15 August 2012

Resolution Limited (the "Company")

Results for the half year ended 30 June 2012

Integration and business optimisation at Friends Life delivering results

- Operational delivery on track to meet key performance targets:
    - UK VNB of £67 million, exceeded whole of 2011, driven by operating synergies, migration to higher margin platforms and outsourcing arrangements
    - Annualised synergies of £65 million achieved in the first half of 2012; on track to hit the published target
    - Improved group new business IRR of 10% as UK business migrates to higher margin target platforms
    - Material outsourcing contract and launch of in-house asset manager successfully delivered in Heritage business
    - Friends Provident International (FPI) and Lombard impacted by challenging economic environment; FPI strategic review to rebalance value, volume and risk
- IFRS based operating profit before tax of £163 million (including £27 million of one-off items) (30 June 2011: £390 million, including £216 million of one-off items) reflecting lower expected investment returns on the in-force book, a disappointing performance in the international businesses partly offset by reduction in costs of new business
- MCEV operating profit before tax of £235 million (30 June 2011: £180 million) reflecting growth in profitable new business, partly offset by reduction in expected existing business contribution

Confidence in underlying operations and improving cash generation allows increase in interim dividend

- Robust capital position:
    - Estimated FLG IGCA surplus of £1.9 billion, representing a coverage ratio of 204% (before interim dividend)
    - Significant progress to improve economic capital position with an estimated FLG economic capital surplus of £3.0 billion, representing a coverage ratio of 174% (before interim dividend)
- Focus on returning excess capital to shareholders continues; excess capital is defined as capital in excess of both working capital requirements and after ensuring that capital buffers are maintained in specific stress scenarios; £400 million prudence buffer held
- Although the capital position remains robust, the decision not to return £250 million to shareholders in July 2012 was based on the expected future capital requirements of the Group against a backdrop of heightened investment, economic and regulatory uncertainty
- Balance sheet has minimal exposure to higher risk sovereign debt and retains a highly rated corporate bond portfolio
- Underlying cash flow generation has improved despite challenging economic environment:
    - Sustainable free surplus generation in the first half of £120 million, reflecting good progress in reducing UK new business strain, offset by lower investment returns and targeted investment costs
    - Available shareholder cash of £619 million has also been impacted by lower returns but maintains a £400 million prudence buffer and underpins longer term confidence in the dividend
- Interim dividend raised by 5% to 7.05 pence per share, supported by underlying cash generation from operational improvements and a robust balance sheet
- The Company envisages moving to a progressive dividend and will consider doing so when sustainable cash generation meets its £400 million per annum distributable cash target

Simplifying the governance structure and focus on delivering shareholder value

- The Company and Resolution Operations LLP ("ROL") continue to focus on the ways in which value can best be delivered to shareholders. The Board and ROL believe that whilst the current structure of the Group was appropriate to launch the Company, shareholder value can now best be delivered by moving from an externally advised project based structure to a more conventional, simplified governance structure
- Further details of the changes to the Company's governance arrangements and relationship with ROL are under discussion and implementation of the agreed changes is expected to be completed in the next six months. In the meantime, the market will be updated on these changes as they are completed
- The Company, having received advice from ROL, now confirms that:
    - The Company will no longer seek acquisitions
    - The Company will continue to focus on securing maximum value from each part of the Group
    - The focus on cash emergence and financial discipline will continue
    - The Company will no longer seek a specific exit event and consequently the previously announced self-managed exit plan of separate IPOs of the UK Go to Market and Heritage business units is no longer envisaged
- Specifically:
    - The boards of the Company and Friends Life Group plc will be streamlined and conventional governance adopted to include individuals, to maintain continuity, from both current boards
    - The Company and ROL have agreed that the Operating Agreement under which ROL has provided mergers and acquisitions, strategic and oversight services and skills to the Company will end at the latest on 10 December 2013, which is the earliest date on which the Operating Agreement could be ended in accordance with its original and current terms
    - The Company and ROL expect to agree changes to the Operating Agreement and the various other commercial agreements between their respective groups which would mean that ROL would cease to provide services to the Company on or before that date. It is envisaged that many of the skills from ROL will be in-sourced to the Company, with Jim Newman and appropriate ROL personnel transferring to the Company
- Subject to legal and regulatory processes (including a shareholder vote to change the Company's constitution), it is expected that:
    - Mike Biggs will remain as chairman of the Company
    - Sir Malcolm Williamson will become the deputy chairman of the Company
    - Clive Cowdery will join the Board
    - Andy Briggs will become CEO and Tim Tookey will become CFO of the Company
- Once the changes to the Company's governance arrangements have been finalised, John Tiner has indicated his intention to retire as a partner with ROL and step down from the board of Friends Life Group plc; John Tiner intends to build on his non-executive roles
- The Company and ROL are committed to maintaining the Company's premium listing and as a result of the changes announced today, there appear to be no reasons why the outcome of CP12/2 would have any material impact on the Company
- The Company will retain the value focus and philosophy under which it was originally formed by The Resolution Group managing its assets to secure maximum value for shareholders
- To date the Company has approved and remains committed (on the terms of the Operating Agreement) to funding £5.0 million (£1.1 million of which has already been spent) for ROL's research and development activities, subject to such expenditure complying with the Operating Agreement. This funding is for two on-going financial services projects outside the scope of the UK Life Project which relate to:
    - The acquisition and consolidation of closed life insurance businesses in Western Europe, ex-UK; and
    - The acquisition of captive asset managers

ROL has confirmed to the Company that it will not make any further requests for funding out of the balance of £15 million of the £20 million funding available under the current Operating Agreement

Mike Biggs, Chairman of Resolution Limited, said:

“Despite the ongoing market and regulatory uncertainty, the underlying business continues to make good operational progress in line with the clear strategy and value agenda of the Company. With the acquisition phase ended and to avoid the expectation of a specific exit event and time, the Board and ROL believe that now is the right time to agree to end the Operating Agreement between them and move to a more conventional governance and operating structure for the Company.

The Company will continue to deliver against the value philosophy and financial discipline under which it was founded by The Resolution Group which will remain as a supportive shareholder.”

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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). Dial in telephone number: UK National call 0871 700 0345, UK Standard International +44 (0) 1452 555 566 Passcode: 16370052.

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, confirmation number: 8243343. A webcast 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

Third quarter interim management statement	15 November 2012
Full year 2012 results	26 March 2013

2012 interim dividend

Ex-dividend date	5 September 2012
Dealing days for calculating the price of the new shares to be offered pursuant to scrip dividend scheme for the final dividend	5 September 2012 to 11 September 2012
Record date	7 September 2012
Final time and date for receipt of the mandate forms and dividend election input messages	5.00pm, 21 September 2012
Payment of interim dividend and first day of dealing in the new shares	5 October 2012

Website www.resolution.gg

Contents of the interim results statement

Chairman's statement

Overview

In the first half of 2012, the Company remained focused on delivering value from the acquired businesses and can report good progress in the operational performance of Friends Life against a backdrop of economic, investment and regulatory uncertainty.

The results in the first half of 2012 demonstrate good progress made in reducing new business acquisition costs and a material improvement in the value of new business. The UK Go to Market business, which comprises the Protection, Corporate Benefits and Retirement Income businesses, has made good progress towards the financial targets set as business has migrated to targeted platforms driving margins, further cost savings and profitable increases in volume. The Heritage business, which contains the existing book of business, has made progress against its initiatives including the outsourcing arrangements and further work on capital optimisation. The international businesses still face some challenges and FPI is undergoing a strategic review that will look to rebalance the business with a focus on value, volume and risk. The key headwind in the first half of 2012 was lower than expected investment returns which have offset some of the good operational progress made in the businesses.

Core projects were successfully delivered in the first half of 2012. The significant outsourcing agreement with Diligenta was to make costs more variable in order to secure the delivery of cash returns from the existing book of business, and the successful launch of Friends Life Investments ("FLI"), an in-house asset manager that will help save on fees paid to external managers and add value through more optimal asset allocation.

The net Market Consistent Embedded Value ("MCEV") of the Group as at 30 June 2012 was £5,939 million.

The operating report and business review that follow this statement contain a more comprehensive account of the first half of 2012.

Cash and capital

Dividend

The Company's dividend policy remains unchanged and 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, the Board has proposed an interim dividend of 7.05 pence per share, up 5%. The full year dividend guidance is similarly for an increase of 5% which would equate to 14.09 pence per share, subject to shareholder approval. The increase in dividend reflects the Board's confidence in the operational cash generation and robust capital position of the Group.

The Company envisages moving to a progressive dividend and will consider doing so when sustainable cash generation meets its £400 million per annum distributable cash target.

Returns of capital

On 20 July 2012, the Company cancelled the targeted £250 million capital return expected by shareholders.

Although the capital position remains robust, the decision to cancel the targeted £250 million capital return to shareholders was based on the estimated capital position of the Group as at the end of June 2012 after careful consideration of the expected future capital requirements and applying stresses to both Pillar I and economic capital against a backdrop of heightened investment, economic and regulatory uncertainty.

Today, the Company has provided a detailed update on its cash and capital position and associated sensitivities as at 30 June 2012. A summary of the key points is below.

The Company maintains a robust capital position:

- the estimated FLG IGCA surplus of £1.9 billion represents a coverage ratio of 204%, before the interim dividend;
- significant progress was made in the first half of 2012 to improve the economic capital position with an estimated economic surplus at FLG of £3.0 billion, representing a coverage ratio of 174%, before the interim dividend; and
- the Group's balance sheet has minimal exposure to higher risk sovereign debt and retains a highly rated corporate bond portfolio.

The Company’s focus on returning excess capital to shareholders continues. Excess capital is capital in excess of both working capital requirements and after ensuring that capital buffers are maintained in specific stress scenarios. Future returns of excess capital remain subject to market conditions and regulatory approval, and will also consider the more challenging regulatory environment, especially with respect to Solvency II.

Future value creation

The Company will continue to deliver against the clear value philosophy and strategy which drove the creation of the Company. These include:

- rationalising new business to products and channels where the enlarged Group benefits from competitive advantages, can meet its financial targets and deliver sustainable and acceptable returns and cash flow for investors;
- driving out cost reductions from reducing overlap, rationalising and streamlining operations and outsourcing key functions and activities as appropriate;
- optimising the balance sheet and reducing operational risks in the Company; and
- identifying and delivering capital synergies and returning excess capital to shareholders.

The Company expects that the separation of the UK Go to Market businesses from the UK Heritage back book of business will continue because the Company believes this will drive greater financial discipline and focus on cost reduction and cash generation.

The Board believes that the Company is now well placed to deliver the financial targets and operational objectives, under the team at Friends Life, and augmented by the addition of proposed resources from ROL. The Company’s operating agenda is clear:

- deliver the target synergies;
- deliver the capital optimisation programme;
- deliver ongoing operational improvements in the UK business; and
- deliver the operational turnaround of the international businesses.

Simplifying the governance structure and delivering shareholder value

Background

The Company and ROL continue to focus on the ways in which value can best be delivered to shareholders and with this in mind have been jointly undertaking a fundamental review of the UK life consolidation project. To date, the Company's UK life consolidation project has been focused on creating value for shareholders from the consolidation of larger UK life groups. The UK Life Project has resulted in a financially disciplined, sustainable and value focused business which is making good operational progress and is on track to meet its financial targets. We believe that the project based structure we adopted was appropriate to launch the Company, but shareholder value can now best be delivered by moving from this externally advised project based structure to a more conventional, simplified governance structure.

As part of these changes I can confirm:

- The Company will no longer seek acquisitions;
- The Company will continue to focus on securing maximum value from each part of the Group;
- The focus on cash emergence and financial discipline will continue; and
- The Company will no longer seek a specific exit event and consequently the previously announced self-managed exit plan of separate IPOs of the UK Go to Market and Heritage business units is no longer envisaged.

