3 September 2010	**–**	3,498	–	3,498
Cost of acquisition of AXA UK Life Business(i)	**–**	(2,724)	–	(2,724)
Total comprehensive (loss)/income for the year	**(342)**	427	(301)	456
Issue of share capital (net of capitalised expenses and movement in RSL shares held by subsidiaries)	**61**	1,967	–	2,165
Share repurchase	**(250)**	–	–	–
Dividends on equity shares	**(274)**	(144)	(350)	(65)
Share-based payments	**5**	3	5	3
(Decrease)/increase in MCEV reserves for the year	**(719)**	3,027	(565)	3,333
Closing ordinary shareholders' equity	**5,796**	6,515	5,949	6,514

(i) Transaction costs of £3 million relating to the acquisitions of BHA and WLUK are included in non-recurring items and non-operating variances in 2011. All transaction costs were incurred in FLG. 2010 transaction costs of £28 million were incurred in respect of the acquisition of the AXA UK Life Business, of which £14 million was incurred in FLG.

Consolidated statement of financial position – MCEV basis

At 31 December 2011

	RSL	RSL	FLG	FLG
	2011 £m	2010 £m	2011 £m	2010 £m
Assets				
Pension scheme surplus	**20**	22	20	22
VIF covered business excluding assets of operations classified as held for sale	**3,844**	3,966	3,844	3,966
Intangible assets	**25**	29	25	29
Property and equipment	**58**	46	58	46
Investment properties	**3,015**	3,189	3,015	3,189
Investment in associates and joint venture	**31**	27	31	27
Financial assets	**103,636**	99,445	103,643	99,465
Deferred acquisition costs	**105**	119	105	119
Reinsurance assets	**3,213**	2,637	3,213	2,637
Current tax assets	**6**	22	6	22
Insurance and other receivables	**1,175**	1,024	1,175	1,023
Cash and cash equivalents	**8,791**	9,288	8,690	9,057
Assets of operations classified as held for sale				
– VIF covered business	**–**	236	–	236
– other assets	**–**	970	–	970
Total assets	**123,919**	121,020	123,825	120,808
Liabilities				
Insurance contracts	**37,326**	35,142	37,326	35,142
Unallocated surplus	**640**	1,090	640	1,090
Financial liabilities				
– investment contracts	**74,224**	71,535	74,224	71,535
– loans and borrowings	**1,440**	1,599	1,201	1,399
– amounts due to reinsurers	**1,800**	1,666	1,800	1,666
Net asset value attributable to unit holders	**1,173**	1,173	1,173	1,173
Provisions	**230**	221	230	221
Deferred tax liabilities	**304**	270	304	270
Current tax liabilities	**20**	11	20	11
Insurance payables, other payables and deferred income	**961**	869	953	858
Liabilities of operations classified as held for sale	**–**	925	–	925
Total liabilities	**118,118**	114,501	117,871	114,290
Equity attributable to:				
– Equity holders of the parent	**5,796**	6,515	5,949	6,514
– Non-controlling interests	**5**	4	5	4
Total equity	**5,801**	6,519	5,954	6,518
Total equity and liabilities	**123,919**	121,020	123,825	120,808

Group MCEV analysis of earnings

For the year ended 31 December 2011

	FLG			RSL (ex. FLG)[i]	RSL	RSL	FLG
	2011			2011	2011	2010	2010
	Covered business £m	Non-covered business £m	Total £m	Non-covered business £m	Total £m	Total £m	Total £m
Opening Group MCEV	**6,470**	**44**	**6,514**	**1**	**6,515**	3,488	3,181
Opening adjustments:							
capital and dividend flows	**–**	**–**	**–**	**–**	**–**	1,979	2,165
acquired businesses:							
– acquired value of BHA	**226**	**–**	**226**	**–**	**226**	–	–
– cost of acquisition of BHA[ii]	**(168)**	**–**	**(168)**	**–**	**(168)**	–	–
– acquired value of WLUK	**271**	**–**	**271**	**–**	**271**	–	–
– cost of acquisition of WLUK[ii]	**–**	**(248)**	**(248)**	**–**	**(248)**	–	–
– acquired value of AXA UK Life Business	**–**	**–**	**–**	**–**	**–**	3,498	3,498
– cost of acquisition of AXA UK Life Business[ii]	**–**	**–**	**–**	**–**	**–**	(2,724)	(2,724)
Adjusted opening Group MCEV	**6,799**	**(204)**	**6,595**	**1**	**6,596**	6,241	6,120
Operating MCEV earnings	**443**	**(35)**	**408**	**(41)**	**367**	316	331
Non-operating MCEV earnings	**(661)**	**(1)**	**(662)**	**–**	**(662)**	144	158
Total MCEV earnings	**(218)**	**(36)**	**(254)**	**(41)**	**(295)**	460	489
Other movements in IFRS net equity	**–**	**(32)**	**(32)**	**13**	**(19)**	(42)	(22)
Closing adjustments:							
– capital and dividend flows	**(1,204)**	**859**	**(345)**	**(126)**	**(471)**	(133)	(62)
– foreign exchange variances	**(15)**	**–**	**(15)**	**–**	**(15)**	(11)	(11)
– transfer of GOF and TIP businesses to AXA UK plc	**50**	**(50)**	**–**	**–**	**–**	–	–
Closing Group MCEV	**5,412**	**537**	**5,949**	**(153)**	**5,796**	6,515	6,514

(i) RSL (ex. FLG) refers to the Resolution holding companies.

(ii) Transaction costs of £3 million relating to the acquisitions of BHA and WLUK are included in non-recurring items and non-operating variances in 2011. All transaction costs were incurred in FLG. Transaction costs of £28 million were incurred in 2010 in respect of the acquisition of the AXA UK Life Business, of which £14 million was incurred in FLG.

Notes to the MCEV results

For the year ended 31 December 2011

1. Basis of preparation

Introduction

Resolution Limited is presenting the results and financial position for its life and pensions business on the MCEV basis and for its other businesses on the IFRS basis. The MCEV basis is in compliance with the European Insurance CFO Forum MCEV Principles[(i)] ("the MCEV Principles"), issued in June 2008, and re-issued in amended form in October 2009. In accordance with guidance issued by the CFO forum in September 2011, no allowance has been made for the impacts of the developing Solvency II regulatory regime.

On 31 January 2011 the Group, through its subsidiary FLL, acquired all of the share capital of BHA. The consolidated income statement therefore includes the results of BHA from that date.

On 7 November 2011 the Group, through its subsidiary FLG, acquired all of the share capital of WLUK. This was subsequently transferred to FLL. The consolidated income statement therefore includes the results of WLUK from that date.

In addition, under the terms of the 2010 acquisition of the AXA UK Life Business, the GOF and TIP portfolios of business legally owned by the Group as a result of the acquisition were transferred back to AXA UK plc during the year. These portfolios were classified as held for sale as at 31 December 2010 and their disposal was completed on 1 November 2011.

This MCEV supplementary information presents results for the Group and the Friends Life group.

The MCEV results were approved by the Board of Directors on 26 March 2012.

Segmental analysis and definitions

The segmentation and definitions adopted are consistent with those used in the prior year.

MCEV methodology

Overview

The MCEV basis of reporting is designed to recognise profit as it is earned over the term of a life insurance policy. The total profit recognised over the lifetime of the policy is the same as that recognised under the IFRS basis of reporting, but the timing of recognition is different.

Covered business

Covered business comprises all life and pensions business written by the Friends Life group in the UK and through overseas life insurance subsidiaries and associates (collectively referred to as "life and pensions covered business").

The external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are formally allocated to covered business on the basis that all obligations to make payments in respect of this debt are guaranteed by FLL. The external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are included within the MCEV at market value, based on listed ask prices.

Non-covered business

The Group's non-covered business includes the IFA distribution businesses, the management services businesses and the net pension asset of FPPS on an IAS 19 basis. FLG corporate net assets, certain holding company costs, RSL corporate net assets, the deferred consideration notes issued by the Company, the acquisition finance facility (until the date of its repayment in April 2011) and the internal LT2 subordinated debt 2020- issued by FLG to Resolution holding companies are all non-covered business.

While the management services businesses are classified as non-covered, the expenses and cash flows of those businesses are linked to the life and pensions businesses via service agreements. The cash flows of the companies are calculated on the "look-through" principle and are allowed for when setting appropriate expense and tax assumptions.

[(i)] Copyright© Stichting CFO Forum Foundation 2008

Segmental reporting under MCEV

The covered business within the Friends Life group has been split into the following segments in line with IFRS reporting:

- UK, which includes the life and pensions businesses within the UK from FLL, FLP, FLC, FAL, FLAS and WLUK;
- International, which includes FPIL, the overseas life assurance business within FLL and the 30% share in AmLife Insurance Berhad and AmFamily Takaful Berhad; and
- Lombard.

Corporate functions are not strictly an operating segment, but are reported to management, and are provided to reconcile the Group's reportable segments to the total result. FLG corporate includes the external STICS, the external LT2 subordinated debt 2021, the external LT2 subordinated debt 2022, FLG corporate costs and the cost of holding any required capital in excess of the operating segment capital policy.

New business

New business within the life and pensions covered business includes:

- premiums from the sale of new policies;
- payments on recurring single premium policies, including Department for Work and Pensions rebate premiums, except existing stakeholder-style pensions business where, if a regular pattern in the receipt of premiums for individuals has been established, the regular payment is treated as a renewal of an existing policy and not new business;
- non-contractual increments on existing policies;
- new entrants to existing schemes in the corporate benefits business; and
- immediate pension annuity contracts arising from internal vestings.

The MCEV new business definition is consistent with the quarterly new business disclosures.

Calculation of embedded value

The reported Group MCEV provides an estimate of the total consolidated MCEV of the Group and comprises the MCEV in respect of the life and pensions covered business, together with the IFRS net assets in respect of the non-covered business, excluding intangible assets relating to future new business.

The MCEV provides an estimate of the value of shareholders' interest in the covered business, excluding any value that may be generated from future new business. The MCEV comprises the sum of the shareholders' net worth of the life and pensions covered business and the value of in-force covered business. The shareholders' net worth of the life and pensions covered business includes the listed debt of the external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 at market value, based on listed ask prices.

The MCEV is calculated on a post-tax basis. Where gross results are presented, these have been calculated by grossing up the post-tax results for covered business at the appropriate rate of corporation tax for each segment. For non-covered business the gross results are presented gross of any IFRS tax attributed.

a) Shareholders' net worth

The shareholders' net worth of the life and pensions covered business consists of free surplus and required capital.

Free surplus is the market value of any assets allocated, but not required, to support the in-force covered business at the valuation date. Required capital is the market value of assets, attributed to the covered business over and above that required to back liabilities for covered business, whose distribution to shareholders is restricted. The Group's required capital is set at the greater of local regulatory capital requirements and those requirements arising from internal capital management policies, which include economic risk capital objectives. The economic risk capital is determined from internal models, based on the Group's risk appetite. The level of required capital is shown in note 10.

b) Value of in-force covered business

The value of in-force covered business consists of:

- present value of future profits; less
- time value of financial options and guarantees;
- frictional costs of required capital; and
- cost of residual non-hedgeable risks.

Present value of future profits ("PVFP")

The value of existing business is the present value of the future distributable profits available to shareholders from the in-force covered business. Future profits are projected using best estimate non-economic assumptions and market consistent economic assumptions.

The non-economic assumptions include: the behaviour of customers (e.g. persistency), mortality, morbidity, the level of expenses required to maintain the book of business, tax and the regulatory environment. The assumptions are a reflection of best estimates of the likely behaviours, outcomes, or circumstances in the future. The estimates are made, typically, on an annual basis following experience investigations based on the data available at the time, both from the book of business and externally sourced information. The aim is to set assumptions at a level that reflects recent or current experience.

The PVFP includes the capitalised value of profits and losses arising in subsidiary companies providing administration and other services to the extent that they relate to covered business. This is referred to as the "look-through" into service company expenses. In addition expenses arising in holding companies that relate directly to acquiring or maintaining covered business have been allowed for.

In valuing shareholders' cash flows, allowance is made in the cash flow projections for taxes in the relevant jurisdiction affecting the covered business. Tax assumptions are based on best estimate assumptions, applying local corporate tax legislation and practice together with known future changes and taking credit for any deferred tax assets.

The economic assumptions are market consistent whereby, in principle, each cash flow is valued in line with the price of similar cash flows that are traded in the capital markets. For example, an equity cash flow is valued using an equity risk discount rate, and a bond cash flow is valued using a bond risk discount rate. If a higher return is assumed for equities, the equity cash flow is discounted at this higher rate.

In practice, for liabilities where the payouts are either independent or move linearly with market movements, a method known as the "certainty equivalent approach" has been applied whereby all assumed assets earn the reference rate and all cash flows are discounted using the reference rate. This gives the same result as applying the method in the previous paragraph.

Time value of financial options and guarantees ("TVOG")

The PVFP is based on a single deterministic projection of future economic assumptions. However, a single projection does not fully reflect the potential for extreme events and the resulting impact of options and guarantees on the shareholder cash flows. While the PVFP allows for the intrinsic value of an option or guarantee under a single set of economic assumptions, it does not reflect the potential range of future economic scenarios on the shareholder cash flows. Stochastic modelling techniques are used to assess the impact of potential future economic scenarios on an option or guarantee and to determine the average value of shareholder cash flows under a number of market consistent scenarios.

The TVOG is calculated as the difference between the average value of shareholder cash flows under a number of market consistent scenarios, and the intrinsic value under a single projection within the PVFP.

The material financial options and guarantees are those in the with-profits funds of the subsidiary life companies of FLG, in the form of the benefits guaranteed to policyholders and the guaranteed annuity rates associated with certain policies. The risk to shareholders is that the assets of the with-profits funds are insufficient to meet these guarantees. While shareholders are entitled to only a small share of profits in the with-profits funds (e.g. via one-ninth of the cost of bonus), they can potentially be exposed to the full cost of fund assets being insufficient to meet policyholder guarantees. The TVOG has been assessed using a stochastic model derived from the current Realistic Balance Sheet model. This model has been calibrated to market conditions at the valuation date. Allowance has been made under the different scenarios for management actions, such as altered investment strategy, consistent with the Realistic Balance Sheet model. The TVOG would be markedly higher without the hedging activities and management actions currently undertaken.

Only modest amounts of new with-profits business are written and the guarantee levels offered are lower, hence there is no material impact in respect of the TVOG on the value of new business.

Frictional costs of required capital

The value of in-force covered business includes a deduction for the additional costs to an investor of holding the assets backing required capital through investment in a life company, rather than investing in the asset directly. These additional frictional costs comprise taxation and investment expenses on the assets backing the required capital.

The frictional costs of required capital are calculated as the difference between the market value of assets backing required capital and the present value of future releases of that capital allowing for future investment return (net of frictional costs) on that capital. The calculation allows for the run-off of the required capital over time using projections of the run-off of the underlying risks and regulatory requirements.

Details of the level of required capital are set out in note 10.

Cost of residual non-hedgeable risks ("CNHR")
The main area of non-hedgeable risk relates to non-financial risks, such as insurance and operational risks, where no deep, liquid market exists to fully mitigate the risk. Allowance for non-financial risk is made directly within:

- the PVFP via an appropriate choice of best estimate assumptions and with the impact of variability of the risk on the level, and hence cost, of required capital; and
- the TVOG for the impact of variations of non-financial risks on the possibility of shareholders needing to meet the guarantees within the with-profits funds of the subsidiary life companies of FLG.

The CNHR covers those non-hedgeable risks that are not already allowed for fully in the PVFP or in the TVOG. The most significant of these risks are those for which the impact of fluctuations in experience is asymmetric; where adverse experience has a higher impact on shareholder value than favourable experience and the best estimate assumptions do not reflect this asymmetry. The areas identified as having the potential for material asymmetry are operational risk, persistency risk and reinsurance counterparty default risk.