The Company will retain the value focus and philosophy under which it was originally formed, managing its assets to maximise value for shareholders.

Proposals

The key elements of the change to the governance structure we have announced today are that:

- subject to necessary regulatory approvals, the boards of the Company and Friends Life Group plc will be streamlined and conventional governance structures adopted;
- the Company envisages that the same directors will sit on the boards of the Company and of Friends Life Group plc, including individuals, to maintain continuity, from both current boards;
- the Company and ROL have agreed that the Operating Agreement under which ROL has provided mergers and acquisitions, strategic and oversight services to the Company will end on 10 December 2013 at the latest;
- many of the skills from ROL will be in-sourced to the Company, and Jim Newman and appropriate ROL personnel will transfer to the Company.

Subject to legal and regulatory processes, including a shareholder vote to change the Company's constitution, it is expected that I will be Chairman of the Company and Sir Malcolm Williamson will become Deputy Chairman. Clive Cowdery will join the Board. Andy Briggs will be Chief Executive Officer and Tim Tookey will be Chief Financial Officer of the Company.

Given the proposed changes to the arrangements between RSL and ROL, it is anticipated that Ian Maidens will shortly cease to be an ROL partner and will move to working with ROL and RSL on a consultancy basis. John Tiner has indicated his intention to retire as a partner with ROL and step down from the board of Friends Life Group plc. John intends to build on his non-executive roles.

Implementation

Further details of the changes to the Company's governance arrangements and relationship with ROL are under discussion and implementation of the agreed changes is expected to be completed in the next six months. We will update the market as these changes are completed.

The Company and ROL are committed to maintaining the Company's premium listing and as a result of the changes announced today, there appear to be no reasons why the outcome of the FSA's consultation paper CP12/2 would have any material impact on the Company.

Outlook

The economic, investment and regulatory backdrop remain uncertain. Against this, the Company is making good operating progress but this is being offset by lower than expected investment market returns. At Friends Life, the achievement of the 10%+ ROEV and the distributable cash target of £400 million from sustainable cash flow sources, both of which are reliant on investment income, remain targets but over the medium term, should current economic conditions and investment market volatility persist.

The Company expects that going forward, as it moves to having a more conventional and simplified governance structure with the clear value philosophy under which it was originally formed, it will be valued as a financially disciplined and cash generative group with a balance sheet that does not contain undue risks for its investors. The concept of mid-teens returns over the course of the project will no longer be appropriate.

The Board would like to thank all staff in Friends Life and ROL for their continued hard work.

Operating report by Resolution Operations LLP

Introduction

ROL is pleased to report that in the first half of 2012 good progress has been made towards achieving the financial targets of Friends Life. This progress is against a continued backdrop of investment market volatility and what the Company believes is a tougher and less certain regulatory environment. This operating report will provide an update on:

- the strategic aims of the Company;
- the UK Life Project, including the key achievements in the first half of 2012, the economic and regulatory environment impacting the performance of the business, the key reporting metrics and drivers of the results in the period, the cash and capital position of the group, the M&A and exit options for shareholders; and
- the outlook.

Strategy

As stated previously, the Company's strategic aim for its UK Life Project is the creation of a sustainable business or businesses which meet customers' needs while also delivering cash returns to shareholders. ROL continues to believe that maximisation of shareholder value can best be achieved through the ongoing development of both the new and in-force activities of Friends Life. These activities should be pursued without disadvantaging any element of the Group's capital structure whilst continuing to ensure that the interests of policyholders remain protected.

Friends Life is focused on the disciplined management of the back book of business to deliver cash from existing policies, and writing profitable new UK business in the product areas of Corporate Benefits, Protection and Retirement Income. In writing new business in these areas, Friends Life is prioritising value over volume by controlling costs, leveraging its efficient target platforms and distribution arrangements, employing pricing discipline and utilising its scale to deliver returns on capital. Outside the UK, Friends Life has a similarly focused and disciplined approach to managing existing and new business sales through its International and Lombard businesses.

UK Life Project

The Company continues to make good progress in the pursuit of its strategic objectives in the first half of 2012. Friends Life has improved the underlying performance of the operating businesses, particularly in the UK, where management actions have driven strong growth in new business profits with reduced cash strain. This improved operating performance has however been impacted by the challenging economic environment resulting in weaker investment markets and lower interest rates compared to the previous period and the Company's expectations. These have adversely affected overall returns.

On 20 July 2012 the Company announced the cancellation of the targeted £250 million capital return originally expected to be returned to shareholders in the first half of 2012. It was determined that against the current backdrop of heightened investment, economic and regulatory uncertainty and after careful consideration of the expected future capital requirements of Friends Life Group that it would be inappropriate to complete the capital return. The Group's capital position remains robust with Friends Life Group having an estimated IGCA surplus at 30 June 2012 of £1.9 billion.

Notwithstanding the more challenging environment a number of core projects were delivered in the first half of the year, including the previously announced Diligenta outsourcing transaction, which commenced successfully at the beginning of March 2012. The separation and integration activity is also making good progress with separation from Bupa completed at the end of January 2012. The separation from AXA remains on track with three quarters of transitional service arrangements now exited. Synergy delivery as part of the integration process has achieved £65 million of run-rate cost savings, up from the £45 million at the end of 2011. As expected, the bulk of the additional synergies recognised in the first half of 2012 reflect the realisation of contractualised savings through the Diligenta outsourcing transaction, with the closure of a number of the Friends Life offices also contributing to the improved run-rate. Total run-rate and contractualised synergies amount to £112 million at 30 June 2012, up from the £105 million reported in the 2011 full year results.

On 2 July 2012 Friends Life launched an in-house asset management business, Friends Life Investments ("FLI") with £6 billion of fixed interest assets. This business has been built around the current in-house investment team augmented with key hires bringing to the Group the capability and expertise needed to manage these asset portfolios. FLI will continue to accumulate fixed interest assets over time and is expected to add value to the Group through savings on external management fees, VAT and improved investment portfolio construction over time.

Economic and regulatory environment

The economic environment over the last twelve months has remained uncertain with lower than expected global growth exacerbated by the debt crisis and political uncertainty in Europe. In the UK, the uncertainty in Europe has had an adverse impact on customer confidence and growth, taking the UK back into recession.

In the first half of 2012, lower than expected market levels reduced returns from the in-force funds in the form of lower annual management charges compared to prior periods. In the debt markets, short and medium term Gilt yields, a key driver of future expected returns, remained at or around 2011 year end levels driven in part by the UK's position as a relative safe haven. Corporate bond spreads have remained elevated over the same period.

Friends Life's business units have all been impacted by reduced consumer confidence with customers in the international businesses postponing decisions regarding investing or saving for the future. This has been compounded in some regions, notably Asia, by increased competition levels which have led to overall margin pressures. Friends Life's UK product markets remain relatively stable with the principal challenges resulting from the changing regulatory agenda.

The UK business's preparations are on track for the forthcoming regulatory changes towards the end of 2012 including the inception of the Retail Distribution Review ("RDR"), auto-enrolment and gender neutral pricing. The Group continues to believe that it is well-positioned to benefit from the opportunities expected to be generated by these regulatory changes.

The corporate benefits market is large and continues to be a fast-growing but lower margin, market. Competition on price remains intense with the current market continuing to have a bias to paying commissions in a pre-RDR environment. Nevertheless opportunities in this market are promising driven by the ongoing shift from defined-benefit to defined-contribution schemes, whilst the advent of auto-enrolment and the RDR are likely to widen the market and level the competitive playing field.

The UK protection market is mature, concentrated and has remained relatively stable over the past few years despite the weak macroeconomic climate. In the period following the introduction of the RDR, the Group expects to benefit from any shift in the business models of distributors to focus more on protection products. Further changes regarding gender neutral pricing and life tax reforms will have an effect on the price of individual protection and are expected to increase market pricing volatility in the early part of 2013. Friends Life's protection business is well positioned to succeed in this scenario as it operates a value-based proposition, focused on product quality.

The environment in the retirement income market also remains positive with continued growth expected to be driven by population demographics as 'baby boomers' retire. Further to this the competitive market reflects the expectations for future capital demands, in light of Solvency II, as well as persisting low Gilt rates. Despite these factors the Group does not expect the current cautious pricing levels and associated margins to be maintained in the second half of 2012 in which lower margins are assumed. On the regulatory front the business is meeting the drive for increased transparency in the retirement income sector by implementing the ABI Code of Conduct, which is due in March 2013. This aims to improve the customer's understanding of their options at retirement, and highlights the importance of the strategy to develop a broader product range in the retirement income space.

The implications of Solvency II remain a key focus with the Group monitoring the regulations and likely impacts as they develop. As stated in March, the uncertainty around a number of the key issues, including the treatment of matching adjustments, could have a material impact on future capital requirements. Over the coming period the Group will continue to monitor legislative developments in Europe and input to the UK's implementation plans.

Business performance

Friends Life's results in the first half of 2012 reflect two key elements: improved financial discipline and the effects of the macroeconomic environment. Friends Life has continued to make good progress in delivering against those elements of the published strategy within management's control; however, economic uncertainties have impacted the results with lower investment market levels and expected returns reducing surplus generation.

The Group delivered a robust IFRS operating performance in the first half of 2012, with an operating profit of £163 million in the period principally reflecting good progress towards reducing acquisition expense levels offset by the macro economic factors impacting surplus generation. On an MCEV basis, operating profits of £235 million reflect the strong performance in the UK where the value of new business ("VNB") of £67 million already exceeds that generated in the whole of 2011 (year ended 31 December 2011: £59 million). Despite this improvement the contribution from existing business continues to be constrained with lower opening value of in-force, following market falls in the second half of 2011, combining with persistent low rates of return.

Cash generation remains a key focus of the Group although this has also been impacted by the low level of returns in the first half of 2012. Sustainable free surplus of £120 million generated in the first half reflects Friends Life's ongoing drive to reduce new business cash strain. UK new business cash strain of £60 million in the first half of 2012 has been reduced by an annualised £183 million from the £303 million baseline in 2010, representing 92% of the £200 million targeted new business cash strain reduction. The activity to migrate the Go to Market businesses to their respective target platforms has supported this improvement alongside the continued focus on operating costs and the delivery of targeted synergies.

	2013 Target	**2012 Half year**	2011 Half year	2011 Full year	2010 Full year baseline[(i)]
VNB (£m)					
- UK		**67**	28	59	
- International		**18**	20	40	
- Lombard		**12**	18	52	
IRR% - Blended group new business [(ii)(iii)]	15+	**10.0**	9.6	10.0	8.6
New business cash strain (£m)	192	**120**	161	278	392

(i) 2010 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.

The International results are relatively disappointing although they demonstrate a resilient performance, with stable funds under management, against a challenging economic and competitive background. Pricing discipline and shift in new business mix to higher margin products have largely maintained the value of new business in a period when market and competitive pressures have reduced the overall level of new business volumes.

Lombard's first half performance is also subdued with lower economic returns and one-off costs impacting the result. Lombard's sales are up 4% on a constant currency basis (2% down in sterling) in a highly uncertain market environment although the mix of business has resulted in reduced new business contribution levels in the period.

The Business Review that follows this report will cover the operating performance in detail.