The CNHR has been calculated by considering the financial cost to shareholders of the impact of asymmetric risks and with regard to the results of risk-based capital modelling. The risk-based capital is calculated using internal models, consistent with those used in the Group's Individual Capital Assessment, with:

- a 99.5% confidence level over one year;
- allowance for diversification between non-hedgeable risks;
- no allowance for diversification between non-hedgeable and hedgeable risks; and
- no allowance for diversification between covered and non-covered business.

The CNHR impacts both the value of existing business and new business.

Participating business
Future regular bonuses on participating business are projected in a manner consistent with current bonus rates and expected future market consistent returns on assets deemed to back the policies.

Future terminal bonuses are assumed to be set at a level to exhaust all the assets deemed to back the policies over the future lifetime of the in-force with-profit policies.

The PVFP includes the shareholders' share of future profits from the with-profits funds, based on the assumed bonus rates.

There may be some extreme future economic scenarios in which total assets in each of the with-profits funds are not sufficient to pay all policyholder claims and the resulting shortfall would be met by shareholders. Stochastic modelling techniques are used to assess the impact of future economic scenarios on the with-profits funds' ability to pay all policyholder claims and to determine the average additional cost to shareholders arising from future projected shortfalls. This cost to shareholders has been included in the TVOG.

Consolidation adjustments
The effect of transactions and reinsurance arrangements between life insurance subsidiary companies has been included in the results split by segment in a consistent manner. No elimination is required on consolidation.

Goodwill and intangible assets
Goodwill and intangible assets relating to the non-covered business are included on an IFRS basis. Intangible assets recognised under IFRS relating to the value of future new business, such as distribution relationships and brand value, have been excluded from the Group MCEV.

Exchange rates
The results and cash flows of overseas subsidiaries and joint ventures have been translated at the average exchange rates for the period and the assets and liabilities have been translated at the period end rates. Translation differences are shown as foreign exchange adjustments in the consolidated statement of comprehensive income. Exchange rate driven movements in MCEV earnings are reported within economic variances.

Details of the exchange rates used are shown in note 10.

2. Analysis of MCEV earnings

The following tables show the movement in the MCEV of the Group including the results for the AXA UK Life Business, WLUK and BHA from the dates of the respective acquisitions.

All of the Group's covered business is wholly contained within the Friends Life group.

The analysis is shown separately for free surplus, required capital and the value of the in-force covered business. All figures are shown net of tax.

For the year ended 31 December 2011

	FLG						RSL	
	Covered business							
Net of tax	Free surplus £m	Required capital £m	VIF £m	MCEV £m	Non-covered business £m	Total £m	Non-covered business £m	Total £m
Opening MCEV	**977**	**1,291**	**4,202**	**6,470**	**44**	**6,514**	**1**	**6,515**
Opening adjustments:								
– acquired value of BHA	**3**	**91**	**132**	**226**	**–**	**226**	**–**	**226**
– cost of acquisition of BHA(i)	**(168)**	**–**	**–**	**(168)**	**–**	**(168)**	**–**	**(168)**
– acquired value of WLUK	**(42)**	**102**	**211**	**271**	**–**	**271**	**–**	**271**
– cost of acquisition of WLUK(i)	**–**	**–**	**–**	**–**	**(248)**	**(248)**	**–**	**(248)**
Adjusted opening MCEV	**770**	**1,484**	**4,545**	**6,799**	**(204)**	**6,595**	**1**	**6,596**
Value of new business	**(325)**	**80**	**364**	**119**	**–**	**119**	**–**	**119**
Expected existing business contribution:								
– expected existing business contribution: reference rate	**22**	**(8)**	**55**	**69**	**–**	**69**	**–**	**69**
– expected existing business contribution: in excess of reference rate	**(46)**	**32**	**217**	**203**	**–**	**203**	**–**	**203**
Transfers from VIF and required capital to free surplus	**686**	**(81)**	**(605)**	**–**	**–**	**–**	**–**	**–**
Operating experience variances and development costs	**(51)**	**(4)**	**7**	**(48)**	**–**	**(48)**	**–**	**(48)**
Operating assumption changes	**204**	**(16)**	**(86)**	**102**	**–**	**102**	**–**	**102**
Other operating items	**242**	**(64)**	**(180)**	**(2)**	**(35)**	**(37)**	**(41)**	**(78)**
Operating MCEV earnings	**732**	**(61)**	**(228)**	**443**	**(35)**	**408**	**(41)**	**367**
Economic variances	**(353)**	**200**	**(300)**	**(453)**	**–**	**(453)**	**–**	**(453)**
Other non-operating items	**109**	**(352)**	**35**	**(208)**	**(1)**	**(209)**	**–**	**(209)**
Total MCEV earnings	**488**	**(213)**	**(493)**	**(218)**	**(36)**	**(254)**	**(41)**	**(295)**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**(32)**	**(32)**	**13**	**(19)**
Closing adjustments:								
– capital and dividend flows	**(682)**	**(521)**	**(1)**	**(1,204)**	**859**	**(345)**	**(126)**	**(471)**
– foreign exchange variances	**(1)**	**(3)**	**(11)**	**(15)**	**–**	**(15)**	**–**	**(15)**
– transfer of GOF and TIP businesses to AXA UK plc	**246**	**–**	**(196)**	**50**	**(50)**	**–**	**–**	**–**
Closing MCEV	**821**	**747**	**3,844**	**5,412**	**537**	**5,949**	**(153)**	**5,796**

(i) Transaction costs of £3 million relating to the acquisitions of BHA and WLUK are included in non-recurring items and non-operating variances in 2011. All transaction costs were incurred in FLG.

For the year ended 31 December 2010

Net of tax	FLG Covered business Free surplus £m	Required capital £m	VIF £m	MCEV £m	Non-covered business £m	Total £m	RSL Non-covered business £m	Total £m
Opening MCEV	812	362	1,873	3,047	134	3,181	307	3,488
Opening adjustments:								
– capital and dividend flows	–	–	–	–	2,165	2,165	(186)	1,979
– acquired businesses(i)	30	1,409	1,904	3,343	155	3,498	–	3,498
– cost of acquisition	–	–	–	–	(2,724)	(2,724)	–	(2,724)
Adjusted opening MCEV	842	1,771	3,777	6,390	(270)	6,120	121	6,241
Value of new business	(245)	31	331	117	–	117	–	117
Expected existing business contribution:								
– expected existing business contribution: reference rate	13	(3)	30	40	–	40	–	40
– expected existing business contribution: in excess of reference rate	5	(8)	162	159	–	159	–	159
Transfers from VIF and required capital to free surplus	386	(32)	(354)	–	–	–	–	–
Operating experience variances and development costs	4	(38)	30	(4)	–	(4)	–	(4)
Operating assumption changes	(42)	5	20	(17)	–	(17)	–	(17)
Other operating variances	36	(3)	13	46	(10)	36	(15)	21
Operating MCEV earnings	157	(48)	232	341	(10)	331	(15)	316
Economic variances	104	(61)	131	174	(2)	172	–	172
Other non-operating items	288	(406)	70	(48)	34	(14)	(14)	(28)
Total MCEV earnings	549	(515)	433	467	22	489	(29)	460
Other movements in IFRS net equity	–	–	–	–	(22)	(22)	(20)	(42)
Closing adjustments:								
– capital and dividend flows	(416)	37	3	(376)	314	(62)	(71)	(133)
– foreign exchange variances	2	(2)	(11)	(11)	–	(11)	–	(11)
Closing MCEV	977	1,291	4,202	6,470	44	6,514	1	6,515

(i) Transaction costs of £28 million were incurred in 2010 in respect of the acquisition of the AXA UK Life Business, of which £14 million was incurred in FLG.

3. Segmental analysis of MCEV earnings

The table below shows a further breakdown of the MCEV earnings. All of the Group's covered business is wholly contained within the Friends Life group.

All earnings are shown on a gross of tax basis with attributed tax shown separately.

For the year ended 31 December 2011

	FLG						RSL	
	Covered business							
Gross of tax	UK £m	Int'l £m	Lombard £m	FLG corporate £m	Non-covered business £m	Total £m	RSL (ex. FLG)[(i)] Non-covered business £m	Total £m
Value of new business	59	40	52	–	–	151	–	151
Expected existing business contribution	330	27	49	(46)	–	360	–	360
Operating experience variances	(9)	(7)	(12)	–	–	(28)	–	(28)
Operating assumption changes	147	(3)	(4)	–	–	140	–	140
Other operating variances	9	(20)	(2)	19	–	6	–	6
Development costs	(28)	(7)	(1)	–	–	(36)	–	(36)
Life and pensions covered business operating profit/(loss) before tax	508	30	82	(27)	–	593	–	593
Other income and charges	–	–	–	–	(35)	(35)	–	(35)
Life and pensions operating profit/(loss) before tax	508	30	82	(27)	(35)	558	–	558
Corporate income and charges	–	–	–	–	–	–	(41)	(41)
Operating profit/(loss) before tax	508	30	82	(27)	(35)	558	(41)	517
Economic variances	(519)	(58)	(120)	97	–	(600)	–	(600)
Other non-operating items	(329)	–	5	41	(2)	(285)	–	(285)
(Loss)/profit before tax	(340)	(28)	(33)	111	(37)	(327)	(41)	(368)
Attributed tax on operating profits	(137)	–	(20)	7	–	(150)	–	(150)
Attributed tax on other activities	227	4	27	(36)	1	223	–	223
(Loss)/profit after tax	(250)	(24)	(26)	82	(36)	(254)	(41)	(295)

(i) RSL (ex.FLG) refers to the Resolution holding companies.

For the year ended 31 December 2010

Gross of tax	FLG						RSL	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FLG corporate £m	Non-covered business £m	Total £m	RSL (ex. FLG)[(i)] Non-covered business £m	Total £m
Value of new business	19	43	83	–	–	145	–	145
Expected existing business contribution	210	29	38	(30)	–	247	–	247
Operating experience variances	37	12	(17)	–	–	32	–	32
Operating assumption changes	(41)	(2)	20	–	–	(23)	–	(23)
Other operating variances	96	(7)	39	(63)	–	65	–	65
Development costs	(21)	(6)	(1)	–	–	(28)	–	(28)
Life and pensions covered business operating profit/(loss) before tax	300	69	162	(93)	–	438	–	438
Other income and charges	–	–	–	–	(11)	(11)	–	(11)
Life and pensions operating profit/(loss) before tax	300	69	162	(93)	(11)	427	–	427
Corporate income and charges	–	–	–	–	–	–	(15)	(15)
Operating profit/(loss) before tax	300	69	162	(93)	(11)	427	(15)	412
Economic variances	276	25	33	(103)	(2)	229	–	229
Other non-operating items	(48)	(1)	1	(20)	57	(11)	(14)	(25)
Profit/(loss) before tax	528	93	196	(216)	44	645	(29)	616
Attributed tax on operating profits	(81)	(4)	(39)	27	1	(96)	–	(96)
Attributed tax on other activities	(59)	(1)	(7)	30	(23)	(60)	–	(60)
Profit/(loss) after tax	388	88	150	(159)	22	489	(29)	460

(i) RSL (ex.FLG) refers to the Resolution holding companies.

UK covered business

The 2011 life and pensions covered business operating profit before tax for the UK segment was £508 million (2010: £300 million). The 2010 UK results did not include WLUK and BHA, and only included the results of the AXA UK Life Business from 3 September 2010.

VNB

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The expected existing business contribution is the sum of two components:

- the expected earnings over the period assuming the opening assets earn the beginning of period reference rate; and
- the additional expected earnings (in excess of the beginning of period reference rate) consistent with management's expectation for the business.

The reference rate is based on the one-year swap return plus, for UK immediate annuity business only, an illiquidity premium equivalent to 75bps at the beginning of the year.

The additional earnings are the excess over the reference rate and reflect management's long-term expectation of asset returns, based on assumed asset mix.

The total expected contribution of £330 million (2010: £210 million) is comprised of £295 million (2010: £177 million) from applying expected rates of return to the value of in-force at the start of the period and £35 million (2010: £33 million) of expected return on shareholders' net assets.

The expected contribution from value of in-force reflects the expected return on the opening value of in-force of £3,271 million at 1 January 2011 adjusted for the value of in-force of the acquired BHA and WLUK businesses during the year (2010: opening value of in-force of £1,091 million at 1 January 2010, adjusted for the value of in-force of the acquired AXA UK Life Business during the year).

The UK contribution on shareholders' net worth of £35 million (2010: £33 million) includes £3 million from the expected return on shareholders' net assets in the BHA and WLUK businesses.

Operating experience variances

Operating experience variances relate to variances between actual experience and that anticipated in the projection assumptions.

Operating experience variances totalled £(9) million (2010: £37 million) and comprise the following elements:

- £40 million benefit from tax variances, primarily as a result of the availability of tax relief to offset tax arising on the recognition of regulatory surplus in the non-profit and with-profit funds, where such tax relief was not anticipated in the MCEV, or was achieved earlier than anticipated;
- £17 million benefit from better than assumed mortality experience in particular on the life protection business;
- £9 million benefit from better than assumed morbidity experience, in particular on the income protection business;
- £(18) million charge from actual expenses being higher than long-term expense assumptions, the majority of which relates to maintenance costs incurred during the year that will not form part of the ongoing cost base, partially offset by an investment expense under-run;
- £(54) million charge in respect of worse than expected persistency experience primarily on corporate pensions business, arising from a combination of scheme withdrawals, amendments to charging structures on existing schemes and premium reductions. At 31 December 2010 there was a provision of £37 million to cover short-term adverse persistency experience in the corporate pensions business. £26 million of this provision has been used to meet the adverse variance over 2011 and the remainder released following the strengthening of the long-term persistency assumptions; and
- £(3) million net charge from other sources.

Operating assumption changes

Operating assumption changes of £147 million in the year (2010: £(41) million) is comprised of:

- £185 million benefit from the impact on in-force business of the contractual future expense savings within the outsourcing arrangement with Diligenta. The arrangement with Diligenta has contractualised future expense savings with this benefit reflected in the MCEV maintenance expense assumptions (further detail is provided in note 10);
- £82 million benefit from changes to morbidity assumptions following completion of the latest experience review;
- £29 million benefit from updating mortality assumptions for protection and annuity business to reflect recent experience in these products;
- £(82) million charge from setting up a short-term provision for expected worsening of persistency in the run-up to the implementation of the RDR;
- £(73) million charge resulting from a strengthening of the long-term persistency assumptions on corporate pensions business; partially offset by the release of short-term adverse experience provisions brought forward and not utilised during the year; and
- £6 million benefit from other changes.

Other operating variances

Other operating variances of £9 million (2010: £96 million) is comprised of:

- £11 million benefit from the impact of an increase in reinsurance retention levels on protection business in BHA following its integration with the UK business;
- £9 million benefit from various modelling changes and the impact of adopting certain elements of PS06/14 guidance on protection business within the AXA UK Life Business and BHA;
- £(12) million charge from updating the cost of non-hedgeable risk; and
- £1 million benefit from other changes.

Development costs

The total development costs of £28 million (2010: £21 million) relate to the costs that are expected to enhance current propositions and generate future profits which are not captured in the MCEV. These costs relate principally to development of the corporate benefit, protection and retirement income business units.

International covered business

The life and pensions covered business operating profit before tax for the International segment was £30 million in 2011 (2010: £69 million).

VNB

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The expected contribution of £27 million (2010: £29 million) reflects £24 million (2010: £27 million) from the expected return on the opening value of in-force of £473 million (2010: £398 million) and £3 million (2010: £2 million) from the expected return on shareholders' net assets.

Operating experience variances

Operating experience variances of £(7) million (2010: £12 million) is comprised of:

- £(5) million charge from adverse persistency experience on certain OLAB and AmLife products, partially offset by better than expected experience on FPIL business;
- £(5) million charge from actual expenses being higher than long-term expense assumptions reflecting maintenance expense overruns and other project costs;
- £4 million benefit from better than assumed mortality experience; and
- £(1) million charge from other operational elements and other minor variances.