Path to achieving targets

The Company set out targets for the Friends Life businesses in February 2011, focused on a combination of business unit operating performance and overall group returns. In the UK:

- Corporate Benefits business – Friends Life has targeted reducing cash new business strain to £75 million per annum, increasing VNB to £25 million per annum and delivering a new business IRR in double figures by 2013. In the period to 30 June 2012, sales were £291 million on an annual premium equivalent ("APE") basis across the Corporate Benefits proposition, with 79% of this written on the target new generation pension platform ("NGP") and the recently launched Corporate platform ("My Money"). Progress towards delivering the targeted cash strain reduction has been good with new business strain of £32 million lower than that in the first half of 2011 whilst at the same time doubling VNB levels (£10 million). IRR of 6.8% also shows an upward trend from 6.6% in the first half 2011 although the result reflects the current small scale of the new corporate platform and inclusion of WLUK at the end of 2011. We expect the favourable IRR trajectory to continue and for 2013 market commitments to be hit through continued cost savings and pricing discipline and the benefits of the volumes of auto-enrolment business;
- Protection business – Friends Life has targeted reducing new business cash strain to £30 million per annum, increasing VNB to £80 million per annum and achieving a new business IRR of 20% per annum by 2013. In the first half of 2012, sales were £44 million APE, with 81% of this business now written on the targeted Individual and Group protection platforms. In the first half of 2012, VNB was £28 million and new business strain reduced to £23 million. The value generated from this new business and corresponding IRR, at 9.8%, reflects a significant improvement in the performance of this proposition and highlights progress towards the financial targets. The ongoing priority for the business includes the migration of strategic partners such as Countrywide to the target platforms, which are expected to further enhance returns giving increased confidence in achieving the required targets;
- Retirement Income business – Friends Life has targeted increasing retention rates on vesting pension funds to 50% and increasing VNB to £50 million per annum by 2013. The business continues to focus on developing the required capability with early steps towards the delivery of an enhanced annuity proposition taken in the first half of 2012. Consequently there has been limited change in the proportion of internal vesting rates with these not expected to reflect the benefit of revised product offerings until 2013. Notwithstanding this, the Retirement Income business delivered gross VNB of £25 million in the first half of 2012 providing confidence that the £50 million per annum VNB target can be delivered by the end of 2013.

The International and Lombard businesses are targeted to achieve new business IRR of 20% by the end of 2013. In addition, the International business is targeted to deliver £20 million of dividends to the group by end 2013 with Lombard expected to deliver £30 million by the end of 2014. An update on the strategic review of the international businesses and targets will be provided before the end of 2012.

As noted above, Friends Life has made substantial progress towards the targeted £200 million reduction in new business strain. This reflects the successful efforts to reduce expense levels in the UK businesses with a significant element of the £65 million run-rate synergies (targeted £143 million by 2015) contributing to a reduction in UK acquisition costs. The strain reduction also reflects the cessation of certain new business sales, and the migration of new business to the target platforms in addition to the action in 2011 to recognise negative reserves on all Protection business lines.

The challenging economic conditions and investment market volatility over the last year or so have created a difficult environment for financial services companies in general. These conditions also impact Friends Life's customers and clients and their behaviour with respect to buying products or investing savings. As a result the Company has reassessed its underlying assumptions with respect to interest rates and asset returns. As reported in March 2012, achieving the ROEV target (10%+ by 2013) requires the outperformance of the business in many areas to offset the impact of economic conditions which continue to be adverse to those incorporated within the previously stated target returns. This situation is unchanged and thus should current economic conditions and investment market volatility persist, including the market view of future interest rates, then attaining both the distributable cash target from sustainable activities, and the ROEV target, both of which are reliant on investment income, will be over the medium term.

Cash and capital

Friends Life has maintained a robust balance sheet in the first half of 2012 despite continuing difficult economic conditions. At 30 June 2012, Friends Life had an estimated IGCA surplus of £1.9 billion (31 December 2011: £2.1 billion) reflecting the payment of the £250 million dividend to Resolution Holdings (Guernsey) Limited in March 2012. The June 2012 position represents a coverage ratio of 204%, before the payment of the interim dividend, over the Group capital resource requirement (excluding WPICC). In addition the Group also retains a highly rated corporate bond portfolio and has limited exposure to higher risk European sovereign debts. Friends Life has made good progress with improving its economic capital position and has an estimated economic capital surplus of £3.0 billion as at 30 June, representing a coverage ratio of 174%, before the payment of the interim dividend.

The business review that follows this report covers the cash and capital position of the Group in detail.

M&A and exit

In today's announcement, the Company has announced that shareholder value can best be delivered by moving to a more conventional, simplified governance structure. As part of the proposed changes, the Company has also confirmed that it will no longer seek acquisitions and will focus instead on securing maximum value from each part of the Group. The Company also confirmed that it will no longer seek a specific exit event.

Outlook

The Company is making good operating progress in an uncertain economic, investment and regulatory environment. The key challenge facing the group is lower than expected returns as a result of the weaker economic environment. The Company believes that it has a sustainable, cash generative and financially disciplined business that should navigate the economic and regulatory challenges to deliver shareholder value.

Business review
Key performance indicators

The Group uses the following key performance indicators.

£m (unless otherwise stated)	**Half year 2012**	Half year 2011	Full year 2011
IFRS based operating profit before tax	**163**	390	681
IFRS (loss)/profit after tax	**(58)**	45	(31)
MCEV[(i)] operating profit before tax	**235**	180	517
MCEV profit/(loss) after tax	**296**	54	(295)
Group embedded value on an MCEV basis	**5,939**	6,482	5,796
FLG operating ROEV[(ii)]	**6.4%**	4.5%	6.5%
Group available shareholder cash	**619**	793	853
Estimated IGCA surplus capital (£bn)	**1.9**	2.0	2.1
Asset quality[(iii)] for shareholder related assets	**97%**	96%	97%

- IFRS based operating profit before tax of £163 million is £227 million lower than the first half of 2011 principally reflecting the one-off benefits of £216 million reported in 2011. On a comparable basis, after the removal of one-off items in 2012, positive £27 million, the result reflects a fall of £38 million as good progress in reducing UK new business strain is offset by difficult economic conditions and one-off costs. The current economic environment in which interest rates remain low has adversely impacted surplus generation, particularly in International, while lower funds under management have impacted levels of fee generation in the UK business. The results also reflect a number of one-off costs including costs incurred as the business invests in operational capability for the future.
- IFRS loss after tax of £(58) million (30 June 2011: £45 million profit) principally reflects the costs of separation and integration activities, delivering the Diligenta outsourcing and preparing for Solvency II. Other non-operating items include a marginally reduced amortisation charge compared to the original run-off on acquired intangibles reflecting revised expectations for International acquired VIF ("AVIF") run-off, while the comparative period includes the gain on the acquired BHA business offset by one-off amortisation and impairment of AVIF.
- MCEV operating profit before tax of £235 million (30 June 2011: £180 million) reflects the significant progress made, led by the UK business, in improving the value of new business. The good progress made on new business returns has however been partially offset by sustained low expected returns combined with the impact of the lower opening value of in-force on expected return, reflecting the adverse economic conditions in 2011.
- MCEV profit after tax of £296 million (30 June 2011: £54 million) reflects the good operating performance as well as favourable economic variances principally driven by a narrowing of corporate bond spreads. These are partially offset by non-recurring costs incurred, in line with IFRS.
- Group embedded value on an MCEV basis of £5,939 million is up £143 million in the six month period (31 December 2011: £5,796 million). The improvement reflects the good operating performance offset by dividend payments.
- FLG operating ROEV[(ii)] of 6.4% (30 June 2011: 4.5%) reflects the operating MCEV result with the improved returns arising from UK new business offset by continued low returns on the existing book of business.
- Group available shareholder cash of £619 million decreased by £234 million from 31 December 2011 (£853 million) impacted primarily by Resolution Limited dividends and debt payments.
- Estimated FLG IGCA surplus capital of £1.9 billion (31 December 2011: £2.1 billion) represents a coverage ratio of 204% (31 December 2011: 219%). The reduction principally reflects the payment of a £250 million dividend to Resolution Holdings (Guernsey) Limited in March 2012 which underpinned the payment of the 2011 final dividend to shareholders.
- The Group has maintained high asset quality, with 97% of shareholder-related corporate debt and asset-backed securities at investment grade or above (31 December 2011: 97%). The Group has no significant shareholder exposure to sovereign debt or corporate bonds of higher risk European economies. No defaults were recorded in the period and the shareholder share of default provisions remained unchanged at £0.6 billion.

(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.
(ii) 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.
(iii) Corporate debt and asset-back securities at investment grade or above.

IFRS results

Group 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.

£m	UK	Int'l	Lombard	Corporate	**RSL Half year 2012**	RSL[i] Half year 2011	RSL[ii] Full year 2011
New business strain	**(41)**	**(24)**	**(18)**	**–**	**(83)**	(103)	(181)
In-force surplus	**196**	**51**	**28**	**–**	**275**	323	572
Long-term investment return	**(26)**	**–**	**–**	**9**	**(17)**	(14)	(26)
Principal reserving changes and one-off items	**27**	**–**	**–**	**–**	**27**	216	404
Development costs	**(18)**	**(4)**	**–**	**–**	**(22)**	(14)	(36)
FLG other income and charges	**(1)**	**(2)**	**–**	**1**	**(2)**	(2)	(11)
RSL other income and charges	**–**	**–**	**–**	**(15)**	**(15)**	(16)	(41)
IFRS based operating profit before tax	**137**	**21**	**10**	**(5)**	**163**	390	681
Short-term fluctuations in investment return					**18**	(2)	(261)
Non-recurring items					**(118)**	(79)	(293)
STICS interest adjustment to reflect IFRS accounting for STICS as equity					**16**	16	31
IFRS profit before acquisition accounting adjustments and shareholder tax					**79**	325	158
Gain on acquisition of businesses					**–**	68	116
Costs associated with business acquisitions					**–**	(1)	(3)
Amortisation and impairment of acquired in-force business					**(204)**	(453)	(675)
Amortisation of other intangible assets					**(42)**	(41)	(84)
IFRS loss before shareholder tax					**(167)**	(102)	(488)
Shareholder tax					**109**	147	457
IFRS (loss)/ profit after tax					**(58)**	45	(31)

(i) Half year 2011 results comprise six month results for Friends Provident and the AXA UK Life Business, five months for BHA, six months for GOF and TIP. The GOF and TIP businesses were sold on 1 November 2011.
(ii) Full year 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.

The Group IFRS based operating profit in the period to 30 June 2012 totalled £163 million, a reduction of £227 million on the same period in 2011 (30 June 2011: £390 million). After the removal of principal reserving changes and one-off items (30 June 2012: £27 million, 30 June 2011: £216 million) the 2012 half year result is £38 million lower than the first half of 2011 reflecting the Group's focus on financial discipline within the operating companies in a challenging macroeconomic environment. The economic conditions, in which expected returns remain low, have adversely affected the results with the International business in particular impacted by lower interest rate levels. The results also reflect a number of one-off costs in both the International and Lombard businesses, including the strategic review, while other one-off development costs have been incurred in the UK as the business invests in operating capabilities for the future.

The result comprises the operating profit of the life businesses of £168 million, £10 million of corporate income for FLG and £(15) million of corporate costs for the Resolution holding companies. Further details of the operating performance of the Group are included in the relevant business unit operating sections.

Non-operating items

Short-term fluctuations in investment returns, on assets backing the shareholder and non-profit funds, were a favourable £18 million in the period to 30 June 2012. This benefit principally reflects the release of credit default allowances as default experience on assets backing annuity liabilities was better than assumed. In addition, an £8 million benefit has resulted from annuity portfolio mismatches reflecting the fact that these liabilities are matched on a realistic basis as opposed to the reported regulatory basis. Partially offsetting these positive items is a £(7) million adverse variance on shareholder assets, which mainly reflects the difference between actual and expected longer term return on the external debt.

Non-recurring items of £(118) million include:

- separation and integration programme costs of £(39) million;
  - Costs, net of provision releases, on the separation and integration programmes totalled £(39) million in the period and take cumulative spend on these projects to £(89) million and £(83) million respectively (31 December 2011: £(72) million and £(67) million before £6 million provision release).
- outsourcing implementation costs of £(27) million;
  - Costs of £(84) million relating to the Diligenta outsourcing implementation were provided for as at 31 December 2011. In the period, £13 million of these provisions have been released against costs of £(40) million, resulting in net costs in the period of £(27) million. The costs incurred to date therefore amount to £(111) million. Total implementation costs are expected to be £(250) million with the remainder being incurred in the period to the end of 2014.
- finance transformation costs of £(48) million largely relating to Solvency II;
- capital optimisation project costs of £(13) million and other non-recurring costs of £(1) million; and
- other non-recurring income of £10 million relating to a curtailment gain on the Friends Life pensions scheme.

Interest payable on the FLG STICS of £(16) million is included as a £(11) million deduction to corporate long-term investment return in the operating profit analysis, and a £(5) million adverse investment fluctuation. As the STICS are accounted for as equity in IFRS (with interest being recorded as a reserve movement), £16 million is added back to the non-operating result to reflect the requirements of IFRS.

Acquisition accounting adjustments, totalling £(246) million, represent the amortisation of the intangible assets recognised on the acquisitions. These charges comprise £(204) million of amortisation of acquired in-force business, and £(42) million of amortisation of other intangible assets. The amortisation of acquired in-force business in 2011 included a one-off charge of £(201) million (£(130) million for the AXA UK Life Business, £(71) million for BHA) which reflected the accelerated run-off of in-force surplus following the recognition of negative reserves in these businesses. The Group continues to monitor the expected run-off profile of the acquired in-force business with this adjusted in 2012 to reflect changes to the expected run-off profile of the International business's acquired in-force book.

A shareholder tax credit of £109 million has been recognised in the period and is higher than the loss before tax of £(167) million would imply. The principal differences between the implied and actual shareholder tax credit relate to:

- £47 million shareholder tax 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;
- £30 million shareholder tax credit relating to the reduction in the UK corporation tax rate; offset by
- £(9) million shareholder tax charge in respect of provisions and the non-taxable result of the Resolution holding companies.

The tax credit includes £87 million credit in respect of the amortisation and impairment of AVIF and other acquired intangibles in the period.

Summary IFRS balance sheet

£m	**RSL 30 June 2012**	RSL 31 December 2011
Acquired value of in-force business	**4,219**	4,437
Other intangible assets	**366**	410
Financial assets	**102,945**	103,636
Cash and cash equivalents	**8,672**	8,791
Other assets	**8,592**	8,132
Total assets	**124,794**	125,406
Insurance and investment contracts	**112,130**	112,455
Loans and borrowings		
– deferred consideration notes	**363**	423
– subordinated debt	**680**	681
– other	**72**	91
Other liabilities	**5,766**	5,761
Total liabilities	**119,011**	119,411
IFRS net assets	**5,783**	5,995
Equity attributable to equity holders of the parent	**5,453**	5,672
Attributable to non-controlling interests	**330**	323
Total equity	**5,783**	5,995
Shares in issue(i)	**1,391,673,934**	1,373,527,605

(i) Shares in issue at 31 December 2011 have been adjusted to exclude Resolution Limited shares held by subsidiaries of 2,661,384 (30 June 2012: nil).

At 30 June 2012, IFRS total equity was £5,783 million (31 December 2011: £5,995 million), with equity attributable to equity holders of the parent of £5,453 million (31 December 2011: £5,672 million). IFRS net assets per share attributable to shareholders were £3.92 (31 December 2011: £4.13) based on shares in issue at the balance sheet date, excluding, at 31 December 2011, the Company's shares held by subsidiaries. The change in shares in 2012 reflects the scrip dividend and the disposal of the Company's shares held by subsidiaries.

Financial assets are predominantly invested in listed shares, other variable yield securities, corporate bonds, asset backed securities and government securities. Asset quality has been maintained with 97% of shareholder-related corporate bonds and asset-backed securities held at investment grade or above and there is limited exposure to European sovereign debts.

At 30 June 2012, the ratio of debt to IFRS equity attributable to equity holders of the parent, gross of debt, was 17.0% (31 December 2011: 17.4%), with the impact of the repayment of the deferred consideration notes ("DCNs") in the period offsetting the reduction in equity.

MCEV results

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 period, together with the effect of updating the previous period'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 Half year 2012	RSL(i) Half year 2011	RSL(ii) Full year 2011
Value of new business	**67**	**18**	**12**	**–**	**97**	66	151
Expected existing business contribution	**170**	**12**	**18**	**(35)**	**165**	181	360
Operating experience variances	**3**	**(8)**	**(10)**	**–**	**(15)**	(6)	(28)
Other operating variances	**19**	**–**	**–**	**–**	**19**	(7)	6
Operating assumption changes	**9**	**–**	**5**	**–**	**14**	(2)	140
Development costs	**(18)**	**(4)**	**–**	**–**	**(22)**	(14)	(36)
FLG other income and charges	**(1)**	**–**	**–**	**(7)**	**(8)**	(22)	(35)
RSL other income and charges	**–**	**–**	**–**	**(15)**	**(15)**	(16)	(41)
Operating profit/(loss) before tax	**249**	**18**	**25**	**(57)**	**235**	180	517
Economic variances					**242**	(48)	(600)
Amortisation of non-covered business intangible assets					**(1)**	(1)	(3)
Costs associated with the business acquisitions					**–**	(1)	(3)
Non-recurring costs					**(115)**	(79)	(345)
Other non-recurring items and non-operating variances					**24**	34	66
Profit/(loss) from continuing operations before tax					**385**	85	(368)
Tax					**(89)**	(31)	73
Profit/(loss) from continuing operations after tax					**296**	54	(295)

(i) Half year 2011 results comprise six month results for Friends Provident and the AXA UK Life Business, five months for BHA, six months for GOF and TIP. The GOF and TIP businesses were sold on 1 November 2011.
(ii) Full year 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.

Operating result

The Group MCEV operating profit in the period to 30 June 2012 was £235 million, up from the £180 million reported in the first half of 2011. The results reflect a good operating performance highlighting the successful focus on profitable growth, synergy delivery and platform migration across the UK business. The value of new business ("VNB") has grown significantly from £66 million to £97 million period on period, whilst the impact of lower expected returns resulting from economic movements in 2011 has partially offset this benefit. Expected rates of return applied to equities and properties have both fallen compared to 2011, although this is partially offset by an increase in expected returns on corporate bonds.

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 period. Economic variances in the first half of 2012 had a £242 million favourable impact on results (30 June 2011: £(48) million adverse) reflecting the continued volatility in investment markets. The widening in corporate bond spreads in the second half of 2011, driven by volatile economic conditions, has reversed to a degree over the first half of 2012 benefiting the result by £145 million. In addition, lower future inflation assumptions have benefited the MCEV by £40 million and lower interest rates have improved MCEV by £48 million. Equity markets have broadly matched expectations, and generated only a small surplus on unit-linked business.

Non-recurring costs in the first half of 2012 total £(115) million (30 June 2011: £(79) million) and include costs of £(91) million, consistent with those included in IFRS after excluding Diligenta costs. A further £(24) million, net of reserve releases, relate to the implementation of the outsourcing agreement with Diligenta. The charge incurred on the outsourcing implementation differs between IFRS and MCEV as it reflects the differing reserving approaches taken on these bases. The total implementation costs for the outsourcing will be the same across both bases over the period in which they are incurred.

Other non-recurring items and non-operating variances of £24 million relate to tax items including the 1% reduction in the corporation tax rate announced in the 2012 budget.

MCEV balance sheet

Gross life and pensions MCEV £m	**30 June 2012 Net worth**	**30 June 2012 VIF**	**30 June 2012 Total**	31 December 2011 Total
UK	**2,162**	**3,075**	**5,237**	5,341
International	**94**	**528**	**622**	571
Lombard	**77**	**475**	**552**	541
FLG corporate	**639**	**–**	**639**	564
FLG other(i)	**66**	**–**	**66**	91
Gross FLG MCEV	**3,038**	**4,078**	**7,116**	7,108
FLG corporate- external STICS	**(298)**	**–**	**(298)**	(327)
FLG corporate - external LT2 subordinated debt	**(618)**	**–**	**(618)**	(632)
FLG corporate - internal LT2 subordinated debt	**(200)**	**–**	**(200)**	(200)
Net FLG MCEV	**1,922**	**4,078**	**6,000**	5,949
RSL net assets (including internal LT2 subordinated debt)	**302**	**–**	**302**	270
RSL deferred consideration notes	**(363)**	**–**	**(363)**	(423)
Net Group MCEV	**1,861**	**4,078**	**5,939**	5,796
Shares in issue(ii)			**1,391,673,934**	1,373,527,605

(i) Includes IFA distribution and management services businesses including the pension asset of FPPS.
(ii) Shares in issue at 31 December 2011 have been adjusted to exclude Resolution Limited shares held by subsidiaries of 2,661,384 (30 June 2012: nil).

At 30 June 2012, net Group MCEV was £5,939 million (31 December 2011: £5,796 million) giving MCEV per share of £4.27 based on shares in issue at the balance sheet date (31 December 2011: £4.22).

At the end of the period the ratio of debt to gross Group MCEV (excluding internal debt) was 17.7% (31 December 2011: 19.3%), with the change primarily reflecting the increase in Group MCEV combined with the part repayment of the deferred consideration notes. The ratio of debt to gross FLG MCEV was 15.7% (31 December 2011: 16.3%).

The Resolution holding companies' net worth, including internal and external debt, increased by £92 million reflecting the payment of cash dividends of £150 million and corporate costs, offset by the receipt of a £250 million dividend from FLG and the disposal of £7 million of Company shares previously held by subsidiaries.

Resolution Limited shares held by Group subsidiaries are excluded from Resolution holding companies' net worth (in accordance with IFRS) therefore the disposal of these shares increases the Resolution holding companies' net worth.

The annualised FLG operating ROEV, after tax, for the period to 30 June 2012 was 6.4% and compares to the full year 2011 ROEV of 6.5%, which included the benefit of year end assumption changes including the impact of the Diligenta outsourcing arrangement. Compared to the 2010 baseline of 5.5% the half year result represents steady progress, and a significantly better performance than the previous half year annualised return of 4.5%. The improvement in operating ROEV principally reflects the period on period improvements made to the contribution of new business although the low expected returns, particularly on shareholder assets, continue to provide a challenging environment in which to deliver increased returns.

UK operating review

The UK business has evolved rapidly since 2009, making good progress separating and integrating the acquired businesses and subsequently reorganising the business units into the Heritage and Go to Market units. The Heritage business unit forms the bulk of the UK business by assets and in-force value, as illustrated below, while the Go to Market business units are focused on scale markets where good margins are generally available and where the Group has strong market positions enabling access to those margins.

UK by business unit	**Assets under management %**	**VIF £bn**
UK Heritage	80	2.2
Corporate Benefits	18	0.7
Protection	–	0.1
Retirement income	2	0.1
Total	**100**	**3.1**

Key financial metrics for the UK business are shown below with further details included in the financial result section.

£m	**2012 Half year**	2011 Half year	2011 Full year
IFRS based operating profit before tax	**137**	364	672
MCEV operating profit before tax	**249**	184	507
Operating free surplus generation	**160**	317	798

Profitability of new business

	2012 Half year							
		Go to Market						
£m (unless otherwise stated)	**Heritage**	**Corporate Benefits**	**Protection**	**Retirement Income**	**Total**	2011 Half year	2011 Full year	2010 Full year baseline
VNB	**4**	**10**	**28**	**25**	**67**	28	59	11
New business cash strain	**(20)**	**(32)**	**(23)**	**15**	**(60)**	(98)	(169)	(303)
IRR	**4.2%**	**6.8%**	**9.8%**	**>25%**	**9.4%**	7.0%	7.7%	5.9%
APE	**60**	**291**	**44**	**19**	**414**	372	721	677

The profitability of new business delivered in the first half of 2012 reflects the significant progress made in delivering operating cost synergies, continued migration of new business to target platforms and the outsourcing arrangement with Diligenta.