Operating assumption changes

Operating assumption changes of £(3) million in the year (2010: £(2) million) is comprised of:

- £18 million benefit from changes to fund manager rebate allowances partially offset by changes to commission and allocation assumptions;
- £(9) million charge from increased partial withdrawal assumptions partially offset by changes in lapse assumptions for FPIL business;
- £(13) million charge from the recognition of a short-term provision for adverse persistency and a change in assumptions on return of premium guarantees; and
- £1 million benefit from minor changes to the persistency and mortality assumptions.

Other operating variances

Other net adverse operating variances amounting to £(20) million in the year (2010: £(7) million) principally reflect enhancements to internal models following internal review and a model improvement project, including enhancements to the modelling of partial withdrawals on regular premium contracts.

Development costs

Development costs of £7 million (2010: £6 million) include £3 million in respect of the development of the International Platform and £3 million (2010: £3 million) in relation to the ongoing development of the German pensions proposition.

Lombard covered business

The life and pensions covered business operating profit before tax for the Lombard segment was £82 million (2010: £162 million).

VNB

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The expected contribution of £49 million (2010: £38 million) reflects the expected return on the opening value of in-force of £497 million (2010: £378 million).

Operating experience variances

Operating experience variances of £(12) million (2010: £(17) million) is comprised of:

- £3 million benefit from better than expected mortality experience;

- £(6) million charge resulting from persistency experience being worse than anticipated, notably in respect of the level of surrenders on the Belgian IFA business;
- £(2) million charge from expenses being higher than long-term expense assumptions;
- £(6) million charge from share-based payments representing the fair value charge of the Lombard long-term incentive plan; and
- other minor variances totalling £(1) million.

Operating assumption changes
Operating assumption changes of £(4) million in the year (2010: £20 million) is comprised of:

- £(11) million charge from the recognition of short-term adverse persistency provisions in respect of Belgian and Spanish business;
- £(1) million charge from an increase in long-term maintenance expense assumptions; and
- £8 million benefit from changes in long-term lapse and mortality assumptions following an experience review.

Other operating variances
Other operating variances of £(2) million (2010: £39 million) relate to changes to the cost of non-hedgeable risk.

Development costs
Development costs of £1 million (2010: £1 million) were incurred in relation to the development of new products throughout the year.

FLG corporate covered business

FLG corporate includes the external STICS, the external LT2 subordinated debt 2021, the external LT2 subordinated debt 2022 and the cost of holding any required capital in excess of the operating segment capital policy.

The expected existing business contribution of £(46) million (2010: £(30) million) represents the expected interest costs arising on the debt held within the FLG life and pensions covered business.

The other operating variances are a £19 million benefit as a result of the change to the Group capital management policy to hold 150% (2010: 160%) of the Group Capital Resource Requirement excluding WPICC.

Non-covered business
FLG non-covered business reported an operating loss of £(35) million (2010: £(11) million) due to the interest payable on the internal LT2 subordinated debt 2020 issued to Resolution holding companies, costs relating to the FLG long-term incentive plan, holding company costs and credit facility fees partially offset by the expected return on non-covered assets.

The Resolution holding companies reported an operating loss of £(41) million (2010: £(15) million). The loss comprises £(40) million of finance costs and £(35) million of administrative expenses reflecting fees payable to ROL, Directors' emoluments and other legal and professional fees. Partially offsetting these amounts, is interest income of £34 million, comprising £33 million on the internal LT2 subordinated debt 2020 issued by FLG and £1 million on largely cash-based assets.

Economic variances
Economic variances combine the impact of changes in economic assumptions with the investment return variances over the year.

Adverse macroeconomic factors, notably in the second half of the year, including volatile equity markets and widening corporate bond credit spreads have triggered a deterioration in investment market performance in 2011.

As a result, total adverse economic variances of £(600) million (2010: £229 million benefit) have been recognised, and comprise:

- £(239) million in respect of the UK annuity business, reflecting an increase in corporate bond credit spreads, partially offset by an increase in the illiquidity premium assumption to 90 bps (2010: 75 bps);
- £(241) million impact of adverse investment returns on the value of future profits from annual management charges on the UK unit-linked business;
- £(178) million from the International and Lombard segments, mainly as a result of adverse investment returns on unit-linked business;

- £(52) million due to changes in the allowance for TVOG, primarily from updating economic assumptions to reflect current conditions;
- £97 million benefit arising from a decrease in the market value of debt; and
- £13 million from other impacts.

Other non-operating items

The total other non-operating variances of £(285) million (2010: £(25) million) comprise:

- £(124) million in respect of the up front costs as part of the outsourcing agreement with Diligenta (discussed in note 10);
- £(128) million of non-recurring project costs within the covered business in respect of the separation and integration of UK businesses;
- £(55) million of non-recurring project costs within the covered business in respect of finance reporting improvements and Solvency II costs;
- £(19) million of capital restructuring costs as part of an internal group reorganisation to realise capital and operating synergies within the Friends Life group, and the costs of the RIE five year test (see note 10);
- £(17) million from other non-recurring items, including £(3) million of acquisition costs in relation to stamp duty on the acquisition of BHA and WLUK and £(2) million from non-covered business;
- £23 million benefit from the reduced cost of capital resulting from the Friends Life group internal reorganisation; and
- £35 million from taxation principally reflecting the reduction in corporation tax rate announced in March 2011. The corporation tax rate has been assumed to be reduced by 1% to 25% in April 2012, and then by 1% each year until it reaches the ultimate rate of 23% from April 2014.

A charge of £41 million has been recognised in the UK segment relating to the cost of capital previously held in the FLG corporate segment. An offsetting item of positive £41 million is recognised in the FLG corporate segment. These movements reflect the change during the year in the balance between life company subsidiary capital requirements and Group capital requirements.

4. Earnings per share

Earnings per share have been calculated based on the MCEV profit after tax and on the operating profit after tax, attributable to ordinary equity holders of the parent and the weighted average number of shares in issue. The Directors consider that operating earnings per share provides a better indication of operating performance.

Basic and operating earnings per share

Year ended 31 December 2011	**Earnings £m**	**Per share Pence**
Loss after tax attributable to ordinary equity holders of the parent	**(295)**	**(20.69)**
Economic variances	**600**	**42.08**
Amortisation of non-covered business acquired intangible assets	**3**	**0.21**
Non-recurring items and non-operating variances	**282**	**19.78**
Tax credit on items excluded from operating profit	**(223)**	**(15.64)**
Operating profit after tax attributable to ordinary equity holders of the parent	**367**	**25.74**

Year ended 31 December 2010	Earnings £m	Per share Pence
Profit after tax attributable to ordinary equity holders of the parent	460	48.77
Economic variances	(229)	(24.28)
Amortisation of non-covered business acquired intangible assets	3	0.32
Non-recurring items and non-operating variances	22	2.33
Tax credit on items excluded from operating profit	60	6.36
Operating profit after tax attributable to ordinary equity holders of the parent	316	33.50

Diluted earnings per share from continuing operations

There were no dilutive factors for the year ended 31 December 2011.

Year ended 31 December 2010	£m	Weighted average number of shares Number	Per share Pence
Profit after tax attributable to ordinary shareholders of the parent	460	943,284,481	48.77
Dilution	–	7,347,287	(0.38)
Diluted profit after tax attributable to ordinary shareholders of the parent	460	950,631,768	48.39

Weighted average number of ordinary shares

	2011 Actual	**2011 Weighted**
Issued ordinary shares at beginning of period	**1,452,564,371**	**1,452,564,371**
Own shares held by the Group at beginning of period	**(8,579,292)**	**(8,579,292)**
Effect of:		
– scrip dividend (final 2010)	**13,639,313**	**8,183,588**
– share repurchase	**(92,990,516)**	**(31,044,327)**
– scrip dividend (interim 2011)	**2,975,821**	**717,458**
– reduction in own shares held by the Group	**8,579,292**	**4,324,903**
– own shares acquired through the acquisition of WLUK	**(2,661,384)**	**(393,739)**
Number of ordinary shares at end of period	**1,373,527,605**	**1,425,772,962**

	2010 Actual	2010 Weighted
Issued ordinary shares at beginning of period	2,412,451,145	2,412,451,145
Effect of:		
– scrip dividend (final 2009)	5,753,268	3,436,198
– share consolidation	(2,337,597,599)	(2,335,357,765)
– rights issue	1,370,315,835	865,193,173
– scrip dividend (interim 2010)	1,641,722	382,319
– own shares held by the Group	(8,579,292)	(2,820,589)
Number of ordinary shares at end of period	1,443,985,079	943,284,481

5. Reconciliation of equity attributable to ordinary shareholders

Ordinary shareholders' equity on the MCEV basis reconciles to equity attributable to ordinary shareholders on the IFRS basis as follows:

	RSL	RSL	FLG	FLG
	2011 £m	2010 £m	2011 £m	2010 £m
Equity attributable to ordinary shareholders on an IFRS basis	**5,672**	6,227	5,825	6,226
Less items only included on an IFRS basis (net of tax):				
– IFRS reserving and other IFRS adjustments	**463**	507	463	507
– Deferred front end fees	**33**	24	33	24
– Deferred acquisition costs	**(500)**	(201)	(500)	(201)
– Acquired present value of in-force ("AVIF")	**(3,442)**	(3,608)	(3,442)	(3,608)
– Other intangible assets	**(305)**	(332)	(305)	(332)
Other[(i)]	**–**	(236)	–	(236)
Add items only included on a MCEV basis (net of tax):				
– Adjustment for long-term debt to market value	**31**	(68)	31	(68)
Net worth on a MCEV basis	**1,952**	2,313	2,105	2,312
Value of in-force covered business[(i)]	**3,844**	4,202	3,844	4,202
Equity attributable to ordinary shareholders on a MCEV basis	**5,796**	6,515	5,949	6,514

(i) As at 31 December 2010, the GOF and TIP portfolios were classified as held for sale assets and liabilities in both the Group's IFRS and MCEV statements of financial position with a net value of £281 million. Within the MCEV statement of financial position the held for sale assets were further split between the value of in-force covered business of £236 million and other assets. Within the MCEV supplementary information, the value of in-force covered business for the GOF and TIP portfolios was included in the Group's total value of in-force covered business of £4,202 million as at 31 December 2010. There were no held for sale assets and liabilities as at 31 December 2011.

6. New business

The following tables set out the analysis of new business in terms of volumes and profitability.

New business volumes have been shown using two measures:

- Present Value of New Business Premiums ("PVNBP"). PVNBP is equal to the total single premium sales received in the period plus the discounted value of regular premiums expected to be received over the lifetime of new contracts, and is expressed at point of sale;
- Annual Premium Equivalent ("APE"). APE is calculated as the new regular premium per annum plus 10% of single premiums.

The MCEV new business definition is consistent with the quarterly new business disclosures.

The premium volumes and projection assumptions used to calculate the present value of regular premiums within PVNBP are the same as those used to calculate the value of new business.

The value of new business is calculated using economic assumptions at the beginning of the period for all products except immediate annuities. For annuity business, as the contribution is sensitive to the interest rate at outset, the appropriate rate for each month's new business is used.

The value of new business is calculated using operating assumptions at the end of period for all products. The operating assumptions are consistent with those used to determine the embedded value.

The value of new business is shown after the effects of the frictional costs of holding required capital and share-based payments, and after the effect of the costs of residual non-hedgeable risks on the same basis as for the in-force covered business.

The 2011 and 2010 tables below exclude new business in relation to the GOF and TIP businesses disposed of during the period.

New business value for the year ended 31 December 2011

	New business premiums Single £m	Regular £m	APE £m	Average annual premium multiplier(i)	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
UK Corporate								
– Corporate benefits	**538**	**442**	**496**	**4.2**	**2,384**	**(2)**	**(3)**	**(0.1)**
– Group protection	**–**	**22**	**22**	**6.0**	**132**	**5**	**7**	**5.3**
UK Individual								
– Individual protection	**47**	**75**	**80**	**6.3**	**520**	**16**	**22**	**4.2**
– Individual pensions	**357**	**16**	**52**	**3.9**	**420**	**1**	**1**	**0.2**
Annuities(ii)	**374**	**–**	**37**	**–**	**374**	**21**	**29**	**7.8**
Investments	**342**	**–**	**34**	**–**	**339**	**2**	**3**	**0.9**
UK total	**1,658**	**555**	**721**	**4.5**	**4,169**	**43**	**59**	**1.4**
International	**648**	**187**	**252**	**5.1**	**1,603**	**36**	**40**	**2.5**
Lombard	**2,372**	**–**	**237**	**–**	**2,372**	**40**	**52**	**2.2**
Non-UK total	**3,020**	**187**	**489**	**5.1**	**3,975**	**76**	**92**	**2.3**
Total	**4,678**	**742**	**1,210**	**4.7**	**8,144**	**119**	**151**	**1.9**

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).

(ii) The value of new business for annuities shown in the table above has been valued assuming an illiquidity premium of 75bps over the eight months to 31 August 2011 and 90bps from 1 September to 31 December 2011.

New business value for the year ended 31 December 2010

	New business premiums Single £m	Regular £m	APE £m	Average annual premium multiplier(i)	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
UK Corporate								
– Corporate benefits	273	303	330	4.2	1,535	(4)	(5)	(0.3)
– Group protection	–	6	6	5.3	32	–	–	–
UK Individual								
– Individual protection	19	50	52	6.1	323	(9)	(13)	(4.0)
– Individual pensions	226	9	31	7.9	297	5	7	2.4
Annuities(ii)	290	–	29	–	290	19	26	9.0
Investments	239	–	24	–	239	3	4	1.7
UK total	1,047	368	472	4.6	2,716	14	19	0.7
International	515	186	238	4.8	1,405	40	43	3.0
Lombard	3,022	–	302	–	3,022	63	83	2.7
Non-UK total	3,537	186	540	4.8	4,427	103	126	2.8
Total	4,584	554	1,012	4.6	7,143	117	145	2.0

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).

(ii) The value of new business for annuities shown in the table above has been valued assuming an illiquidity premium of 75bps over the 12 months to 31 December 2010.

The pre-tax VNB has increased to £151 million in 2011 (2010: £145 million). This increase reflects the growth in the UK pre-tax VNB to £59 million (2010: £19 million) which has been impacted by the following factors:

- The inclusion of a full year of sales for the AXA UK Life Business;
- The acquisition of BHA in January 2011;
- The £15 million positive impact of the Diligenta outsourcing agreement which has lowered the contractual future servicing costs of new business; and

- The activities undertaken to reduce costs and focus on those products that offer the most attractive returns.

Partially offsetting the growth in the UK is a £31 million decrease in the Lombard pre-tax VNB, reflecting reduced sales and lower margins, principally driven by the impact of economic conditions (see below for further details).

Revised UK business unit structure

In August 2011, the Company announced the creation of four UK business units at Friends Life:

- The three UK Go to Market businesses of Corporate Benefits, Protection and Retirement Income which align with the product areas the UK business will focus on for active marketing; and
- UK Heritage which will manage the requirements of customers with products that are no longer being actively marketed, alongside those with legacy products that have previously been closed to new business.

The 2011 table below shows the new business value under this revised business unit structure.

New business value for the year ended 31 December 2011 presented in accordance with the revised UK business unit structure

	New business premiums							
	Single £m	Regular £m	APE £m	Average annual premium multiplier[(i)]	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
Corporate Benefits	**574**	**382**	**440**	**4.0**	**2,103**	**11**	**15**	**0.7**
Protection	**–**	**92**	**92**	**6.1**	**563**	**12**	**16**	**2.8**
Retirement Income[(ii)]	**321**	**–**	**32**	**–**	**321**	**23**	**32**	**10.0**
UK Heritage	**763**	**81**	**157**	**5.2**	**1,182**	**(3)**	**(4)**	**(0.3)**
UK total	**1,658**	**555**	**721**	**4.5**	**4,169**	**43**	**59**	**1.4**
International	**648**	**187**	**252**	**5.1**	**1,603**	**36**	**40**	**2.5**
Lombard	**2,372**	**–**	**237**	**–**	**2,372**	**40**	**52**	**2.2**
Non-UK total	**3,020**	**187**	**489**	**5.1**	**3,975**	**76**	**92**	**2.3**
Total	**4,678**	**742**	**1,210**	**4.7**	**8,144**	**119**	**151**	**1.9**

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).

(ii) The value of new business for annuities included in the table above has been valued assuming an illiquidity premium of 75bps over the eight months to 31 August 2011 and 90bps from 1 September 2011 to 31 December 2011.

UK

The pre-tax VNB from the UK segment was £59 million (2010: £19 million), comprising:

- UK Corporate Benefits VNB of £15 million, reflecting strong overall volumes and improving margins in the second half of 2011 arising from the delivery of cost synergies;
- UK Protection VNB of £16 million, a significant improvement in VNB in the second half of the year, reflecting the focus on higher value critical illness and income protection products as well as the migration to the lower cost strategic platform;
- UK Retirement Income VNB of £32 million reflecting the profitable new annuity business which has continued to be written despite challenging macroeconomic conditions; and
- UK Heritage VNB of £(4) million which specifically focuses on products no longer actively marketed, and reflects the closure of certain products lines and the impact of year end basis changes.

International

International pre-tax VNB was £40 million (2010: £43 million) with the decrease due to a compression in margins and the adverse impact of modelling refinements on the VNB, partially offset by an overall increase in sales volumes.

FPIL VNB has benefited from higher sales but comparative margins have been impacted by operating basis changes. The OLAB VNB has reduced due to the impact of lower persistency and economic conditions on the cost of guarantees on the German pension business, in combination with slightly lower sales in comparison to 2010. The AmLife VNB has been maintained despite lower sales volumes.

Lombard
Lombard pre-tax VNB of £52 million (2010: £83 million) has reduced in 2011 as a result of both lower sales volumes and margins combined with a relatively unchanged cost base. Performance during the year has being impacted by a number of factors including:

- the absence of strong fiscal policy drivers to generate new business which Lombard experienced in the first half of 2010;
- northern Europe primarily impacted by the negative economic environment and lower activity among IFAs especially in Belgium; and
- market uncertainties in respect of a number of potential fiscal changes and significantly adverse macroeconomic conditions in Europe, resulting in clients delaying decisions and affecting investor confidence.

New business performance metrics
New business written requires an initial capital investment to meet the set-up costs and capital requirements.

The IRR provides a measure of the return to shareholders on this initial capital investment. It is equivalent to the discount rate at which the present value of the after-tax cash flows expected to be earned over the lifetime of the business written is equal to the initial capital invested, including setting aside the required capital, to support the writing of the business.

The cash payback on new business is the time elapsed until the total of expected (undiscounted) cash flows is sufficient to recoup the initial capital invested, including the release of the required capital, to support the writing of new business.

The value of new business is shown after the effects of the frictional costs of holding required capital, and after the effect of the costs of residual non-hedgeable risks on the same basis as for the in-force covered business.

New business key performance metrics

	2011			2010		
	Pre-tax VNB £m	**Internal rate of return on new business %**	**Cash payback on new business Years**	Pre-tax VNB £m	Internal rate of return on new business %	Cash payback on new business Years
UK Corporate						
– Corporate benefits	**(3)**	**5.7**	**14**	(5)	6.2	14
– Group protection	**7**	**7.4**	**11**	–	4.7	16
UK Individual						
– Individual protection	**22**	**6.8**	**10**	(13)	2.7	16
– Individual pensions	**1**	**7.2**	**11**	7	14.2	7
Annuities	**29**	**20.5**	**7**	26	20.0	7
Investments	**3**	**7.6**	**9**	4	9.4	8
UK total	**59**	**7.7**	**11**	19	7.1	12
International	**40**	**12.7**	**7**	43	15.4	6
Lombard(i)	**52**	**>25**	**4**	83	>25	4
Non-UK total	**92**	**16.3**	**6**	126	19.4	5
Total(i)	**151**	**10.0**	**10**	145	11.2	9

(i) The 2011 Lombard IRR (and therefore the blended group IRR) now takes account of the Luxembourg regulatory regime in which DAC is an allowable asset.

New business key performance metrics presented in accordance with the revised UK business unit structure

	2011		
	Pre-tax VNB £m	**Internal rate of return on new business %**	**Cash payback on new business Years**
UK Corporate Benefits	**15**	**8.3**	**12**
UK Protection	**16**	**5.5**	**12**
UK Retirement Income	**32**	**22.0**	**7**
UK Heritage	**(4)**	**6.0**	**13**
UK total	**59**	**7.7**	**11**
International	**40**	**12.7**	**7**
Lombard(i)	**52**	**>25**	**4**
Non-UK total	**92**	**16.3**	**6**
Total(i)	**151**	**10.0**	**10**

(i) The 2011 Lombard IRR (and therefore the blended Friends Life group IRR) now takes account of the Luxembourg regulatory regime in which DAC is an allowable asset.

7. Segmental analysis of Group MCEV

At 31 December 2011

	2011									2010
	Free surplus £m	**Required capital £m**	**Total net worth £m**	**PVFP £m**	**TVOG £m**	**Frictional costs £m**	**Non-hedgeable risks £m**	**Total VIF £m**	**Total £m**	Total £m
UK	**790**	**1,666**	**2,456**	**3,276**	**(100)**	**(109)**	**(182)**	**2,885**	**5,341**	5,995
International	**18**	**51**	**69**	**525**	**(1)**	**(4)**	**(18)**	**502**	**571**	557
Lombard	**13**	**71**	**84**	**484**	**–**	**(4)**	**(23)**	**457**	**541**	577
FLG corporate (ex external STICS and external LT2 subordinated debt 2021, 2022)										
– IFA and distribution	**61**	**–**	**61**	**–**	**–**	**–**	**–**	**–**	**61**	22
– Pension asset of FPPS	**30**	**–**	**30**	**–**	**–**	**–**	**–**	**–**	**30**	39
– Other	**646**	**(82)**	**564**	**–**	**–**	**–**	**–**	**–**	**564**	620
Gross MCEV of FLG(i)	**1,558**	**1,706**	**3,264**	**4,285**	**(101)**	**(117)**	**(223)**	**3,844**	**7,108**	7,810
FLG corporate – external STICS	**–**	**(327)**	**(327)**	**–**	**–**	**–**	**–**	**–**	**(327)**	(393)
FLG corporate – external LT2 subordinated debt 2021, 2022	**–**	**(632)**	**(632)**	**–**	**–**	**–**	**–**	**–**	**(632)**	(201)
FLG corporate – internal LT2 subordinated debt 2020	**(200)**	**–**	**(200)**	**–**	**–**	**–**	**–**	**–**	**(200)**	(702)
Net MCEV of FLG	**1,358**	**747**	**2,105**	**4,285**	**(101)**	**(117)**	**(223)**	**3,844**	**5,949**	6,514
Resolution(ii) corporate net assets	**270**	**–**	**270**	**–**	**–**	**–**	**–**	**–**	**270**	901
Resolution Limited DCNs	**(423)**	**–**	**(423)**	**–**	**–**	**–**	**–**	**–**	**(423)**	(500)
Resolution(ii) acquisition finance facility	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	(400)
Net Group MCEV of Resolution Limited attributable to equity holders of parent	**1,205**	**747**	**1,952**	**4,285**	**(101)**	**(117)**	**(223)**	**3,844**	**5,796**	6,515

(i) For the purposes of this table "Gross" refers to the MCEV gross of the clean market value of the external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022. The accrued interest and tax adjustment on market valuation is included in the gross MCEV of FLG corporate.

(ii) Resolution holding companies.

i) Net worth

The external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are included within the MCEV at market value, as detailed in note 10.

ii) PVFP

The PVFP at 31 December 2011 is stated after recognition of provisions of £65 million (2010: £26 million) net of tax from the UK, in respect of worsening persistency in the run-up to the implementation of the RDR, and £10 million (2010: £4 million) from Lombard set up as a short-term persistency provision in respect of the Spanish and Belgian markets.

iii) TVOG

The TVOG at 31 December 2011 of £101 million (31 December 2010: £38 million), is split between £69 million (31 December 2010: £12 million) market risk and £32 million (31 December 2010: £26 million) non-market risk. The non-market risk includes lapses, annuitant longevity, and operational risk within the with-profits funds. The allowance for non-market risk is made by consideration of the impact of extreme scenarios from the Group's economic capital model. The increase in TVOG is principally driven by updating the assumptions to reflect current economic conditions.

iv) Frictional costs of holding required capital

The projected required capital for life company subsidiaries is derived from the Group's capital management policy which is to hold the greater of 150% of Pillar 1 CRR excluding WPICC and 125% of Pillar 2 CRR including any Individual Capital Guidance.

Additionally, the Group capital management policy in respect of FLG is to hold 150% of Group CRR excluding WPICC (2010: 160% of Group CRR excluding WPICC). The cost of holding any additional capital is shown in the FLG corporate segment. The Group's capital management policy was amended in the period, resulting in the recognition of a £19 million gain in the FLG corporate segment, reflecting the lower cost of capital.

v) CNHR

The cost of residual non-hedgeable risk of £223 million (31 December 2010: £184 million) is presented as an equivalent annual cost of capital charge of 2% (31 December 2010: 2%) on projected risk-based Group required capital for all non-hedgeable risk. In line with management's view of the business, allowance has been made for diversification benefits within the non-hedgeable risks of the covered business.

8. Segmental analysis of Group MCEV earnings

The following tables show a further breakdown of the MCEV earnings for each of the Group and Friends Life group respectively, comprising the MCEV earnings for the life and pensions covered business and the IFRS earnings for the respective non-covered businesses.

All figures are shown net of attributed tax.

Year ended 31 December 2011

	FLG						RSL	
	Covered business						**RSL**	
	UK £m	**Int'l £m**	**Lombard £m**	**FLG corporate £m**	**Non-covered business £m**	**Total £m**	**(ex.FLG)[(i)] Non-covered business £m**	**Total £m**
Opening Group MCEV	**5,995**	**557**	**577**	**(659)**	**44**	**6,514**	**1**	**6,515**
Opening adjustments:								
– acquired value of BHA	**226**	**–**	**–**	**–**	**–**	**226**	**–**	**226**
– cost of acquisition of BHA	**(168)**	**–**	**–**	**–**	**–**	**(168)**	**–**	**(168)**
– acquired value of WLUK	**271**	**–**	**–**	**–**	**–**	**271**	**–**	**271**
– cost of acquisition of WLUK	**–**	**–**	**–**	**–**	**(248)**	**(248)**	**–**	**(248)**
Adjusted opening Group MCEV	6,324	557	577	(659)	(204)	6,595	1	6,596
Operating MCEV earnings	**371**	**30**	**62**	**(20)**	**(35)**	**408**	**(41)**	**367**
Non-operating MCEV earnings	**(621)**	**(54)**	**(88)**	**102**	**(1)**	**(662)**	**–**	**(662)**
Total MCEV earnings	**(250)**	**(24)**	**(26)**	**82**	**(36)**	**(254)**	**(41)**	**(295)**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**(32)**	**(32)**	**13**	**(19)**
Closing adjustments:								
– capital and dividend flows	**(783)**	**39**	**4**	**(464)**	**859**	**(345)**	**(126)**	**(471)**
– foreign exchange variances	**–**	**(1)**	**(14)**	**–**	**–**	**(15)**	**–**	**(15)**
– transfer of GOF and TIP businesses to AXA UK plc	**50**	**–**	**–**	**–**	**(50)**	**–**	**–**	**–**
Closing Group MCEV	**5,341**	**571**	**541**	**(1,041)**	**537**	**5,949**	**(153)**	**5,796**

(i) RSL (ex. FLG) refers to the Resolution holding companies.

The opening adjustments consist of the purchases of BHA and WLUK.

Other movements in IFRS net equity of £(19) million (2010: £(42) million) reflect £(32) million in respect of actuarial losses on defined benefit pension schemes and £13 million in respect of the reduction in own shares held by the Group's subsidiaries during the year.

The total closing capital and dividend outflow of £(471) million comprises:

- £(226) million outflow in respect of dividends to equity holders of Resolution Limited, net of the impact of scrip dividends in the year;
- £(250) million outflow in respect of the share repurchase programme which completed in October 2011; and
- £5 million net inflow in respect of other items, including the impact on reserves of the fair value charge for the Lombard equity settled incentive scheme.

The closing adjustments in respect of the GOF and TIP business transfer represent:

- an increase in the MCEV for covered business of £50 million following the transfer. This increase comprises a £246 million increase in free surplus in the UK business, representing the consideration received from AXA UK plc after deduction of the value of the shareholders' net worth transferred. This is partially offset by a £(196) million reduction in VIF in the UK business, reflecting the VIF asset of the GOF and TIP business transferred to AXA UK plc; and
- a decrease in the MCEV for non-covered business of £50 million, representing the value of the payment from FLG to AXA UK plc to account for the surplus attributable to the GOF and TIP portfolios that arose during the period between 3 September 2010 and 1 November 2011 (respectively the dates of acquisition and disposal of the GOF/TIP portfolios).

Year ended 31 December 2010

	FLG						RSL	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FLG corporate £m	Non-covered business £m	Total £m	RSL (ex.FLG)[i] Non-covered business £m	Total £m
Opening Group MCEV	2,687	471	440	(551)	134	3,181	307	3,488
Opening adjustments	3,343	–	–	–	(404)	2,939	(186)	2,753
Adjusted opening Group MCEV	6,030	471	440	(551)	(270)	6,120	121	6,241
Operating MCEV earnings	219	65	123	(66)	(10)	331	(15)	316
Non-operating MCEV earnings	169	23	27	(93)	32	158	(14)	144
Total MCEV earnings	388	88	150	(159)	22	489	(29)	460
Other movements in IFRS net equity	–	–	–	–	(22)	(22)	(20)	(42)
Closing adjustments:								
– capital and dividend flows	(423)	(7)	3	51	314	(62)	(71)	(133)
– foreign exchange variances	–	5	(16)	–	–	(11)	–	(11)
Closing Group MCEV	5,995	557	577	(659)	44	6,514	1	6,515

(i) RSL (ex. FLG) refers to the Resolution holding companies.

9. Maturity profile of value of in-force business by proposition

As at 31 December 2011

	Total £m	1–5 £m	6–10 £m	11–15 £m	16–20 £m	21–25 £m	26–30 £m	31–35 £m	36–40 £m	41+ £m
					Years					
UK										
With-profits funds	**447**	**189**	**110**	**72**	**40**	**20**	**10**	**4**	**2**	**–**
Protection	**509**	**241**	**124**	**80**	**40**	**16**	**6**	**1**	**1**	**–**
Investments	**718**	**385**	**180**	**89**	**42**	**16**	**5**	**1**	**–**	**–**
Pensions	**1,028**	**431**	**297**	**169**	**82**	**34**	**12**	**3**	**–**	**–**
Annuities	**183**	**15**	**30**	**30**	**27**	**28**	**24**	**16**	**9**	**4**
UK total	**2,885**	**1,261**	**741**	**440**	**231**	**114**	**57**	**25**	**12**	**4**
Non-UK										
International	**502**	**270**	**123**	**69**	**30**	**9**	**1**	**–**	**–**	**–**
Lombard	**457**	**178**	**105**	**72**	**44**	**26**	**15**	**9**	**5**	**3**
Non-UK total	**959**	**448**	**228**	**141**	**74**	**35**	**16**	**9**	**5**	**3**
Total VIF	**3,844**	**1,709**	**969**	**581**	**305**	**149**	**73**	**34**	**17**	**7**

Below is the maturity profile for UK Heritage and Go to Market businesses reflecting the revised structure of the UK business.

As at 31 December 2011

	Total £m	1–5 £m	6–10 £m	11–15 £m	16–20 £m	21–25 £m	26–30 £m	31–35 £m	36–40 £m	41+ £m
					Years					
UK										
UK Go to Market	**757**	**284**	**192**	**120**	**72**	**43**	**25**	**12**	**6**	**3**
UK Heritage	**2,128**	**977**	**549**	**320**	**159**	**71**	**32**	**13**	**6**	**1**
UK total	**2,885**	**1,261**	**741**	**440**	**231**	**114**	**57**	**25**	**12**	**4**

10. MCEV assumptions

10.1 Economic assumptions – deterministic calculations

Economic assumptions are derived actively, based on market yields on risk-free fixed interest assets at the end of each reporting period.