The value of UK new business, totalling £67 million in the period to 30 June 2012, already exceeds that generated in the whole of 2011 (31 December 2011: £59 million) and continues to progress towards the target levels. Similarly new business cash strain has also decreased period on period with a 39% improvement compared to the first half of 2011. These improvements combined are a reflection of the material progress made by each of the business units as they drive forward their respective strategies.

The profitability of UK new business with an IRR of 9.4% similarly reflects the good underlying business unit performance with the improvement in Protection and Retirement Income feeding into the overall result. Corporate Benefits profitability also reflects an upward trend on the first half 2011 although the improvement has been partly offset by the lower IRR on the current not-yet-scale new corporate platform and the acquired WLUK business which has not yet transferred to the target platform.

Financial performance

UK IFRS based operating profit

£m	**2012 Half year**	2011 Half year(i)	2011 Full year(ii)
New business strain	**(41)**	(66)	(112)
In-force surplus	**196**	214	402
Long-term investment return	**(26)**	4	(5)
Principal reserving changes and one-off items	**27**	222	416
Development costs	**(18)**	(10)	(28)
Other income and charges	**(1)**	–	(1)
IFRS based operating profit before tax	**137**	364	672

(i) Half year 2011 results comprise six month results for Friends Provident and the AXA UK Life Business, five months for BHA, six months for GOF and TIP. The GOF and TIP businesses were sold on 1 November 2011.

(ii) Full year 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.

The interim 2012 UK operating profit of £137 million is £227 million lower than the same period in 2011 (30 June 2011: £364 million) mainly reflecting the significant one-off benefits reported in the comparative period. After the removal of principal reserving changes and one-off items (30 June 2012: £27 million, 30 June 2011: £222 million) the UK result is £32 million lower than 2011. This underlying result reflects a number of factors with strong progress made in reducing the costs of writing new business offset by the impacts of a low return environment, increased intragroup interest costs and one-off costs. One-off costs of £(3) million have been incurred in respect of the establishment of Friends Life Investments ("FLI"), with £3 million benefits being recognised through reduced levels of reserves for future investment management fees. The increase in development costs incurred in the period includes an increase in spend as the business invests in the retirement income strategy as well as operational capabilities in the lead up to Retail Distribution Review and auto-enrolment implementation.

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	**2012 Half year**	2011 Half year	2011 Full year
Total UK new business cash strain	**(60)**	(98)	(169)
DAC/DFF adjustments	**19**	33	60
Other IFRS adjustments	**–**	(1)	(3)
Total UK IFRS new business strain	**(41)**	(66)	(112)

In the period, IFRS new business strain has been reduced by 38% to £(41) million (30 June 2011: £(66) million) reflecting the Group's actions to reduce acquisition expense levels. The reduction in IFRS new business strain is principally driven by the underlying new business cash strain which is detailed in the Go to Market and Heritage operating sections that follow.

Deferred acquisition costs ("DAC") are recognised on pensions and investment new business with the lower level of deferral compared to prior periods reflecting the reduced commission levels following the decision to stop selling investment bonds in 2011.

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

£m	**2012 Half year**	2011 Half year	2011 Full year
Total UK cash surplus	**166**	207	354
DAC/DFF adjustments	**(1)**	(1)	(7)
Other IFRS adjustments	**31**	8	55
Total UK IFRS surplus	**196**	214	402

In-force surplus of £196 million reduced from £214 million in the first half of 2011 principally reflecting the impact of the challenging economic environment. The reduced level of funds under management, driven by both low period on period market levels and net outflows from the Heritage business, reduced the amount of fees generated in the first half of 2012. In addition, the effect of year end basis changes made at 31 December 2011 has resulted in the non-recurrence of the benefit of favourable experience variances included in the first half of 2011.

The overall contribution to in-force surplus of the acquired WLUK business is £12 million in the first six months of 2012 following the business's acquisition in November 2011. Maintenance expenses incurred by WLUK were £11 million, excluding these maintenance expenses are flat period on period.

The £(1) million net amortisation of DAC and deferred front end fees ("DFF") reflects the relatively small value of these costs that have been capitalised in the post-acquisition period.

The other IFRS adjustments mainly relate to the reversal of investment contract reserve movements which are not allowable under IFRS.

Longer-term investment return

£m	**2012 Half year**	2011 Half year	2011 Full year
Longer-term return on life and pension shareholder funds - excluding debt	**27**	35	70
Longer-term return on life and pension shareholder funds - debt	**(53)**	(31)	(75)
Total	**(26)**	4	(5)

The decrease in longer-term investment return in the UK business is a reflection of the reduced expected rates of return combined with the increased cost of debt compared to the same period in 2011. In the first half of 2012 rates of expected return for gilts, corporate bonds and cash have reduced significantly resulting in a £8 million reduction in investment return.

The increased debt costs in the first half of 2012 reflect a full six month's interest charge on the internal LT2 subordinated debt issued by FLL to Friends Life holding companies in 2011 (with £500 million issued in April 2011 and a further £200 million issued in December 2011). The benefit of the interest received is reflected in the Corporate business unit's operating result.

Principal reserving changes and one-off items

Principal reserving changes and one-off items include a benefit of £17 million relating to revised transfers on guaranteed annuity options triggered by the vesting of pensions business within the with-profit funds. Other one-off items of £10 million mainly reflect the favourable impact of a refinement of the reserving for attributable expenses as well as the recognition of benefits to be achieved following the set up of FLI.

UK operating expenses

£m	**2012 Half year**	2011 Half year(i)	2011 Full year	2010 Full year baseline(ii)
Acquisition	**77**	89	178	220
Maintenance	**141**	130	263	256
	218	219	441	476
Development	**18**	10	28	23
Total	**236**	229	469	499

(i) 2011 half year operating expenses do not include the acquired WLUK business as this was acquired on 7 November 2011, but include BHA from the date of acquisition.
(ii) 2010 full year baseline includes an estimate of 12 months operating expenses for AXA UK Life Business, BHA and WLUK.

UK operating expenses, which exclude commission payments and non-recurring costs, totalled £236 million in the period, up £7 million on the same period in 2011. The increase in development spend, up £8 million in the period, is the principal driver of this period on period increase and reflects preparations by the UK business for the forthcoming regulatory changes such as the Retail Distribution Review and auto-enrolment. Development costs also include expenditure associated with the recently launched corporate platform 'My Money' as well as the Retirement Income strategy.

Acquisition and maintenance costs amounted to £218 million in the period, marginally lower than the same period in 2011. After adjusting for the inclusion of the acquired WLUK business (£15 million) and inflation (£7 million), costs in the period have been reduced by £23 million principally reflecting the in year delivery of £65 million run-rate savings.

Maintenance expenses have increased in the period by £11 million, largely reflecting the inclusion of the acquired WLUK business in the 2012 results. In addition, costs of £3 million have been incurred in relation to the set up of FLI although these costs have been offset by a benefit in principal reserving changes and one-off items. Excluding these impacts, maintenance expenses are lower than the comparative 2011 period with further reductions expected as the business completes the integration process and delivery of the target £143 million synergies by 2015.

UK other income and charges

Other income and charges of £(1) million include the trading profit of £1 million in Sesame Bankhall Group ("SBG"). SBG is a broad-based financial services group and the UK's largest distributor of retail financial advice, operating 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. SBG's result is in line with expectations in the first six months as the business continues to make significant investments in its technology infrastructure and in a range of new services for its customers to strengthen its market-leading position in advance of the RDR implementation.

UK MCEV operating profit

£m	**2012 Half year**	2011 Half year(i)	2011 Full year(ii)
Value of new business	**67**	28	59
Expected existing business contribution	**170**	167	330
Operating experience variances	**3**	(7)	(9)
Operating assumption changes	**9**	–	147
Other operating variances	**19**	6	9
Development costs	**(18)**	(10)	(28)
Life and pensions covered business operating profit before tax	**250**	184	508
Other income and charges	**(1)**	–	(1)
Operating profit before tax	**249**	184	507

(i) Half year 2011 results comprise six month results for Friends Provident and the AXA UK Life Business, five months for BHA, six months for GOF and TIP. The GOF and TIP businesses were sold on 1 November 2011.
(ii) Full year 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.

The increase in the UK MCEV operating profit to £249 million (30 June 2011: £184 million) results from the Group's focus on profitable growth, synergy delivery and platform migration driving improved levels of new business profitability.

Value of new business

The contribution from new business has improved significantly over recent periods with the £67 million reported in the first half of 2012 representing a 139% increase on the same period in 2011. The improvement in new business profitability has been driven by the ongoing delivery of cost synergies, including the outsourcing transaction, as well as the ongoing drive to increase the proportion of business written on the target new business platforms.

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 as the business matures.

The expected return on the value of in-force has remained broadly stable compared to the same period in 2011. The adverse economic environment continues to adversely impact expected rates of return with the rates applied to equities and properties falling since 2011. This reflects a fall in the reference rate for such assets where the ten year risk free swap rate is 2.4% at 31 December 2011 (31 December 2010: 3.7%). This reduction has however been partially offset by an increase in the reference rate for one year cash and gilts swaps and illiquidity premium, and the expected returns applied to corporate bonds are also higher reflecting the higher yields in the current market. As detailed in the 2011 full year results, the illiquidity premium was increased from 75bps to 90bps reflecting the widening of corporate bond spreads observed.

The WLUK business, acquired in November 2011 and therefore not a component of the first half result in 2011, contributed £6 million to the expected existing business contribution in 2012.

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.

	Rates of return	
	2012	2011
Reference rate (non annuity business)	**1.35**	1.14
Reference rate (annuity business)	**2.25**	1.89
Best estimate returns:		
Corporate bonds	**2.98**	2.45
Cash/Government Bonds	**1.35**	1.14
Equity	**5.40**	6.70
Property	**4.40**	5.70
Illiquidity premium	**90 bps**	75 bps

Operating experience variances

The positive operating experience variance of £3 million consists of positive mortality and morbidity experience offset by small negative variances relating to operating exceptional expenses, such as the set up of FLI, and taxation.

As reported in the 2011 year end results the Group established a provision of £88 million in respect of short-term adverse corporate pensions persistency experience, in the lead up to RDR implementation. The Group expects this experience to be driven by increased 'churn' of new business by the commission-paying market. In the first half of 2012 experience has been inside expectations with £16 million of the provision utilised in the period leaving £72 million in place as at 30 June 2012.

Operating assumption changes

A favourable operating assumption change of £9 million has been included resulting from the capitalisation of VAT savings following the repatriation of £6 billion of assets from external fund managers to the newly formed in-house investment company, FLI.

Other operating variances

Favourable other operating variances of £19 million include a £17 million benefit following revised transfers related to guaranteed annuity options on the vesting of pensions business from within the with-profit funds as well as £2 million of other small operating variances.

UK Heritage

Market environment

The Heritage business is making good progress in preparing for the significant number of changes facing the UK life and pensions market.

The Heritage business has a broad range of products that will be impacted by the Retail Distribution Review, gender neutral pricing and auto-enrolment of pensions. Consequently the Heritage business is undertaking the product and systems enhancements necessary to fulfil the Group's regulatory obligations in particular Treating Customers Fairly. In doing so, the business is applying commercial judgement to the need for investment, taking account of the scale of products and planned longer term outsourced platform developments.

Strategy implementation

The UK Heritage business unit serves over four million customers. It manages a significant proportion of the value of in-force of the Group, relating to a large suite of products that are no longer actively marketed and are administered on complex legacy systems. Consequently the business is very different to the UK Go to Market businesses. Good progress continues in embedding 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.

The 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; and
- retention of in-force business.

The Heritage business has previously identified six strategic themes to begin to harness these value drivers. Progress on the themes prioritised in 2012 is set out below. The Heritage business expects to address the remaining strategic themes, fund rationalisation and customer value management, over a longer timeframe.