Reference rates – risk-free

The risk-free reference rate is determined with reference to the swap yield curve appropriate to the currency of the cash flows. For some business types, where the impact on VIF is small, a long-term risk-free reference rate has been used.

For annuity business the swap yield curve is extrapolated where necessary to provide rates appropriate to the duration of the liabilities.

	Reference rate – risk-free	
	2011 %	2010 %
UK		
Long-term rate	**2.40**	3.70
Swap yield curve		
– Term 1 year	**1.35**	1.14
– Term 5 years	**1.57**	2.69
– Term 10 years	**2.36**	3.70
– Term 15 years	**2.78**	4.09
– Term 20 years	**3.00**	4.15
International long-term rate	**2.40**	3.70
Lombard long-term rate	**2.55**	3.46

Reference rate – Illiquidity premium adjustment

The MCEV Principles recognise that the inclusion of an illiquidity premium within the reference rate is appropriate where the liabilities are not liquid.

In this regard, the methodology adopted for the valuation of immediate annuities in the UK uses a reference rate that has been increased above the swap yield curve to allow for an illiquidity premium. This reflects the fact that, for these products, the backing asset portfolio can be held to maturity and earns risk-free returns in excess of swaps. Any illiquidity premia in respect of assets backing other product types are recognised within the MCEV as and when they are earned.

The illiquidity premium has been evaluated by considering a number of different sources of information and methodologies. There are two main approaches being commonly used to determine the illiquidity premium within the life insurance industry:

- a "negative basis trade", which attributes a component of the difference between the spread on a corporate bond and a credit default swap (for the same issuing entity, maturity, seniority and currency) as being the illiquidity premium; and
- structural models – such as that used by the Bank of England in their analysis of corporate bond spreads – that use option pricing techniques to decompose the spread into its constituent parts including default risk, credit risk premium and a residual illiquidity premium.

Both of these methods have been used to help inform the extent of the illiquidity premium within the asset portfolios backing immediate and some deferred annuity business.

Corporate bonds spreads have increased significantly over the year and the illiquidity premium has been increased from 75bps to 90bps, applicable from 1 September 2011, in line with these observed increases. The VNB calculation utilises the average illiquidity premium over the year and so will include 75bps for the business written in the first eight months of the year and 90bps for the business written after that. The MCEV economic variances are based on the assumptions at the end of the year and so use an illiquidity premium of 90bps.

No illiquidity premium has been applied for any other covered business.

The reference rate has been adjusted as set out in the table below.

	Embedded value		New business	
	2011	2010	**2011**	2010
UK illiquidity premium	**90bps**	75bps	**80bps**(i)	75bps

(i) average illiquidity premium which changed from 75 bps to 90bps from 1 September 2011.

Expected asset returns in excess of reference rates

Margins are added to the reference rates to obtain investment return assumptions for equity, property and corporate bonds. These risk premia reflect management's expectations of asset returns in excess of the reference rate from investing in different asset classes. As a market consistent approach has been followed, these investment return assumptions affect the expected existing business contribution and the economic variances within the analysis of MCEV earnings, but do not affect the opening or closing embedded values. In addition, they will affect the additional disclosures of the payback periods.

For equities and property, the excess is calculated as the difference between the long-term rate of return and the one-year risk-free reference rate. The long-term rate of return is derived using a 10 year swap rate plus a risk premium of 3% for equities (2010: 3%) and 2% for property (2010: 2%).

For cash and government bonds no excess over the one-year risk-free reference rate has been assumed. For corporate bonds, the return is based on the excess of actual corporate bond spreads on the reporting date, less an allowance for defaults, over the one-year risk-free reference rate.

For annuity business the excess return reflects the excess of the bond portfolio over the reference rate including the illiquidity premium adjustment.

Expense inflation

Maintenance expenses for UK and International business (excluding Lombard) are assumed to increase in the future at a rate of 1% (2010: 1%) per annum in excess of the assumed long-term rate of inflation. This is derived from the difference between the risk-free rate of return based on the FT Actuaries 15 year gilt index and the average of the FTSE Actuaries over five-year index-linked gilt yield at 5% and 0% inflation.

Maintenance expenses for Lombard are assumed to increase in the future at a rate of 0.75% per annum in excess of the assumed long-term rate of inflation. This is derived from an inflation swap curve based on a Eurozone price index taking into account the run-off profile of the business.

	Expense inflation	
	2011 %	2010 %
UK	**3.70**	4.4
International	**3.70**	4.4
Lombard	**2.95**	3.0

Exchange rates

The results and cash flows of all businesses, except Lombard, AmLife and AmFamily, are calculated in Sterling. The results and cash flows for Lombard are calculated in Euros and those of AmLife and AmFamily in Malaysian Ringgits, and converted to Sterling at the following rates:

	Exchange rates	
	2011	2010
Closing exchange rate		
– Euro	**0.835**	0.857
– Malaysian Ringgit	**0.203**	0.207
Average exchange rate		
– Euro	**0.869**	0.859
– Malaysian Ringgit	**0.204**	0.200

Other economic assumptions

Bonus rates on participating business have been set at levels consistent with the economic assumptions.

The MCEV allows for distribution of profit between the policyholders and shareholders within the following with-profits funds at the current rate of one-ninth of the cost of bonus:

- FLL With-Profits Fund (“FLL WPF”)
- FLAS With-Profits Fund (“FLAS WPF”)
- FLC Old With-Profits Fund (“FLC OWPF”)
- FLC New With-Profits Fund (“FLC NWPF”)
- WLUK With-Profits Fund (“WLUK WPF”)

In addition it is assumed that the shareholder interest in the non-profit business of the FLL WPF continues at the current rate of 60% of future profits.

FLC contains the Reattributed Inherited Estate (“RIE”) which was transferred to the FLC NPFs as part of the reattribution of the FAELLAS inherited estate. The reattribution was implemented as part of an intra group Part VII scheme (“the

Scheme) transferring business into FLC. The Scheme took effect on 1 April 2001 and was amended as part of a subsequent transfer of mainly unit-linked business into FLC on 1 January 2007 (the “2006 Scheme”).

With-profits policies where policyholders had elected to take part in the reattribution were transferred to the FLC NWPF. With-profits policies which were not so elected were transferred to the FLC OWPF with a proportionate share of the FAELLAS inherited estate.

The Scheme rules require that a test be undertaken every five years to determine whether it is possible to transfer any of the RIE from the FLC NPFs to the FLC shareholders’ fund or to distribute any of the inherited estate retained in the FLC OWPF in the form of Special Bonuses (and associated transfer to the shareholders’ fund). The latest five yearly test was undertaken as at 31 December 2010.

The RIE in the FLC NPFs is predominately in the form of the VIF of non-profit business written within those funds. To the extent that this VIF emerges into cash during the five-year period commencing 31 December 2010, the cash may be available to be transferred to the FLC shareholders’ fund subject to passing the relevant financial strength tests and subject to an overall cap on such further transfers of £928 million prior to the next five-year testing as at 31 December 2015. At 31 December 2011, a further £484 million is being transferred to the shareholders’ fund. The MCEV as at 31 December 2011 allows for the best estimate projections of further amounts to be transferred in future.

10.2 Economic assumptions – stochastic calculations

Model

The time value of financial options and guarantees is determined using a Barrie & Hibbert economic scenario generator and is calculated using 2,000 simulations. The model is consistent with the model used for the Realistic Balance Sheet and is calibrated to market conditions at the valuation date using the gilt risk-free curve and implied volatilities in the market. Correlations between the asset classes are derived from historic data.

Swaption implied volatilities

	2011 Swap term				2010 Swap term			
Option term	**10 yrs %**	**15 yrs %**	**20 yrs %**	**25 yrs %**	10 yrs %	15 yrs %	20 yrs %	25 yrs %
UK Sterling								
10 years	**17.6**	**17.6**	**17.8**	**17.9**	15.3	14.7	14.3	14.0
15 years	**15.4**	**15.6**	**15.8**	**15.8**	14.5	13.9	13.5	13.1
20 years	**14.1**	**14.3**	**14.3**	**14.2**	13.1	12.6	12.1	11.7
25 years	**13.3**	**13.2**	**13.0**	**12.7**	12.3	11.8	11.3	10.8

Equity and property implied volatilities

Equity volatility is calibrated to market implied volatility and is a reasonable fit to the implied volatility of the FTSE 100 put options held by the with-profits funds. Property holdings are modelled assuming an initial volatility of 15% (2010: 15%) and a running yield of 4.3% (2010: 4.7%). Sample implied volatilities are shown in the table below.

	2011		2010	
Option term	**Equity %**	**Property %**	Equity %	Property %
5 years	**26.9**	**14.8**	27.4	15.9
10 years	**27.0**	**15.1**	27.7	16.2
15 years	**27.3**	**14.6**	28.0	16.4

10.3 Other assumptions

Required capital

Required capital under MCEV amounted to £747 million (2010: £1,291 million).

The projected required capital is derived from the Group’s capital management policy which is to hold, within life company subsidiaries, the greater of 150% of Pillar 1 CRR excluding WPICC and 125% of Pillar 2 CRR including any Individual Capital Guidance. In addition the Group’s capital management policy is to hold 150% (2010: 160%) of Group CRR excluding WPICC, and the cost of holding any additional capital is shown within the FLG corporate covered business segment.

Taxation

The opening and closing embedded values in respect of covered business are determined on an after tax basis. The tax assumptions used are based upon the best estimate of the actual tax expected to arise. The attributable tax charge and profit before tax are derived by grossing up the profit after tax at the appropriate tax rates for each of the UK, Isle of Man, Luxembourg and Malaysia. Deferred tax is provided on the mark-to-market revaluation of the external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 allocated to the life and pensions covered business within FLG corporate. For UK and OLAB business the appropriate tax rate has been calculated as the average rate of corporation tax applicable over the whole calendar year, and hence the rate applicable for 2011 reflects the reduction in corporation tax that took effect from April 2011.

For non-covered business, attributed tax is consistent with the IFRS financial statements.

	Tax rates	
	2011 **%**	2010 %
UK	**26.5**	28.0
International		
– OLAB (UK)	**26.5**	28.0
– FPIL (Isle of Man)	**0.0**	0.0
– AmLife and AmFamily (Malaysia)	**25.0**	25.0
Lombard	**23.5**	23.5

The PVFP for UK and OLAB business includes allowance for the annual reductions in corporation tax announced in the Emergency Budget in June 2010 and the further reduction of 1% announced in the Budget in March 2011. The MCEV allows for anticipated future annual reductions in corporation tax from 26% to 23% (2010: 27% to 24%) over the period to 2014 and for an ultimate rate of 23% (2010: 24%) from April 2014.

The tax assumptions used within the MCEV do not take account of the additional 1% reduction in corporation tax announced on 21 March 2012. As a result of this change, the corporation tax rate is therefore expected to be 24% from 1 April 2012, 23% from 1 April 2013 and 22% from 1 April 2014. The impact of this change is estimated to be an increase in the MCEV of £25 million as at 31 December 2011.

VAT in the UK of 20.0% (2010: 20.0%) has been included on relevant investment management expenses and outsourced administration contracts.

Demographic assumptions

Other assumptions (for example mortality, morbidity and persistency) are a reflection of the best estimate of the likely behaviours, outcomes or circumstances in the future. Typically the estimates are made on an annual basis following experience investigations based on the data available at the time both from the book of business and externally sourced information. The aim is to set assumptions at a level that reflects recent experience, unless there are reliable indicators that suggest their adoption would result in a significant variance compared to these assumptions in the future. In some instances, there may be little or no direct experience to use in setting assumptions and the future outcome is therefore uncertain.

The RDR will come into effect from 1 January 2013 and an £88 million provision (gross of tax and including £6 million recognised in the WLUK acquisition balance sheet) has been recognised to cover negative variances expected on initial commission business pre RDR in 2012 where long-term assumptions are expected to be temporarily inadequate.

Future improvements in annuitant mortality have been assumed to be in accordance with the projections published by the Continuous Mortality Investigation (“CMI”) in 2011, with a long-term rate of 1.25% per annum In the prior year, future improvements were assumed to be in accordance with the “medium cohort” projections (with certain amendments) published by the CMI in 2002, with a minimum annual rate of improvement in future mortality of 1.5% per annum for males and 1.25% per annum for females.

Expense assumptions

The management expenses (including those relating to holding companies) attributable to the covered businesses have been analysed between expenses relating to the acquisition of new business, maintenance of in-force business (including investment management expenses) and development expenses.

Future maintenance expense assumptions reflect the expected ongoing expense levels required to manage the in-force business.

Productivity gains have generally only been included to the extent they have been achieved by the end of the reporting period.

In June 2009 FLSL entered into a 15 year agreement with Capita Life & Pensions Regulated Services Limited ("Capita") to outsource the administration of mature traditional life and pensions policies. This agreement includes the rationalisation of IT systems and significant longer term cost reductions. The maintenance expense assumptions for the relevant business allow for the agreed service fees with Capita. In addition allowance is made for the initial significant development expenditure and anticipated longer term savings as a result of a reduction in IT costs, which result in an overall expense overrun in FLSL.

Future projected short-term expense overruns in the Lombard business have been allowed for by reducing the PVFP by £1 million for a projected overrun to 2013 (2010: £2 million for a projected overrun to 2012).

In November 2011 Friends Life announced a 15 year agreement with Diligenta to outsource IT and Programmes and in-house Customer Service functions – along with HR, Finance and Business Risk services that support IT and Programmes and Customer Services. This agreement will result in significant longer term cost reductions and has resulted in an overall increase in MCEV of £76 million in 2011. The maintenance expense assumptions for the business units allow for the agreed service fees with Diligenta which results in a positive operating assumption change of £185 million and a positive impact on VNB of £15 million. In addition allowance is made for the initial significant development expenditure of £(124) million, considered to be non-recurring and shown within other non-operating items.

Other one-off costs shown within non-recurring items can be categorised as:

- Finance transformation and Solvency II project costs;
- Separation and integration costs;
- Capital restructuring costs; or
- Corporate acquisitions/disposal costs.

Any other one-off costs that do not fall into these categories are treated as operating exceptional costs within operating experience variances.

The MCEV makes provision for certain development costs to the extent that these are known with sufficient certainty and in line with current plans.

Development costs of £36 million (2010: £28 million) have been excluded from the calculation of unit costs and have been recognised in operating profits. Development costs relate to investment in activities expected to create value in the future, but where that expected value cannot be anticipated within the current year's financial results until the value is realised.

Development costs

	FLG	FLG
	2011 £m	2010 £m
UK	**28**	21
International	**7**	6
Lombard	**1**	1
Total	**36**	28

Non-hedgeable risks

A charge equivalent to 2% (2010: 2%) has been applied to the projected risk-based group required capital for all non-hedgeable risks over the remaining lifetime of in-force business.

In line with management's view of the business, allowance has been made for diversification benefits within the non-hedgeable risks of the covered business.

Other assumptions

The external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are included within the MCEV at market value, based on listed ask price.

31 December 2011	Principal £m	Clean market value of debt £m	Accrued interest £m	Tax adjustment on market valuation £m	Value of debt included in FLG corporate[(i)] £m
2003 STICS	**210**	**142**	**2**	**17**	**161**
2005 STICS	**268**	**185**	**8**	**19**	**212**
LT2 subordinated debt 2021	**162**	**182**	**12**	**(9)**	**185**
LT2 subordinated debt 2022	**500**	**450**	**29**	**4**	**483**
Total	**1,140**	**959**	**51**	**31**	**1,041**

31 December 2010	Principal £m	Clean market value of debt £m	Accrued interest £m	Tax adjustment on market valuation £m	Value of debt included in FLG corporate[(i)] £m
2003 STICS	210	172	2	9	183
2005 STICS	268	221	8	10	239
LT2 subordinated debt 2021	162	201	12	(15)	198
Total	640	594	22	4	620

(i) The value of debt included in the FLG corporate category is the market value of debt, including accrued interest, and the tax asset/liability on the market value adjustment.