Outsourcing

The significant policy administration and IT outsourcing deal with Diligenta which commenced on 1 March 2012 is operating as expected. Combined with the existing outsource arrangement with Capita, materially all of Heritage policy administration is now outsourced. This means a considerable part of the Heritage cost base is now directly variable, and will decrease as policies run off. The resulting certainty around administration costs reduces the risk of expense assumptions in the embedded value coming under pressure.

Since the initial transfer of 1,900 staff and smooth transition of work to Diligenta with effect from 1 March 2012, implementation of the deal has continued to progress well. The customer services work of circa 400 full time employees ("FTE") transitioned seamlessly from WIPRO (an existing outsource provider) to TCS (Indian parent company of Diligenta) in May, again on schedule and with no disruption to service. The IT application and support work of circa 200 FTE also transferred to TCS in May without disruption.

Building an in-house asset manager

Building in-house asset management capability supports the aim of running a lean cost base with the expectation that assets can be managed more efficiently in the longer term. FLI successfully launched on 2 July 2012 with £6 billion of fixed interest assets under management. This successful development of in-house capability demonstrates the opportunity to deliver more value from the existing book through optimised investment strategies at lower cost.

The VAT savings from reduced fees payable to third party asset managers have benefited MCEV operating profit by £9 million, offset by setup costs of £3 million referred to above.

FLI is set to continue growing and aims to recapture a further £3-£5 billion of assets over the remainder of 2012. The current phase of development is focused on the recapture of the core non-linked and shareholder assets of the Group. Subsequent phases are expected to focus on fixed income assets currently managed in the Group's with-profits and unit-linked funds.

To achieve maximum business efficiency, FLI's middle and back office support functions are outsourced. This also provides the benefits of future scalability and flexibility while achieving certainty on costs.

Capital optimisation programme and with-profits fund management

The current capital optimisation programme ("COP") to simplify the legal structure of the business and remove capital inefficiencies continues to progress well. Friends Life has five UK life companies within the Group and the ultimate result of the programme will be to reduce these in order that they are broadly aligned to the Heritage business and Go to Market business lines. The most significant steps of this project are expected to be completed by the end of 2012. The Group is confident that the costs to be incurred to deliver this restructure will be exceeded by benefits.

The programme to develop and implement a uniform capital management framework for the six with-profits funds within the Heritage business is currently underway. This programme is closely linked to the COP, as a number of with-profits funds are included in the planned COP transfers of business.

Financial performance

Value of in-force business

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

	£bn	%
Pensions	**0.4**	18
Investments	**0.7**	33
Annuities	**0.2**	9
Protection	**0.4**	17
With-profits	**0.5**	23
Total UK Heritage VIF 30 June 2012	**2.2**	100

By product line, the primary drivers of future profit and cash 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 funds under management

The challenging economy over the first half of 2012 has not had a significant negative impact on the Heritage results. The operating performance to date during 2012 indicates the lapse experience of the book is performing in line with the business's assumptions including the provision set aside for increased scheme re-broking activity prior to RDR becoming effective on 1 January 2013.

The business has seen net outflows of both unit-linked pensions and investment business. Unit-linked investment business, primarily single premium bonds, reflects the positive action taken in 2011 to close Investment Bond products and the maturity of this book. Whilst net outflows are significant, the Heritage business expects to be able to manage these books of business within the current assumptions.

£bn	Pensions	Investments	Total
31 December 2011	**18.9**	**16.3**	**35.2**
Inflows	0.3	0.1	0.4
Outflows	(1.2)	(0.9)	(2.1)
Net investment return	–	(0.1)	(0.1)
30 June 2012	**18.0**	**15.4**	**33.4**

New business

£m (unless otherwise stated)	**2012 Half year**	2011 Half year	2011 Full year
Value of new business	**4**	8	(4)
New business cash strain	**(20)**	(30)	(54)
IRR	**4.2%**	6.8%	6.0%
APE	**60**	87	157

The Heritage business 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.

New business strain is £(20) million compared to £(30) million in the first half of 2011 reflecting the closure of bond products to new business in the second half of 2011.

The contribution from UK Heritage new business in the first half of 2012 was a profit of £4 million representing a fall of £4 million from the first half of 2011. This change reflects:

- a marginal increase in Department of Work and Pensions ("DWP") rebate business which contributed £8 million to Heritage pensions VNB in the first half of 2012 (30 June 2011: £7 million). Further rebates have been received in July but thereafter are expected to be minimal. The UK Government has determined that 2012 is the final year in which DWP rebates will be provided.
- the closure of bond products referred to above, leading to a reduction in sales and value generated. In the first half of 2011 the bonds contributed £4 million VNB to the UK result with a marginal contribution in 2012.

IRR of 4.2% reflects the same drivers as VNB.

Key priorities

The key priorities for the Heritage business for the remainder of 2012 are the successful delivery of the Capital Optimisation Programme and continued expansion of Friends Life Investments whilst continuing to deliver value from the in-force portfolio.

Go to Market: Corporate Benefits

Market environment

Corporate Benefits operates in a large, fast-growing but relatively low-margin market with intense price competition and, currently, commission bias.

Friends Life believes opportunities exist as a result of the ongoing shift from defined benefit to defined contribution schemes, auto-enrolment, demographic changes and the advent of the RDR.

Strategy implementation

Friends Life will continue to improve profitability through four key levers:

- retaining and developing the existing portfolio of schemes through dedicated Client Relationship Managers and workplace marketing operation focusing on key clients and distributors;
- cost reduction through focusing on the business's more efficient, cost-effective target platforms, including the new, "My Money" Corporate Wrap platform, the deployment of a small, focused new sales team and the benefits secured from the outsourcing deal with Diligenta;
- positioning the business optimally for the forthcoming auto-enrolment and RDR market changes: the development of the auto-enrolment hub which will seek to ease the legislative and administrative burden on employers for the significant volumes of business expected from this change. The timing of this business depends upon scheme size and Friends Life, with a balanced portfolio of mid to large schemes, expects the flow of auto-enrolment for its schemes to commence in January 2013, slightly after the very earliest staging schemes in the last quarter of 2012; and
- selectively writing profitable new business within the Friends Life target range of mid to large schemes; these will be primarily through a small number of key distribution relationships. Friends Life have observed increased pressure on pricing, reflecting the competition for commission-paying business before RDR closes this opportunity, but expects a normal environment from 2013. Indeed, as a business which does not currently pay commission in respect of new schemes, Friends Life expects a greater number of opportunities from 2013 from when it can compete for all business and not just non commission-paying business.

Financial performance

£m (unless otherwise stated)	2013 Full year target	2012 Half year	2011 Half year	2011 Full year
VNB	25	**10**	5	15
New business cash strain	(75)	**(32)**	(35)	(51)
IRR	10%+	**6.8%**	6.6%	8.3%
APE	n/a	**291**	219	440

Corporate Benefits again delivered improved new business results with value of new business of £10 million, 100% up on the first half of 2011. This result reflects the increased level of business written (up 33% on the first half of 2011, including 15% from the transfer of WLUK business), the more commercial pricing approach and the benefits of cost reduction. Expectations are that the market commitment of £25 million VNB will be achieved in 2013. New sales include £19 million APE on "My Money", the new corporate platform launched on 31 January. In this period, 79% of new business was written on the target platforms, NGP and My Money.

New business cash strain of £32 million is at a higher run rate than the £26 million implied from the full year 2011 results (noting the step-down between first and second half of the 2011 numbers being due to modelling improvements which were introduced in December). This reflects the higher sales volumes in 2012 including the introduction of the WLUK business but offset by cost reductions. Sales volumes of £291 million in the first half of 2012 in turn reflect the healthy pipeline of business built up following the successful merger of the Friends Provident and AXA UK Life Business and the recognition, including by NMG and Greenwich Associates, of the quality of the Friends Life proposition. In addition, the workplace marketing operation has had a successful first half through the attention given to key relationships by the Client Relationship Management team and buoyed by the seasonal peak of employer-driven salary reviews in January and April. The results also include £2 million VNB in respect of DWP receipts which are significantly weighted towards the first half of the year.

Cost savings and increased volumes continue to drive the IRR on Corporate Benefits business with an IRR of 6.8% in the first half of 2012 up from 6.6% in the first half of 2011. The steady upward trajectory through the second half of 2011 has however been offset by the lower IRR on the transferred-in WLUK business (which is not yet on target platform) and the lower initial IRR on the not-yet-scale My Money platform. FLG expects the favourable IRR trajectory to continue and for 2013 market commitments to be achieved through continued cost savings and pricing discipline and the benefits of the volumes of auto-enrolment business. The Group expects an increase in new business activity as a result of both auto-enrolment itself and auto-enrolment consultancy activity triggering scheme reviews. This is expected to result in a change in market focus with the quality providers, with comprehensive auto-enrolment solutions, taking market share.

A provision was made at the end of 2011 to allow for an expected peak of adverse persistency experience driven by corporate pensions business being re-broked prior to the rule changes taking place from 1 January 2013 as a result of RDR. Experience of scheme losses to commission-paying providers in the first half of 2012 is in line with expectations.

Corporate Benefits funds under management

£bn	
31 December 2011	**15.4**
Inflows	1.3
Outflows	(0.9)
Net investment return	–
30 June 2012	**15.8**

Net fund inflows of £0.4 billion have been generated in the first half of 2012 whilst investment markets have been flat over that period.

Key priorities

Friends Life will continue the development and promotion of My Money (already rated best corporate platform in a platform survey of 70 advice firms) to achieve scale on this platform. The business will continue to champion the NGP platform to deliver growth through the workplace marketing operation and write profitable new business governed by robust pricing discipline.

The Corporate Benefits business is on track to complete and prove the auto-enrolment hub as well as the supporting business processes in time for the arrival of the first tranches of this business. Similarly, preparation continues to ensure that systems and processes are updated to be ready for the regulations and opportunities arising from RDR.

The business continues to focus on moving existing business onto the target platforms but following the clear message from clients that they do not want to manage a migration at the same time as the legislative requirements of auto-enrolment, together with the opportunity to extend the Embassy platform servicing arrangement with AXA, the business has decided not to migrate the book of business from this platform in the short term and is concentrating on ensuring the auto-enrolment solution will also support these clients. This is not expected to have a material effect on the business or delivery of financial targets.

Go to Market: Protection

Market environment

The UK protection market is mature and has remained relatively stable over the past few years despite the turbulent macroeconomic climate. In 2011 the market size was circa £1 billion APE, of which three-quarters consisted of individual protection and one-quarter group protection. The protection market is forecast to have modest growth over the next few years with a number of key factors driving increases for example the RDR, recovery in the mortgage market, and growth in the Whole of Life market.

Protection products are not directly impacted by RDR, nevertheless there is expected to be a positive impact on Protection sales. The industry consensus view is that there is likely to be a short term growth in sales of advised protection products as distributors transition their business model to the post-RDR landscape. The business expects other growth, in the medium term, to come from non-advised sales and this trend is starting to be evidenced. Changes regarding gender neutral pricing (effective from 21 December 2012) and life tax reforms (implemented on 1 January 2013) will almost certainly have an effect on the price of Individual Life Protection; as a result the business expects to see increased market pricing volatility in the early part of 2013.

Over the next year the group protection proposition will be affected by a number of significant regulatory changes in addition to the RDR. These include the welfare reforms and pension auto-enrolment with the business continuing to monitor and develop towards the implementation of these.

Strategy implementation

Friends Life's overall approach is to deliver the strategic change agenda to fulfil the 2013 market commitments, whilst maintaining proposition quality and innovation. Delivery in 2012 to date includes the successful implementation of the partnership with Connells, which both increases the proposition's distribution footprint and provides capability on the Protect+ platform for migration of other strategic partners later in the year. The Protection business continues to deliver capability and proposition enhancements, including piloting an improved rehabilitation claims service within Group Protection and recent critical illness product enhancements within Individual Protection.