The deferred consideration notes, issued in September 2010 in connection with the acquisition of the AXA UK Life Business, are included within the MCEV at face value. The value at 31 December 2011 is £423 million (2010: £500 million).

The acquisition finance facility was a term loan facility agreement also issued in September 2010 to fund part of the consideration payable for the acquisition of the AXA UK Life Business; this loan was repaid in April 2011. The value at 31 December 2010 was £400 million.

11. Sensitivity analysis

The following tables show the sensitivity of the embedded value and the value of new business to changes in assumptions. The sensitivities below apply to covered business only and include the impact on both shareholder net worth and VIF.

For each sensitivity, the other future experience assumptions remain unchanged, except where changes in economic assumptions directly affect them. The assumptions underlying the statutory reserving calculations remain unchanged in all sensitivities. There are no additional management actions or changes in policyholder behaviour assumed within any of the sensitivities.

Sensitivities shown in a single direction have broadly symmetrical impacts.

Change in MCEV (net of tax) in 2011	FLG covered business UK £m	Int'l £m	Lombard £m	FLG corporate £m	Total £m
Base MCEV	**5,341**	**571**	**541**	**(1,041)**	**5,412**
Market risk					
100bps increase in reference rates	**(130)**	**(5)**	**3**	**47**	**(85)**
100bps decrease in reference rates	**121**	**16**	**(8)**	**(51)**	**78**
Removal of illiquidity premium for immediate annuities	**(607)**	**–**	**–**	**–**	**(607)**
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield[(i)]	**(188)**	**(23)**	**(32)**	**–**	**(243)**
25% increase in equity/property volatility at the valuation date	**(32)**	**–**	**–**	**–**	**(32)**
25% increase in swaption implied volatility at the valuation date	**(4)**	**–**	**–**	**–**	**(4)**
100bps increase in corporate bond spreads[(ii)]	**(303)**	**(4)**	**(14)**	**47**	**(274)**
100bps decrease in corporate bond spreads[(ii)]	**289**	**5**	**14**	**(51)**	**257**
10% adverse movement in Sterling/overseas exchange rate[(iii)]	**(43)**	**(46)**	**(69)**	**–**	**(158)**
10% fall in value of unit-linked funds	**(220)**	**(26)**	**(67)**	**–**	**(313)**
Insurance and other risk					
Reduction to EU minimum capital or equivalent [(iv)]	**41**	**–**	**–**	**–**	**41**
10% decrease in maintenance expenses	**147**	**21**	**23**	**–**	**191**
10% proportionate decrease in lapse rates	**90**	**12**	**33**	**–**	**135**
10% proportionate decrease in PUP rates	**13**	**7**	**–**	**–**	**20**
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	**287**	**4**	**2**	**–**	**293**
– After reinsurance	**52**	**3**	**2**	**–**	**57**
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	**(27)**	**–**	**–**	**–**	**(27)**
– After reinsurance	**(68)**	**–**	**–**	**–**	**(68)**

(i) The movement in UK embedded value from a reduction in market values comprises a nil (2010: £3 million) fall in the value of shareholders' net worth and a £188 million (2010: £189 million) reduction in the value of in-force covered business.

(ii) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 35bps (2010: 30bps) for in-force business and 35bps (2010: 40 bps) for the value of new business.

(iii) Currency risk is expressed in terms of total overseas exposure; the Group's principal currency exposures other than Sterling are the Euro and US Dollar.

(iv) Required capital is set at the greater of regulatory capital and requirements arising from internal capital management policies. In aggregate, the required capital is higher than the regulatory requirement by £902 million (2010: £1,093 million). This sensitivity shows the impact on embedded value of using the lower regulatory capital requirement.

Change in MCEV (net of tax) in 2010	FLG covered business UK £m	Int'l £m	Lombard £m	FLG corporate £m	Total £m
Base MCEV	5,995	557	577	(659)	6,470
Market risk					
100bps increase in reference rates	(144)	(7)	(6)	29	(128)
100bps decrease in reference rates	153	4	1	(31)	127
Removal of illiquidity premium for immediate annuities	(425)	–	–	–	(425)
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield(i)	(192)	(20)	(46)	–	(258)
25% increase in equity/property volatility at the valuation date	(22)	–	–	–	(22)
25% increase in swaption implied volatility at the valuation date	(4)	–	–	–	(4)
100bps increase in corporate bond spreads(ii)	(312)	–	(16)	29	(299)
100bps decrease in corporate bond spreads(ii)	329	–	16	(31)	314
10% adverse movement in Sterling/overseas exchange rate(iii)	(34)	(15)	(47)	–	(96)
Insurance and other risk					
Reduction to EU minimum capital or equivalent(iv)	34	1	2	45	82
10% decrease in maintenance expenses	162	8	23	–	193
10% proportionate decrease in lapse rates	85	15	42	–	142
10% proportionate decrease in PUP rates	13	4	–	–	17
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	227	4	2	–	233
– After reinsurance	62	2	–	–	64
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	(6)	–	–	–	(6)
– After reinsurance	(49)	–	–	–	(49)

(i) to (iv) see previous page.

Change in value of new business (gross of tax) in 2011	FLG covered business UK £m	Int'l £m	Lombard £m	Total £m
Base value of new business	**59**	**40**	**52**	**151**
Market risk				
100bps increase in reference rates	**(8)**	**(3)**	**–**	**(11)**
100bps decrease in reference rates	**8**	**3**	**(1)**	**10**
Removal of illiquidity premium for immediate annuities	**(27)**	**–**	**–**	**(27)**
100bps increase in corporate bond spreads(i)	**(7)**	**–**	**–**	**(7)**
100bps decrease in corporate bond spreads(i)	**1**	**–**	**–**	**1**
Insurance and other risk				
Reduction to EU minimum capital or equivalent	**2**	**–**	**–**	**2**
10% decrease in maintenance expenses	**10**	**5**	**2**	**17**
10% proportionate decrease in lapse rates	**11**	**3**	**5**	**19**
10% proportionate decrease in PUP rates	**4**	**2**	**–**	**6**
5% decrease in mortality/morbidity – life assurance				
– Before reinsurance	**13**	**1**	**–**	**14**
– After reinsurance	**4**	**–**	**–**	**4**
5% decrease in mortality/morbidity – annuity business				
– Before reinsurance	**(3)**	**–**	**–**	**(3)**
– After reinsurance	**(3)**	**–**	**–**	**(3)**
Impact of end of period assumptions on VNB	**8**	**7**	**(1)**	**14**

(i) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 35bps (2010: 30bps) for in-force business and 35bps (2010: 40bps) for the value of new business.

Change in value of new business (gross of tax) in 2010	FLG covered business UK £m	Int'l £m	Lombard £m	Total £m
Base value of new business	19	43	83	145
Market risk				
100bps increase in reference rates	(7)	(1)	3	(5)
100bps decrease in reference rates	2	1	(4)	(1)
Removal of illiquidity premium for immediate annuities	(20)	–	–	(20)
100bps increase in corporate bond spreads[(i)]	(9)	–	–	(9)
100bps decrease in corporate bond spreads[(i)]	8	–	–	8
Insurance and other risk				
Reduction to EU minimum capital or equivalent	3	–	–	3
10% decrease in maintenance expenses	8	2	4	14
10% proportionate decrease in lapse rates	7	2	7	16
10% proportionate decrease in PUP rates	4	2	–	6
5% decrease in mortality/morbidity – life assurance				
– Before reinsurance	8	–	–	8
– After reinsurance	2	–	–	2
5% decrease in mortality/morbidity – annuity business				
– Before reinsurance	(2)	–	–	(2)
– After reinsurance	(2)	–	–	(2)

(i) see previous page.

12. Comparison of MCEV and IFRS classification and segments

The covered business segments within MCEV are consistent with the IFRS business segments.

The split of the MCEV by IFRS business segment for FLG is shown in the tables below:

FLG for the year ended 31 December 2011

	MCEV classification					
	UK £ m	**Int'l £ m**	**Lombard £m**	**FLG corporate £m**	**Non-covered business £m**	**Total MCEV by IFRS segments £m**
IFRS segment						
UK	**5,341**	**–**	**–**	**–**	**63**	**5,404**
International	**–**	**571**	**–**	**–**	**(2)**	**569**
Lombard	**–**	**–**	**541**	**–**	**3**	**544**
FLG corporate	**–**	**–**	**–**	**(1,041)**	**473**	**(568)**
Total MCEV (by MCEV segments)	**5,341**	**571**	**541**	**(1,041)**	**537**	**5,949**

FLG for the year ended 31 December 2010

	MCEV classification					Total MCEV by IFRS segments
	UK £m	Int'l £m	Lombard £m	FLG corporate £m	Non-covered business £m	£m
IFRS segment						
UK	5,995	–	–	–	22	6,017
International	–	557	–	–	–	557
Lombard	–	–	577	–	6	583
FLG corporate	–	–	–	(659)	16	(643)
Total MCEV (by MCEV segments)	5,995	557	577	(659)	44	6,514

13. FLG annualised return on embedded value

	2011 % p.a.	2010 % p.a.
Value of new business	**2.0**	3.3
Expected existing business contribution(i)	**5.3**	5.6
Operating experience variances	**(0.4)**	0.8
Operating assumption changes	**1.8**	(0.5)
Other operating variance	**0.1**	1.1
Development costs	**(0.4)**	(0.6)
Other income and charges(ii)	**–**	0.2
MCEV operating profit before tax and financing	**8.4**	9.9
Impact of financing	**0.5**	0.7
Attributed tax charge on MCEV operating profit	**(2.4)**	(2.3)
MCEV operating profit after tax	**6.5**	8.3
Economic variances	**(9.5)**	4.7
Other non-operating items	**(4.5)**	0.1
Attributed tax on other activities	**3.5**	(1.3)
MCEV (loss)/profit after tax	**(4.0)**	11.8
Actuarial losses on defined benefit pension schemes	**(0.6)**	(0.6)
Foreign exchange adjustments	**(0.2)**	(0.3)
Total return on MCEV over the period	**(4.8)**	10.9

(i) Excludes expected impact of financing of covered debt of £46 million for 2011 (2010: £30 million).

(ii) Excludes £33 million impact of financing of non-covered debt of £200 million for 2011 (2010: £18 million).

The table above provides an analysis of the return on embedded value. The starting FLG embedded value for 2011 is £6,514 million, net of the market-consistent value of debt instruments of £1,296 million at 31 December 2010. The starting FLG embedded value for 2010 is £3,181 million, net of the market-consistent value of debt instruments of £557 million. The 2011 embedded value has been adjusted to allow for the timing of dividend payments, the acquisition of BHA, the acquisition of WLUK and the transfer of the GOF/TIP business to AXA UK, the partial repayment of the internal LT2 subordinated debt 2020 issued to Resolution holding companies by FLG, and the new external LT2 subordinated debt 2022 issued during the period.

The MCEV operating return before tax and financing is based on the gross MCEV (i.e. before the market-consistent value of debt). The return includes both covered and non-covered business. The impact of the financing item reflects the leverage on the return on embedded value created within FLG through the use of debt instruments, net of the cost of financing these instruments.

Appendices

Appendix 1: International additional information

Analysis of International segment

APE, PVNBP and VNB

Year ended 31 December 2011 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
New Business APE	219	27	6	**252**
New Business PVNBP	1,380	173	50	**1,603**
VNB	29	7	4	**40**

IFRS based operating profit

Year ended 31 December 2011 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
New business strain	(30)	(6)	–	**(36)**
In-force surplus	92	5	–	**97**
Investment return and other items	1	–	–	**1**
Principal reserving changes and one-off items	(8)	(4)	–	**(12)**
Development costs	(5)	(2)	–	**(7)**
Other	–	(1)	(2)	**(3)**
IFRS based operating profit before tax	**50**	**(8)**	**(2)**	**40**

MCEV operating profit

Year ended 31 December 2011 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
Value of new business	29	7	4	**40**
Expected existing business contribution	23	2	2	**27**
Operating experience variance	1	(6)	(2)	**(7)**
Operating assumption changes	7	(10)	–	**(3)**
Other operating variances	(21)	2	(1)	**(20)**
Development costs	(5)	(2)	–	**(7)**
Other	–	(1)	–	**(1)**
MCEV operating profit before tax	**34**	**(8)**	**3**	**29**

MCEV

As at 31 December 2011 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
Total	**458**	**75**	**38**	**571**

Operating expenses

Year ended 31 December 2011 **£m**	**FPIL**	**OLAB**	**TOTAL**
Acquisition	20	10	**30**
Maintenance	24	7	**31**
Development	5	2	**7**
Total	**49**	**19**	**68**

As AmLife is an associated undertaking, its operating expenses are excluded from the analysis above.

Appendix 2: New business information

Analysis of Life and Pensions new business

- single new business premiums consist of those contracts under which there is no expectation of continuing premiums being paid at regular intervals;
- regular new business premiums consist of those contracts under which there is an expectation of continuing premiums being paid at regular intervals, including repeated or recurrent single premiums where the level of premiums is defined, or where a regular pattern in the receipt of premiums has been established;
- non-contractual increments under existing group pensions schemes are classified as new business premiums;
- transfers between products where open market options are available are included as new business; and
- regular new business premiums are included on an annualised basis.

Regular and single premiums

	Regular premiums			Single premiums		
	FY[i] 2011 £m	FY[ii] 2010 £m	Change %	**FY[i] 2011 £m**	FY[ii] 2010 £m	Change %
UK Corporate						
– pensions	**442.1**	303.1	46	**537.8**	273.0	97
– protection	**21.6**	5.6	286	**–**	–	–
UK Individual						
– protection	**75.5**	49.9	51	**46.8**	19.1	145
– pensions	**16.2**	8.8	84	**356.9**	225.6	58
– investments	**–**	0.1	(100)	**342.1**	238.9	43
Annuities	**–**	–	–	**374.2**	289.9	29
Total UK Life and Pensions	**555.4**	367.5	51	**1,657.8**	1,046.5	58
International	**186.8**	186.1	–	**648.1**	515.4	26
Lombard	**–**	–	–	**2,371.6**	3,022.0	(22)
Total International Life and Pensions	**186.8**	186.1	–	**3,019.7**	3,537.4	(15)
Total Life and Pensions	**742.2**	553.6	34	**4,677.5**	4,583.9	2

(i) Includes the trading results of the acquired BHA business for the 11 month period from 1 February 2011 and acquired WLUK results for the two month period from 1 November 2011.

(ii) Includes the trading results of the acquired AXA UK Life Business for the four month period from 1 September 2010.

	Regular premiums			Single premiums		
	Q4[(i)] 2011 £m	Q4[(ii)] 2010 £m	Change %	**Q4[(i)] 2011 £m**	Q4[(ii)] 2010 £m	Change %
UK Corporate						
– pensions	**119.7**	91.0	32	**95.8**	102.8	(7)
– protection	**6.5**	2.2	195	**–**	–	–
UK Individual						
– protection	**11.0**	18.4	(40)	**46.8**	14.9	214
– pensions	**4.1**	3.4	21	**46.6**	52.3	(11)
– investments	**–**	–	–	**42.7**	154.7	(72)
Annuities	**–**	–	–	**94.5**	84.6	12
Total UK Life and Pensions	**141.3**	115.0	23	**326.4**	409.3	(20)
International	**43.3**	45.2	(4)	**135.5**	164.8	(18)
Lombard	**–**	–	–	**995.9**	892.3	12
Total International Life and Pensions	**43.3**	45.2	(4)	**1,131.4**	1,057.1	7
Total Life and Pensions	**184.6**	160.2	15	**1,457.8**	1,466.4	(1)

(i) Includes the trading results of WLUK for the 2 month period from 1 November 2011

(ii) Includes the trading results of Friends Provident and the AXA UK Life Business only.

Group new business – APE

APE represents annualised new regular premiums plus 10% of single premiums.