The business has also made progress in developing selective strategic distribution partnerships within both businesses, such as Intrinsic for Individual Protection and Mercer for Group Protection.

Friends Life Individual Protection has prepared for the expected outcome of the RDR, developing a selective range of distribution relationships as well as innovative propositions such as the new Simple range of products, which extend FLG's distribution capabilities with products that are suitable for non-advised sales through a variety of channels and partnerships. The Group Protection proposition is continuing its selective approach to the channels and products which offer acceptable levels of return, whilst continuing to innovate with proposition enhancements such as on-line scheme servicing and growing employee benefits consultant ("EBC") relationship strength.

As referred to above, the implementation of gender neutral pricing and life tax reforms is expected to result in some pricing volatility. The business's focus on a value-based high quality proposition in this market is expected to reduce its exposure to price volatility, compared to some other UK providers, when these changes are implemented.

Financial performance

£m (unless otherwise stated)	2013 Full year target	**2012 Half year**	2011 Half year	2011 Full year
Value of new business	80	**28**	(2)	16
New business cash strain	(30)	**(23)**	(43)	(77)
IRR	20%	**9.8%**	3.9%	5.5%
APE	n/a	**44**	50	92

The progress in financial performance achieved in the second half of 2011 has continued into 2012 with a new business contribution of £28 million (£(2) million in the first half of 2011), at an increased IRR of 9.8% and with new business strain reducing by almost half.

All intermediary partner individual protection new business has now migrated to the Protect+ proposition, continuing the business's strategy of focusing on value over volume and migrating new business capability to the target platforms to achieve productivity benefits. 81% of new business is now written on the three target platforms (Individual Protect+, Individual Simple and Group). Although new business APE is lower than the equivalent period for 2011, profitability is significantly improved. The focus remains on achieving value through product mix and managing profitability during continued subdued economic conditions.

Group protection has benefited both from increased volumes during the (traditionally strong) first half of the year, following early integration of the business, and also from an increased proportion of higher value group income protection business where Friends Life has strong claims management capability.

Key priorities

New business profitability and IRR in the first half of 2012 continues to progress towards the 2013 market commitments. Further improvements will be driven by a clear focus on key priorities, including the migration of strategic partners, such as Countrywide, to the target Friends Life platforms by the end of 2012. The Protection business continues to target improvements in existing relationships and selected new partnership opportunities, and to maintain the overall quality of the Group and Individual propositions. During the second half of 2012 the Group will also seek to manage and benefit from the high volume of impending regulatory and tax changes in both the Individual and Group Protection businesses.

Go to Market: Retirement Income

Market environment

The annuity market continues to show underlying growth with the first quarter of 2012 up 16% on the same period in 2011. The market is proving to be resilient in the face of the volatile economic environment and the associated fall in annuity rates driven by falling UK gilt yields. Growth in baby boomer retirements is expected to contribute to additional annuity sales in 2012 and over the coming years.

Sales in the open market continue to show the trend towards enhanced annuities which now account for half of total open market sales. The strong growth in enhanced annuities over recent years supports the Retirement Income strategy to broaden the product proposition to take account of lifestyle and medical factors in pricing.

The regulatory environment continues to evolve with the ABI Code of Conduct due to come into force in March 2013. This will require all providers to prominently highlight enhanced annuities and the higher income they can potentially offer. The Code will ensure that providers continue to explain the benefits of advice and support, including the benefits of shopping around. The Code also seeks to increase transparency in the annuity market so that customers have a clear picture of how individual providers' product offerings fit in with the wider market.

Solvency II requirements and timing remain uncertain although the industry focus on efficient use of capital is expected to ensure a rational commercial response to the final rules.

Strategy implementation

Progress on each of the five key strategic initiatives has been in line with the strategic plan over the first half of 2012 providing confidence over delivery of the 2013 financial commitments for Retirement Income. A series of further improvements to the proposition are set to be delivered over the next few quarters that will progressively improve the business's ability to retain retiring customers.

Provision of broader product proposition

At the beginning of June 2012 Retirement Income launched an annuity product incorporating lifestyle and medical underwriting. This is expected to be rolled out to maturing pension policyholders over the second half of 2012 leading to an expected increase in retention rates towards target over the course of 2013. The development of the enhanced annuity product ensures that maturing pension policyholders can take advantage of this option when appropriate. The growth in the enhanced annuity market over recent years and the promotion of this option within the ABI Code of Conduct illustrate the importance of this component of the Retirement Income strategy.

Development of sophisticated pricing and underwriting

The longevity team was strengthened further in the first half of 2012 and has now developed the lifestyle underwriting capability required to support the enhanced annuity proposition. In addition, the business is partnering with Swiss Re on the medical proposition thereby benefiting from their underwriting expertise and tools in this field.

Improving customer engagement

The launch of an enhanced annuity follows a number of successful pilot initiatives during the first half of 2012. The pilots have helped to inform product development and the approach to customer engagement in the run up to retirement. With this proposition becoming established, the business will increasingly focus on enhancing operational capability to raise customer awareness and encourage customer engagement in this important option that can enhance their income for life.

Optimising and developing the investment strategy

The launch of FLI will enable the business to leverage its investment and asset liability management capability to support the growth of core product areas such as annuities. The Retirement Income business will benefit from the fixed income investment expertise within the FLI team to ensure that the asset strategy supports competitive rates for customers whilst managing investment risk within appetite.

Development of capabilities to support an open market offering

The next phase of the strategic plan involves developing the operational and technological capacity to support additional business derived from the enhanced annuity products. These developments create the capability for a potential future entry into the open market. Competition in the open market remains concentrated among a small number of established and specialist players. The opportunity to enter into the open market remains additive to the Retirement Income 2013 full year targets. The timing of any launch has not been decided and will take account of impending regulatory changes, including the RDR and gender neutral pricing.

Financial performance

£m (unless otherwise stated)	2013 Full year target	**2012 Half year**	2011 Half year	2011 Full year
Value of new business	50	**25**	17	32
New business cash strain	n/a	**15**	10	13
IRR	15%+	**>25%**	>25%	22.0%
APE	n/a	**19**	16	32

Annuity new business contributed £25 million of VNB in the first half compared to £17 million in the same period of 2011 and a full year 2011 contribution of £32 million. Uncertainty in fixed income markets throughout the first half of 2012 led to cautious pricing levels that resulted in strong new business margins over the period. However, whilst the business remains cautious, margins are expected to reduce to more normal levels over the second half of 2012.

Sales volumes of £19 million in the period reflect stable retention rates and the acquisition of the WLUK business in November 2011.

New business cash strain has also benefited from the cautious pricing levels and strong volumes in the first half of 2012 resulting in a cash release of £15 million compared to a full year contribution of £13 million in 2011.

Key priorities

The Retirement Income business has a number of key priorities which will lead the business towards the 2013 financial targets. These include the promotion of the new enhanced annuity propositions to a significant proportion of Friends Life customers as they prepare for retirement. This is expected to benefit the level of internal vestings although retention rates are not expected to start increasing materially until 2013 due to the lead time and the gradual nature of the roll out.

In order to support the additional business derived from the enhanced annuity products, operational and technological capacity will be developed. These developments will also underpin the development of an option for the business to enter the open market in the future.

International operating review

The International segment comprises:

- Friends Provident International Limited ("FPIL"), an Isle of Man based company manufacturing unit-linked savings and single premium bond products with a focus on affluent expatriates via hubs in Hong Kong, Singapore, Dubai, as well as serving UK customers with offshore products;
- 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;
- 30% interests in both AmLife Insurance Berhad ("AmLife"), a Malaysian life insurance company, and AmFamily Takaful Berhad ("AmFamily"), a Malaysian family takaful business. Both businesses are majority owned by AmBank Berhad, a major Malaysian banking group.

£m	2012 Half year	2011 Half year	2011 Full year
IFRS based operating profit before tax	**21**	41	40
MCEV operating profit before tax	**18**	15	29
Operating free surplus generation	**7**	9	(17)

IFRS based operating profit of £21 million in the first half of 2012 reflects a £20 million reduction from £41 million reported in the same period of 2011. This reduction largely reflects the impact of lower valuation interest rates which have increased new business reserving strain and increased the cost of guarantees on some German business. The 2011 full year result is a better comparator in assessing operating performance as these factors are also reflected in the 2011 full year result. In addition to these economically driven factors, the 2012 half year result also includes one-off costs for strategic reorganisation and implementation.

MCEV operating profit has increased from £15 million to £18 million reflecting efforts to improve new business value as a proportion of volume, whilst also reflecting the non-recurrence of adverse modelling changes reported in 2011. Expenses related to strategic reorganisation and implementation are also reflected in the 2012 result.

Operating free surplus generation has reduced due to higher financial reinsurance repayments in the half year from the 2011 scheme which supported the cash generation in that year. Financial reinsurance continues in 2012, however at a lower level. The cash flow profile of the business supports a continued positive cash trajectory by the end of 2012. This improved cash projection includes the impact of one-off costs of the strategic reorganisation implementation.

Profitability of new business

£m (unless otherwise stated)	2012 Half year	2011 Half year	2011 Full year
VNB	**18**	20	40
New business cash strain	**(48)**	(52)	(89)
IRR	**10.5%**	13.5%	12.7%
APE (at actual exchange rates)	**104**	132	252

The new business result in the period to 30 June 2012 principally reflects the focus on profitability rather than sales volume. As a result International VNB has only reduced by 10% in the period compared to a 22% drop in sales APE. This has been achieved through increasing margins, through new product structures, and an increase in higher margin protection business.

Sales volumes are 22% lower than the equivalent period in 2011, driven mainly by a significant reduction in regular premium business. This has been due to maintenance of pricing discipline and increased controls around business acceptance. Single premium business is below last year in most regions due to reduced investor confidence, although the UK offshore business has performed above expectations. Protection business has had a particularly strong first half year as a result of IFAs moving away from savings to risk products.

New business cash strain is lower principally due to the reduced volumes, but has increased relative to premiums due to an increase in higher strain protection products and negative economic impacts.

The International IRR has reduced from 13.5% to 10.5% due to the adverse impact of lower new business volumes, increased expenses due to improved controls, as well as year end basis and modelling changes.

Future improvements are expected to be driven by the completion of the continued roll-out of the new higher margin product structures to all international regions and a review of the cost base as part of the strategic review described below.

Market environment

The business is facing challenging economic and market conditions in most of its key markets. The economic environment in Europe is continuing to prove challenging and is impacting sentiment in Asia affecting single premium sales in particular. Protection business has however had a particularly strong first half year with growth in most regions.

The largest market is the North Asia region. This is a relatively mature and competitive market. The region has strong medium term growth prospects, however in the short-term, due to the current economic environment and its impact on investment markets, there is a shift towards non-linked business and sales are likely to remain under competitive pressure.

The South East Asia region is managed through Singapore. Singapore continues to evolve as a wealth management hub and offers good growth potential. Singapore's economic and competitive backdrop appears to be more benign than North Asia but the current economic uncertainty is still expected to constrain growth in the short-term.

The United Arab Emirates and the wider Middle East region are immature local markets, however they have a large number of high net worth expatriates and continue to provide good growth prospects.

In Germany, the business participates in the unit-linked individual pensions market. The market environment is challenging in the short term, as low investment market confidence drives consumers towards the still dominant traditional with-profits business. Guaranteed rates of return on traditional products are expected to reduce due to the impact of the introduction of Solvency II. In the medium-term the unit-linked sector has good prospects through demand for private sector savings and investments and the move from state to private pension provision.

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.