	FY[(i)] 2011 £m	FY[(ii)] 2010 £m	Change %	**Q4 2011 £m**	Q4[(iii)] 2010 £m	Change %
UK corporate						
– pensions	**495.9**	330.3	50	**129.3**	101.3	28
– protection	**21.6**	5.6	286	**6.5**	2.2	195
UK Individual						
– protection	**80.2**	51.8	55	**15.7**	19.9	(21)
– pensions	**51.9**	31.4	65	**8.8**	8.6	2
– investments	**34.2**	24.0	43	**4.3**	15.5	(72)
Annuities	**37.4**	29.0	29	**9.4**	8.5	11
Total UK Life and Pensions	**721.2**	472.1	53	**174.0**	156.0	12
International	**251.6**	237.6	6	**56.8**	61.7	(8)
Lombard	**237.2**	302.2	(22)	**99.6**	89.1	12
Total International Life and Pensions	**488.8**	539.8	(9)	**156.4**	150.8	4
Total Life and Pensions	**1,210.0**	1,011.9	20	**330.4**	306.8	8

(i) Includes the trading results of the acquired BHA business for the 11 month period from 1 February 2011 and acquired WLUK results for the two month period from 1 November 2011.

(ii) Includes the trading results of the acquired AXA UK Life Business for the four month period from 1 September 2010.

(iii) Includes the trading results of Friends Provident and the AXA UK Life Business only.

Group Quarterly Progression – APE

	Q4[(i)] 2011 £m	Q3 2011 £m	Q2 2011 £m	Q1[(ii)] 2011 £m
UK corporate				
– pensions	**129.3**	124.6	128.8	113.2
– protection	**6.5**	3.3	7.3	4.5
UK Individual				
– protection	**15.7**	20.5	21.9	22.1
– pensions	**8.8**	10.0	23.3	9.8
– investments	**4.3**	7.9	8.5	13.5
Annuities	**9.4**	9.1	10.1	8.8
Total UK Life & Pensions	**174.0**	175.4	199.9	171.9
International	**56.8**	62.6	68.8	63.4
Lombard	**99.6**	40.7	62.5	34.4
Total International Life & Pensions	**156.4**	103.3	131.3	97.8
Total Life & Pensions	**330.4**	278.7	331.2	269.7

(i) Includes the trading results of WLUK for the 2 month period from 1 November 2011.

(ii) Includes the trading results of the acquired BHA business for the 2 month period from 1 February 2011.

International

APE by region (actual exchange rates)	FY 2011 £m	FY 2010 £m	Change %
North Asia	**103.3**	94.4	9
South Asia	**26.2**	19.4	35
Middle East	**45.6**	45.9	(1)
Europe (Excl UK)	**31.5**	35.2	(11)
UK	**18.0**	14.0	29
Rest of World	**20.9**	18.9	11
Malaysia (AmLife)	**6.1**	9.8	(38)
Total	**251.6**	237.6	6

Lombard

APE by region (actual exchange rates)	FY 2011 £m	FY 2010 £m	Change %
UK and Nordic	**52.1**	72.3	(28)
Northern Europe	**42.2**	118.8	(64)
Southern Europe	**115.2**	94.4	22
Rest of World	**27.7**	16.7	66
Total including large cases	**237.2**	302.2	(22)
Of which: Large cases (greater than €10m)	**83.1**	90.5	(8)
Total excluding large cases	**154.1**	211.7	(27)

New business APE at constant exchange rates

All amounts in currency in the tables above other than Sterling are translated into Sterling at a monthly average exchange rate. The estimated new business assuming constant currency rates would be as follows:

	FY 2011 £m	FY 2010 £m	Change %
International	**256.7**	237.6	8
Lombard	**233.2**	302.2	(23)

New Business – Present value of new business premiums ("PVNBP")

PVNBP equals new single premiums plus the expected present value of new regular premiums. Premium values are calculated on a consistent basis with the EV contribution to profits from new business. Start of period assumptions are used for the economic basis and end of period assumptions are used for the operating basis. A risk-free rate is used to discount expected premiums in future years. The impact of operating assumption changes across a whole reporting period will normally be reflected in the PVNBP figures for the final quarter of the period that the basis changes relate to. No change in operating assumptions will be reflected in the PVNBP for the first and third quarters, when the contribution to profits from new business is not published. All amounts in currency other than Sterling are translated into Sterling at a monthly average exchange rate.

	FY[(i)] 2011 £m	FY[(ii)] 2010 £m	Change %	**Q4[(iii)] 2011 £m**	Q3 2011 £m	Q2 2011 £m	Q1[(iv)] 2011 £m
UK corporate							
– pensions	**2,384**	1,535	55	**573**	612	622	577
– protection	**132**	32	313	**39**	19	47	27
UK Individual							
– protection	**520**	323	61	**102**	131	145	142
– pensions	**420**	297	41	**52**	80	206	82
– investments	**339**	239	42	**40**	79	86	134
Annuities	**374**	290	29	**94**	91	101	88
Total UK Life and Pensions	**4,169**	2,716	53	**900**	1,012	1,207	1,050
International	**1,603**	1,405	14	**397**	378	432	396
Lombard	**2,372**	3,022	(22)	**996**	407	625	344
Total International Life and Pensions	**3,975**	4,427	(10)	**1,393**	785	1,057	740
Total Life and Pensions	**8,144**	7,143	14	**2,293**	1,797	2,264	1,790

(i) Includes the trading results of the acquired BHA business for the 11 month period from 1 February 2011 and acquired WLUK results for the two month period from 1 November 2011.

(ii) Includes the trading results of the acquired AXA UK Life Business for the four month period from 1 September 2010.

(iii) Includes the trading results of the acquired WLUK business for the two month period from 1 November 2011.

(iv) Includes the trading results of the acquired BHA business for the period 1 February 2011 to 31 March 2011.

New UK management structure

The Company announced, in its interim results, the creation of the UK Heritage business unit at Friends Life. This new business unit will manage the requirements of customers with products that are no longer being actively marketed, alongside those with legacy products that have previously been closed to new business.

A reconciliation from the historic presentation of sales into the new business unit structure is shown below for the year to 31 December 2011.APE (£m):

	New UK management structure				
APE £m Year to 31 December 2011	Protection	Corporate benefits	Retirement income	Heritage	**Total UK**
Corporate					
– pensions	–	423	–	73	**496**
– protection	22	–	–	–	**22**
Individual					
– protection	70	–	3	7	**80**
– pensions	–	17	–	35	**52**
– investments	–	–	–	34	**34**
Annuities	–	–	29	8	**37**
Sales across new UK management structure	92	440	32	157	**721**

Appendix 3: Additional cash analysis

The build up of MCEV from available shareholder cash to free surplus and shareholder resources is shown below.

31 December 2011 £m	Life operating businesses	Other operating businesses(i)	Friends Life holding companies	Resolution holding companies	Total
Available shareholder cash	350	–	402	101	853
Working capital and other resources	471	6	53	(31)	499
External debt	–	–	–	(423)	(423)
Intercompany debt			(200)	200	–
Total free surplus	821	6	255	(153)	929
Required capital and inadmissible items	1,788	114	162	–	2,064
External debt	(1,041)	–	–	–	(1,041)
Total shareholder resources	1,568	120	417	(153)	1,952
Value of in-force business	3,844	–	–	–	3,844
Total MCEV	**5,412**	**120**	**417**	**(153)**	**5,796**

(i) Other operating businesses comprise service companies and distribution companies.

Analysis of movement in shareholder resources

	Life operating businesses		Other operating businesses(i)		FLG holding companies		RSL	Total	
£m	Free surplus	Required capital	Free surplus	RC/IA(ii)	Free surplus	RC/IA(ii)	Free surplus	Free surplus	Required capital
Opening shareholder resources	**977**	**1,291**	**55**	**152**	**(305)**	**142**	**1**	**728**	**1,585**
Asset acquired and consideration paid	(207)	193	–	–	(248)	–	–	(455)	193
Post acquisition shareholder resources	**770**	**1,484**	**55**	**152**	**(553)**	**142**	**1**	**273**	**1,778**
Expected return from in-force business	720	(81)	–	–	–	–	–	720	(81)
Investment in new business	(325)	80	–	–	–	–	–	(325)	80
Underlying shareholder resources generation	**395**	**(1)**	**–**	**–**	**–**	**–**	**–**	**395**	**(1)**
Coupon on external debt	(58)	24	–	–	–	–	–	(58)	24
Experience variances and development costs	(51)	(4)	–	–	–	–	–	(51)	(4)
Operating assumption changes	204	(16)	–	–	–	–	–	204	(16)
Other operating movements	242	(64)	–	(30)	(35)	30	(41)	166	(64)
Operating shareholder resources generation	**732**	**(61)**	**–**	**(30)**	**(35)**	**30**	**(41)**	**656**	**(61)**
Change in capital management policy	172	(172)	–	–	–	–	–	172	(172)
Other non-operating variances	(416)	20	3	(3)	(2)	1	–	(415)	18
Shareholder resources generated in the businesses	**488**	**(213)**	**3**	**(33)**	**(37)**	**31**	**(41)**	**413**	**(215)**
Other capital/net asset adjustments	(437)	(524)	(52)	(5)	845	(11)	161	517	(540)
Shareholder dividend	–	–	–	–	–	–	(274)	(274)	–
Total movement	**51**	**(737)**	**(49)**	**(38)**	**808**	**20**	**(154)**	**656**	**(755)**
Closing shareholder resources	**821**	**747**	**6**	**114**	**255**	**162**	**(153)**	**929**	**1,023**

(i) Other operating businesses represent the Group's distribution businesses and service companies. FPMS, the Friends Provident service company, and the defined benefit pension asset are given no value in IGCA and have been presented here as inadmissible assets, rather than free surplus.

(ii) RC/ IA comprises required capital and inadmissible assets.

The following table summarises the movement in shareholder resources as explained previously and includes the movement in VIF to give the total MCEV movement in the period.

	Life operating businesses			Other FLG businesses[i]			RSL	
£m	Free surplus	Required capital	VIF	Free surplus	RC/ IA	Total	Free surplus	Total MCEV
Opening shareholder resources	**977**	**1,291**	**4,202**	**(250)**	**294**	**44**	**1**	**6,515**
Asset acquired and consideration paid	(207)	193	343	(248)	–	(248)	–	81
Post-acquisition shareholder resources	**770**	**1,484**	**4,545**	**(498)**	**294**	**(204)**	**1**	**6,596**
Expected return from in-force business	720	(81)	(333)	–	–	–	–	306
Investment in new business	(325)	80	364	–	–	–	–	119
Underlying shareholder resources generation	**395**	**(1)**	**31**	**–**	**–**	**–**	**–**	**425**
Coupon on external debt	(58)	24	–	–	–	–	–	(34)
Experience variances	(51)	(4)	7	–	–	–	–	(48)
Operating assumption changes	204	(16)	(86)	–	–	–	–	102
Other operating movements	242	(64)	(180)	(35)	–	(35)	(41)	(78)
Operating shareholder resources generation	**732**	**(61)**	**(228)**	**(35)**	**–**	**(35)**	**(41)**	**367**
Other non-operating variances	(244)	(152)	(265)	1	(2)	(1)	–	(662)
Shareholder resources generated in the businesses	**488**	**(213)**	**(493)**	**(34)**	**(2)**	**(36)**	**(41)**	**(295)**
Other capital/net asset adjustments	(437)	(524)	(208)	793	(16)	777	161	(231)
Shareholder dividend	–	–	–	–	–	–	(274)	(274)
Total movement	51	(737)	(701)	759	(18)	741	(154)	**(800)**
Closing shareholder resources	**821**	**747**	**3,844**	**261**	**276**	**537**	**(153)**	**5,796**

(i) Other FLG businesses represent distribution businesses, service companies and FLG holding companies.

Appendix 4: Analysis of 2010 full year baselines comparators

£m	2010 full year as reported Total	Adjustments: Annualisation of ex-AXA	Adjustments: Inclusion of BHA	2010 full year baseline Total
New business strain:				
UK	(149)	(134)	(20)	(303)
International	(83)	n/a	n/a	(83)
Lombard	(6)	n/a	n/a	(6)
Total new business strain	(238)	(134)	(20)	(392)

The Group has also annualised the 2010 UK and Group new business IRRs, 5.9% and 8.6% respectively, with these reflecting the effect of annualising the acquired AXA UK Life Business and BHA. These compare to 2010 full year reported IRRs of 7.1% for the UK and 11.2% for the Group.

Appendix 5: IFRS based operating profit

The following table provides a year on year comparison of the underlying IFRS based operating profit for the Group, after adjusting the 2010 result for the impact of transactions undertaken during the period and one-off items.

	£m
2010 IFRS based operating profit (as reported)	**275**
Add back:	
- 2010 one-off items	19
Adjust for the annualisation of acquired business:	
- Acquired AXA UK Life Business result (additional eight months)	110
- FLG corporate interest (additional eight months)	(38)
2010 underlying IFRS based operating profit(i)	**366**
Impact of management actions on new business strain	47
Impact on the emergence of surplus as a result of adopting certain aspects of PS06/14 (negative reserving)	(40)
Impact of economic returns	(68)
Increase in development and corporate costs	(15)
Increase in debt costs and other	(13)
2011 underlying IFRS based operating profit	**277**
Operating one-off items recognised during the year	404
2011 actual IFRS based operating profit	**681**

(i) As disclosed in the “UK Life Project – cash and capital update” provided to the market on 7 June 2011.

Appendix 6: Updated AVIF amortisation profile

The table below shows the expected AVIF run off pattern over the next 10 years. This projection includes the impact in 2011 of the implementation of certain elements of PS06/14, resulting in:

- an acceleration of AVIF amortisation of £130 million in the AXA UK Life Business;
- an impairment charge against AVIF of £71 million in BHA; and
- a reduced gradient of the UK profile.

The table includes WLUK from the date of acquisition and the impacts of foreign exchange movements in 2011 on Lombard.

AVIF at end of year (£m)											
Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
UK	3,300	3,228	2,957	2,711	2,481	2,259	2,049	1,856	1,675	1,506	1,355
International	863	764	656	556	464	380	306	241	190	146	110
Lombard	522	445	389	339	296	258	226	201	180	162	146
FLG total	4,685	4,437	4,002	3,606	3,241	2,897	2,581	2,298	2,045	1,814	1,611
Amortisation for the period	364	675	435	396	365	344	316	283	253	231	203

Appendix 7: MCEV expected existing business contribution

The following table provides a comparison of the 2011 expected existing business contribution for the Group to the prior year figure, after adjusting for the annualisation of the comparative results for the impact of transactions undertaken during the period.

	£m
2010 actual EEBC (as reported)	**247**
Adjust for the annualisation of acquired businesses(i)	139
2010 underlying EEBC	**386**
Impact of the change in the opening MCEV	13
Impact of the change in expected rates of return	(27)
Impact of the change in expected rates on debt	(12)
2011 underlying EEBC	**360**

(i) Adjusts the underlying comparative result to reflect the acquisitions of the AXA UK Life Business in September 2010 and the BHA business in January 2011.

Appendix 8: Friends Life group operating ROEV

£m MCEV operating returns and % ROEV	2010 Full year £m	2010 Full year %	2010 Baseline[(i)] £m	2010 Baseline[(i)] %	2011 Full year £m	2011 Full year %
Value of new business	145	3.3%	153	2.0%	151	2.0%
Expected existing business contribution[(ii)]	277	5.6%	416	5.5%	406	5.3%
Development & corporate costs [(iii)]	(21)	(0.4%)	(21)	(0.3%)	(38)	(0.4%)
Operating profit before variances	**401**	**8.5%**	**548**	**7.2%**	**519**	**6.9%**
Operating variances and assumption changes	74	1.4%	-	-	118	1.5%
Impact of financing	(48)	0.7%	(87)	0.1%	(79)	0.5%
MCEV operating profit (excluding RSL costs)	**427**	**10.6%**	**461**	**7.3%**	**558**	**8.9%**
Tax on operating profit	(96)	(2.3%)	(111)	(1.8%)	(150)	(2.4%)
MCEV operating return after tax	**331**	**8.3%**	**350**	**5.5%**	**408**	**6.5%**

(i) Assumes h-AXA contributes 12/4 of the actual YE10 result. Assumes BHA contributes 12/5 of the actual HY11 result. Assumes no impact of operating variances and assumption changes.
(ii) Gross of financing costs.
(iii) Also includes other income and charges gross of financing costs.

Appendix 9: IFRS debt movement analysis

£m	2010 31 Dec	Movements in 2011 Repaid	Drawn	Other	2011 31 Dec	LTIR	Other operating cost	Short Term Fluct'ns	Total interest cost
Lombard undated subordinated debt	3	(1)	-	-	**2**	-	-	-	-
£162m external LT2 debt	186	-	-	(3)	**183**	21	-	(5)	**16**
£500m external LT2 bond	-	-	500	(4)	**496**	29	-	-	**29**
STICS [(i)]	n/a	-	-	-	**n/a**	26	-	5	**31**
FLG internal debt	700	(500)	-	-	**200**	33	-	-	**33**
Operational reinsurance and financing[(ii)]	123	-	-	(32)	**91**	3	17	-	**20**
Total FLG debt (excl STICS)/interest cost	**1,012**	**(501)**	**500**	**(39)**	**972**	**112**	**17**	**-**	**129**
DCN – series A	300	(68)	-	-	**232**	-	16	-	**16**
DCN – series B	200	(9)	-	-	**191**	-	14	-	**14**
Acquisition finance facility	400	(400)	-	-	-	-	10	-	**10**
Total Resolution holding companies debt/interest cost	**900**	**(477)**	**-**	**-**	**423**	**-**	**40**	**-**	**40**
Total external Group debt[(iii)] (excl STICS)/interest cost	**1,212**	**(478)**	**500**	**(39)**	**1,195**	**112**	**57**	**-**	**169**

(i) STICS are classed as equity in IFRS but £26 million of the £31 million coupon has been included in operating profit (based on expected return) offset by £5 million adverse short term investment fluctuations and deduction of £31 million in non-operating items in accordance with IFRS.
(ii) Includes Lombard and Friends Provident reinsurance treaties and overdrafts and £7 million of overdrafts in OEICS. Movement shown for 2011 is the net movement for the year.
(iii) Excludes lower tier 2 debt issued by FLG to RHG.

Appendix 10: MCEV debt movement analysis

£m	2010 31 Dec	Movements in 2011 Repaid	Drawn	Other	2011 31 Dec	EEBC	Other income and changes	Econ'c Variances	Total interest cost
£162m external LT2 debt	201	-	-	(19)	**182**	10	-	9	**19**
£500m external LT2 bond	-	-	500	(50)	**450**	17	-	12	**29**
STICS[(i)]	393	-	-	(66)	**327**	19	-	12	**31**
FLG (internal debt)	700	(500)	-	-	**200**	-	33	-	**33**
Total FLG debt (incl STICS)[(i)]/interest cost	**1,294**	**(500)**	**500**	**(135)**	**1,159**	**46**	**33**	**33**	**112**
DCN – Series A	300	(68)	-	-	**232**	-	16	-	**16**
DCN – Series B	200	(9)	-	-	**191**	-	14	-	**14**
Acquisition finance facility	400	(400)	-	-	**-**	-	10	-	**10**
Total Resolution holding companies debt/interest cost	**900**	**(477)**	**-**	**-**	**423**	**-**	**40**	**-**	**40**
Total external Group debt[(ii)] (incl STICS)/interest cost	**1,494**	**(477)**	**500**	**(135)**	**1,382**	**46**	**40**	**33**	**152**

(i) Debt is shown at clean market value and excludes accrued interest and tax adjustment on market valuation of £82 million at 31 December 2011.
(ii) Excludes lower tier 2 issued by FLG to Resolution holding companies.

Appendix 11: Value share

The Resolution Group, which is the private advisory group of which ROL forms a part, remains aligned with shareholders through its investment in the Company's ordinary shares, its direct investment in Resolution Holdco No. 1 LP ("Holdco") and its entitlement to receive 10 per cent of the value created from the UK Life Project through its Value Share. The Value Share structure was established at the time the Company was formed and, in broad terms, rewards members of The Resolution Group where the accumulated value of the deployed equity capital contributed to the UK Life Project has been returned to the Company or its shareholders, or there has been a change of control of the Group. The structure of the Value Share means that it is expected to be payable only on completion of the UK Life Project.

However, given that the Company has only one restructuring project, a mark-to-market valuation of the Value Share can be determined on any given day by deducting the value of cash held at Resolution level from the market value of Resolution, and then comparing the result to the accumulated value of the net equity deployed in Holdco (i.e., in the UK Life Project) accumulated at the agreed rate (currently 4% per annum).

Total gross equity deployed in the UK Life Project is approximately £4,056 million and the accumulated value of net equity deployed (at 4% per annum and after the return of £475 million of capital returned to Resolution Limited to date) is approximately £3,844 million as shown below.

	Equity deployed (£m)		
Transaction	**RSL**	**TRG**	**Total**
Friends Provident[(i)]	1,915.8	0.2	1,916.0
AXA UK Life Business[(ii)]	2,139.8	0.2	2,140.0
BHA[(iii)]	–	–	–
Total	**4,055.6**	**0.4**	**4,056.0**

Date	**Accumulated value of net Equity Deployed at 4% per annum (£m)**
31 December 2009	1,927
30 June 2010	1,904
31 December 2010	4,042
30 June 2011	3,769
31 December 2011	3,844

(i) See page 102 of Friends Provident Group plc acquisition prospectus for more details of equity deployed.
(ii) See page 89 of AXA UK Life Business acquisition prospectus for more details of equity deployed.
(iii) The acquisition of BHA was funded using existing FLG resources.

Based on the accumulated value of net equity deployed and the value of the Company's net assets as at 31 December 2011, the value share is theoretically "in the money" at a Company share price of 285 pence at that date. Therefore the implied value share at 31 December 2011 (based on a closing share price of 251.4 pence on 30 December) was nil (31 December 2010: nil).

Whether there is an implied value to the Value Share calculated on this basis will vary day-to-day depending, among other things, on the Company's share price. Furthermore, this implied market value does not guarantee that the Value Share will be realised for this amount, which will depend on how and when the Company realises value from the UK Life Project.

Definitions

AmFamily means AmFamily Takaful Berhad

AmLife means AmLife Takaful Berhad

Annual Premium Equivalent ("APE") represents annualised new regular premiums plus 10% of single premiums.

Annualised operating return on embedded value is calculated as the MCEV operating profit after tax over the period divided by the net embedded value at the start of the period. Where the period is not a full year, the calculated rate is then annualised.

Asset quality is the percentage of corporate bonds and asset-backed securities in the shareholder and non-profit funds at investment grade compared to the total of such assets in these funds.

AXA UK Life Business means the traditional and protection businesses, a majority of the corporate benefits business and a minority of the wealth management business carried on by AXA UK which were acquired by the Group in September 2010 and which includes WLUK from November 2011.

Board means the Resolution Limited Board.

Cash payback on new business is the time at which the value of the expected cash flows, after tax, is sufficient to have recouped the capital invested to support the writing of the business. The cash flows are calculated on the same assumptions and expense basis as those used for the contribution from new business.

Company means Resolution Limited.

Contribution from new business is the present value of future cash flows expected to arise from the new business sold during the year. It is calculated using economic assumptions at the beginning of the period, and is quoted after the cost of required capital, share-based payments and including an apportionment of fixed acquisition expenses across products.

Equity Backing Ratio ("EBR") is the proportion of equities and property backing assets shares.

Friends Life or Friends Life group means Friends Life Group plc (and its subsidiaries and subsidiary undertakings from time to time including Friends Provident from November 2009, the AXA UK Life Business from September 2010, BHA from January 2011 and WLUK from November 2011.

Friends Life holdings companies means Friends Life Group plc, Friends Life FPG Limited and Friends Life FPL Limited.

Go to Market business means Friends Life's UK Corporate Benefits, Protection and Retirement Income businesses.

Group means Resolution Limited and its subsidiaries and subsidiary undertakings from time to time. For the avoidance of doubt, neither the Group nor the Company form part of The Resolution Group.

Group embedded value on an MCEV basis is the equity attributable to equity holders of the parent as shown in the consolidated statement of financial position – MCEV basis.

Heritage business means Friends Life's UK business comprising products that are no longer actively marketed to new customers and legacy products that have previously been closed to new business.

IFRS based operating profit/(loss) is the profit (or loss) based on longer-term investment return excluding: (i) all investment return variances from expected investment return which is calculated on a long-term rate of return, (ii) policyholder tax, (iii) returns attributable to minority interests in policyholder funds (iv), significant non-recurring items, (v) amortisation and impairment of acquired intangible assets and present value of acquired in-force business; and is stated after deducting interest payable on STICS.

IFRS profit/(loss) after tax is the profit (or loss) after tax as shown in the consolidated income statement.

IGCA surplus capital resources are the Insurance Groups Capital Adequacy surplus capital as defined by the FSA in the Insurance Groups Directive. It is calculated as the surplus of the available capital resources over the capital resources requirement. It excludes the surplus capital held within the long-term funds.

Internal rate of return on new business is equivalent to the discount rate at which the present value of the after tax cash flows expected to be earned over the lifetime of the business written is equal to the capital invested to support the writing of the business. With the exception of investment return, all assumptions and expenses are consistent with those used for calculating Contribution from new business. IRR assumes best estimate investment returns after an allowance

for default risk, whereas Contribution from new business assumes (market consistent) risk-free rates. IRR also takes into account the funding and release of regulatory capital requirements.

Margins are defined as the pre-tax contribution from new business generated by each product type, divided by the new business volume for that product.

MCEV operating profit/(loss) is the MCEV profit (or loss) based on expected investment return and excludes: (i) amortisation and impairment of non-covered business acquired intangible assets, (ii) effect of economic variances (including the impact of economic assumption changes) and (iii) significant non-recurring items.

MCEV profit/(loss) after tax is the MCEV profit (or loss) after tax as shown in the consolidated income statement – MCEV basis.

Northern Trust means Northern Trust International Fund Administration.

Pillar 1 surplus is the excess of capital resources over capital resource requirements calculated in accordance with regulatory requirements.

Pillar 2 surplus is the excess of capital resources over the capital calculated on an economic basis required to ensure that the regulated entities can meet their liabilities, with a high likelihood, as they fall due. The result is reviewed and may be modified by the FSA. Pillar 2 requirements are not generally disclosed.

Present value of new business premiums ("PVNBP") represents new single premiums plus the expected present value of new business regular premiums.

Resolution Holdings companies means the Company, Resolution Holdco No. 1 LP and Resolution Holdings (Guernsey) Limited.

Shareholder resources are a measure of the tangible assets available to the life and pensions business and attributable to shareholders. The movement in 'shareholder resources' provides a view of the sustainability of the business model. Shareholder resources are based on shareholders' invested net assets included within the embedded value, but adjusted to include securitisation and financial reinsurance balances and to exclude intangible assets.

The Resolution Group means Resolution Operations LLP, Resolution Financial Markets LLP, RCAP Guernsey LP, Resolution Capital Limited and their respective subsidiaries and subsidiary undertakings from time to time. For the avoidance of doubt, neither the Group nor the Company are part of The Resolution Group.

UK Life Project means the Company's current restructuring project in the life assurance and asset management sectors.

Abbreviations

ABI	Association of British Insurers
ABS	Asset-Backed Securities
AMC	Annual Management Charge
AGM	Annual General Meeting
ALM	Asset and Liability Management
APE	Annual Premium Equivalent
ASC	Available Shareholder Cash
AVIF	Acquired Value of In-Force
AXA IM	AXA Investment Management
BHA	Friends Life BHA Limited (formerly known as “Bupa Health Assurance Limited”)
BRCC	FLG Board Risk and Compliance Committee
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGU	Cash Generating Unit
CMI	Continuous Mortality Investigations
CMIR	Continuous Mortality Investigations Report
CNHR	Cost of Non-Hedgeable Risk
COP	Capital Optimisation Project
CRO	Chief Risk Officer
CRR	Capital Resource Requirements
DAC	Deferred Acquisition Costs
DCN	Deferred Consideration Notes
DCT	Distributable Cash Target
DFF	Deferred Front End Fees
DPF	Discretionary Participation Features
EBC	Employee Benefit Consultant
EBR	Equity Backing Ratio
ECJ	European Court of Justice
EEA	European Economic Area
ERC	Executive Risk Committee
EU	European Union
F&C	F&C Asset Management plc
F&C CPT	F&C Commercial Property Trust
FAELLAS	Friends AELLAS Limited (formerly known as AXA Equity & Law Life Assurance Society plc)
FAL	Friends Annuities Limited (formerly known as AXA Annuity Company Limited)
FASLH	Friends ASLH Limited (formerly known as AXA Sun Life Holding Limited)
FLAS	Friends Life Assurance Society Limited (formerly known as Sun Life Assurance Society plc)
FLC	Friends Life Company Limited (formerly known as AXA Sun Life plc)
FLDL	Friends Life Distribution Limited
FLG	Friends Life Group plc (formerly known as Friends Provident Holdings (UK) plc). In respect of MCEV disclosures, FLG denotes Friends Life Group plc and its subsidiary undertakings in the period post-acquisition

FLG AC	FLG Audit Committee
FLI	Friends Life Investments
FLL	Friends Life Limited (formerly known as Friends Provident Life and Pensions Limited)
FLSL	Friends Life Services Limited (formerly known as AXA Sun Life Services plc)
FPG	Friends Life FPG Limited
FPIL	Friends Provident International Limited
FPL	Friends Life FPL Limited
FPLAL	Friends Provident Life Assurance Limited
FPMS	Friends Provident Management Services Limited
FLPL	Friends Life and Pensions Limited
FPPS	Friends Provident Pension Scheme
FRS	Financial Reporting Standards
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
FSLPM	Friends SLPM Limited (formerly known as Sun Life Pensions Management Limited)
FSLUA	Friends SLUA Limited (formerly known as Sun Life Unit Assurance Limited)
FUM	Funds Under Management
GMP	Guaranteed Minimum Pension
GOF	Guaranteed Over Fifties
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICA	Individual Capital Assessment
ICG	Individual Capital Guidance
IFA	Independent Financial Adviser
IFRIC	IFRS Interpretation Committee
IFRS	International Financial Reporting Standards
IGCA	Insurance Groups Capital Adequacy
IRR	Internal Rate of Return
LDI	Liability Driven Investment
LTIP	FLG Long-Term Incentive Plan
LT2	Lower Tier 2
MCEV	Market Consistent Embedded Value
MEEM	Multi-purpose Excess Earnings Method
MVR	Market Value Reduction
NBS	New Business Strain
NGP	New Generation Pension
NPF	Non-Profit Fund
NWPF	New With-Profits Fund
OCI	Other Comprehensive Income
OEIC	Open Ended Investment Company
OLAB	Overseas Life Assurance Business
OMO	Open Market Option
OWPF	Old With-Profits Fund
PPFM	Principles and Practices of Financial Management

PVFP	Present Value of Future Profits
PVNBP	Present Value of New Business Premiums
RAG	FLG Remuneration Advisory Group
RCM	Risk Capital Margin
RDR	Retail Distribution Review
RHG	Resolution Holdings (Guernsey) Limited
RICS	Royal Institution of Chartered Surveyors
RIE	Re-attributed Inherited Estate
RM	Malaysian Ringgits
ROEV	Return on Embedded Value
ROL	Resolution Operations LLP
RPI	Retail Prices Index
RSL	Resolution Limited. In respect of MCEV disclosures, RSL denotes Resolution Limited and its subsidiary undertakings
SBG	Sesame Bankhall Group
SID	Senior Independent Director
SSF	Segregated Sub Fund
STICS	Step-up Tier one Insurance Capital Securities
TIP	Trustee Investment Plan
TVOG	Time Value of financial Options and Guarantees
VIF	Value of In-Force
VNB	Value of New Business
WLUK	Winterthur Life UK Limited
WPF	With-Profit Fund
WPICC	With Profits Insurance Capital Component