Strategy implementation

The International business is currently in the process of a strategic review, the results of which will be announced before the end of 2012. The aim of the review is to enhance value by developing a sustainable portfolio of international businesses in regions with sound regulatory positions, focusing on the growth of profits and cash delivery. Reducing unit costs by implementing process improvements, increased outsourcing and a narrower geographical footprint will underpin the new strategy.

The business has continued to invest in building capability and four new executives and a new non-executive chairman have been appointed.

The roll-out of new higher margin product structure continues. The launch into Singapore in the second quarter of 2012 was successful and the Middle East and Hong Kong launches will be completed by the end of 2012.

Key priorities

Key priorities for the business include the completion of the roll out of the new higher margin product structures, completion of the strategic review to build a sustainable portfolio with sound regulatory positions, focused on growth in profits and cash delivery, and the reduction of unit costs.

Financial performance

International IFRS based operating profit

£m	**2012 Half year**	2011 Half year	2011 Full year
New business strain	**(24)**	(20)	(36)
In-force surplus	**51**	69	97
Long term investment return	**–**	–	1
Principal reserving changes and one-off items	**–**	(6)	(12)
Development costs	**(4)**	(3)	(7)
Other	**(2)**	1	(3)
IFRS based operating profit before tax	**21**	41	40

The 2012 half year IFRS based operating profit has reduced from £41 million to £21 million largely due to the impact of the low interest rate environment. The current low level of rates, similarly reflected in the 2011 full year profit, has resulted in an increase in new business reserving strain and an increase in the cost of return of premium guarantees on certain German policies. In addition IFRS profits are impacted in 2012 by one-off costs including costs for strategic reorganisation and implementation.

Notwithstanding the challenging economic conditions the International business has maintained funds under management levels at £6.2 billion with net inflows of £0.2 billion offset by market movements in the period.

New business strain: reconciliation of new business cash strain to IFRS

£m	**2012 Half year**	2011 Half year	2011 Full year
New business cash strain	**(48)**	(52)	(89)
DAC/DFF adjustments	**81**	105	224
Other IFRS adjustments	**(57)**	(73)	(171)
IFRS new business strain	**(24)**	(20)	(36)

New business cash strain has reduced by £4 million, as a result of lower new business volumes, offset by an increase in higher strain (but higher margin) protection products with increased reserving requirements due to the effect of lower valuation interest rates, as well as an increase in acquisition expenses, due to an increased focus on new business related risk and controls.

DAC adjustments relate to the deferral of acquisition costs including initial commission and enhanced allocations. DFF adjustments relate to the deferral of set up charges on portfolio bond business. Reduced sales volumes in the period have resulted in a reduction in the level of this adjustment.

Other IFRS adjustments include the elimination of new financial reinsurance, the benefits of which are included in cash strain but are not recognised as profit under IFRS. The level of financial reinsurance in new business strain in the first half of 2012 is broadly consistent with the first half of 2011. This line also includes the elimination of positive actuarial funding and Sterling reserve impacts which have reduced because of the lower sales volumes.

The net increase in IFRS new business strain of £4 million mainly results from increased reserving due to the shift in mix to protection products, exacerbated by the impact of lower valuation interest rates and increased acquisition expenses.

In-force surplus reconciliation of in-force cash surplus to IFRS

£m	**2012 Half year**	2011 Half year	2011 Full year
In-force cash surplus	**49**	73	79
DAC/DFF adjustments	**(3)**	2	1
Other IFRS adjustments	**5**	(6)	17
IFRS in-force surplus	**51**	69	97

In-force cash surplus has reduced by £24 million compared to the same period in 2011, mainly reflecting the higher levels of financial reinsurance funding repayments in addition to the impact of lower valuation interest rates increasing the costs of guarantees. In addition in-force surplus is reduced by one-off costs relating to the strategic reorganisation and review, as set out below.

Guarantees are related to Return of Premium guarantees on the German product set. Due to changes in valuation interest rates, guarantee provisions increased by £8 million in the half year.

The DAC/DFF adjustments have increased due to the increased size of the in-force book of business.

Other IFRS adjustments include the elimination from IFRS surplus of the financial reinsurance repayments and the elimination of movements on Sterling reserves on investment business. The change in the adjustment compared to last year primarily relates to higher financial reinsurance payments in 2012.

The net decrease in in-force surplus of £18 million primarily results from lower valuation interest rates reducing the return on existing business and increasing the cost of guarantees.

International funds under management

£bn	**31 December 2011**	Inflows	Outflows	Market and other movements	**30 June 2012**
FPIL	**5.6**	0.5	(0.3)	(0.2)	**5.6**
OLAB	**0.5**	–	–	–	**0.5**
AmLife	**0.1**	–	–	–	**0.1**
International total	**6.2**	0.5	(0.3)	(0.2)	**6.2**

Funds under management as at 30 June 2012 remain at £6.2 billion. The business has generated positive net inflows of £0.2 billion but these have been offset by market falls of £0.2 billion.

Principal reserving changes and one-off items

There were no principal reserving changes and one-off items in the period. In 2011 half year principal reserving changes and one-off items were £(6) million adverse and related to a number of small adjustments principally relating to FPIL, arising from the Group's review and enhancement of the business's financial infrastructure.

Operating expenses

£m	**2012 Half year**	2011 Half year	2011 Full year
Acquisition	**17**	15	30
Maintenance	**17**	13	31
	34	28	61
Development	**4**	3	7
Total	**38**	31	68

International operating expenses, which exclude commission payments and non-recurring costs, have increased to £38 million from £31 million. Both acquisition and maintenance costs have increased largely as a result of strengthening the controls and governance infrastructure to meet the risk appetite of the business. In addition, maintenance expenses include £2 million of one-off costs related to strategic reorganisation and review with these expected to lead to expense savings in the future.

International MCEV operating profit

£m	**2012 Half year**	2011 Half year	2011 Full year
Value of new business	**18**	20	40
Expected existing business contribution	**12**	14	27
Operating experience variances	**(8)**	(1)	(7)
Operating assumption changes	**–**	(2)	(3)
Other operating variances	**–**	(13)	(20)
Development costs	**(4)**	(3)	(7)
Life and pensions covered business operating profit before tax	**18**	15	30
Other income and charges	**–**	–	(1)
Operating profit before tax	**18**	15	29

MCEV operating profit has increased from £15 million to £18 million principally reflecting the increased focus on new business profitability and the non-recurrence of adverse modelling changes from previous periods. As referred to above, despite the 22% reduction in period on period sales volumes, the reduction in VNB compares favourably, highlighting the steps taken to increase the new business profitability. The economic conditions in the first half of 2012 remain challenging, with a reduced contribution from existing business reflecting the lower expected equity and property returns. In addition, the result reflects the one-off costs related to strategic reorganisation, although this is expected to lead to operating benefits as the strategy is implemented.

Expected existing business contribution

The expected existing business contribution has decreased from £14 million to £12 million. The effect of the larger in-force book has been offset by lower rates of expected return on equity and property assets. The value of the in-force book at 31 December 2011 was £502 million compared to £473 million at 31 December 2010.

	Rates of return	
%	**2012**	2011
Reference rate	**1.35**	1.14
Best estimate returns:		
Corporate bonds	**2.98**	2.45
Equity	**5.40**	6.70
Property	**4.40**	5.70

Operating experience variances

Adverse operating experience variances of £8 million included £(4) million from the AmLife business, being a £(3) million increase in mis-selling provisions and £(1) million for negative persistency experience. Expense variances relating to one-off costs of strategy implementation amounted to £(2) million, as well as an additional small expense overrun in relation to OLAB business.

Operating assumption changes

There were no operating assumption changes in the current period. In the first half of 2011 there was an adverse operating assumption change of £2 million in respect of AmLife mortality and expenses basis review.

Other operating variances

There were no other operating variances in the current period. In the first half of 2011 there was a charge of £(13) million in respect of modelling improvements.

Lombard operating review

Lombard is the leading pan-European specialist in compliant estate and succession planning solutions for high and ultra-high net worth individuals ("HNWIs") using life assurance. Based in Luxembourg the business offers innovative solutions and superior service through a well-established distribution network of private banks and independent 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 limited levels of reinsured life cover. The business is well placed to benefit from increasing demand for fully compliant structured solutions for HNWIs that are both robust and portable.

£m	2012 Half year	2011 Half year	2011 Full year
IFRS based operating profit	**10**	21	38
MCEV operating profit	**25**	40	82
Operating free surplus generation	**(3)**	4	9

Lombard has continued to deliver strong growth in FUM in the period with balances reaching €22 billion at 30 June 2012. Despite this growth, operating performance has been impacted by a number of factors including the significant macroeconomic turbulence. Uncertainties in the tax and legal framework of several countries where Lombard operates are affecting client confidence further and are making case closure more challenging.

IFRS based operating profit of £10 million is 52% below the first half of 2011. Notwithstanding higher levels of FUM and stable business as usual expenses, profitability has been affected by one-off costs described below.

MCEV operating profit of £25 million is 38% below 2011 levels (33% on a constant currency basis) as a result of both lower VNB and the impact of lower expected returns on existing business contribution.

Operating free surplus generation is lower than in 2011 principally due to one-off expenses and the decrease in expected return from existing life business as a result of economic conditions in the second half of 2011.

Results to date reflect Lombard's profit profile, which remains materially weighted towards the latter part of the year with a largely fixed cost base. As such, extrapolation of the current period's results is unlikely to be indicative of the full year's results.

New business profitability

£m (unless otherwise stated)	2012 Half year	2011 Half year	2011 Full year
VNB	**12**	18	52
New business cash strain	**(12)**	(11)	(20)
IRR[(i)]	**14.1%**	19.0%	>25%
APE	**95**	97	237

(i) Since 2011, Lombard IRR has taken into account the Luxembourg regulatory regime in which DAC is an allowable asset.

The value of new business in the first half of 2012 is 33% below the same period in 2011 (25% below on a constant currency basis). Despite APE volumes being at a similar level to 2011, the IRR and contribution from new business has been affected by product mix.

From a broader distribution perspective, new business is being sourced to an increasing extent from private banks rather than IFAs. This has the potential to bring significantly wider market access and more stable flows of business but is likely to impact short-term margins while distribution channels mature. The proportion of new business originated from private banks in the first half of 2012 was 46% (35% in the first half of 2011).

Despite the difficult economic conditions, several markets have performed strongly with Southern Europe, UK and Belgium (private bank distribution network) generating volumes above 2011 business levels. APE is 2% down on the first half of 2011 (although 4% up on constant currency basis). Growth in these regions also highlights the strength of Lombard's geographic diversity.

APE performance by region is as follows:

APE by region (actual exchange rates, £m unless otherwise stated)	**2012 Half year**	2011 Half year	Change (%)	2011 Full year
UK and Nordic	**30**	25	17	52
Northern Europe	**14**	18	(21)	42
Southern Europe	**41**	41	1	115
Rest of world	**10**	13	(24)	28
Total including large cases	**95**	97	(2)	237
Of which: large cases (greater than €10 million)	**33**	39	(15)	83
Total excluding large cases	**62**	58	6	154

Market environment

The macroeconomic environment in Europe remains extremely fragile and has worsened recently, with the resurgence of Greek issues and wider Eurozone troubles. There are also wider signs of slowdown in most economies and this is resulting in ongoing high volatility and nervousness on the primary stock markets. Although Lombard sales are not directly sensitive to stock market performance, unsettled market conditions have a corresponding effect on client confidence.

In addition to macroeconomic instability, elections and tax reforms announced in a number of Lombard's core markets (e.g. Spain, Italy, Belgium, France) have added uncertainty. There is a lack of momentum in the market with clients and partners reluctant to take decisions. In particular, more sophisticated, entrepreneurial HNWIs prefer to wait until proposed tax changes are on the statute books before committing to new investments.

Against this challenging backdrop, and in the absence of strong external drivers to generate new business, Lombard sales volumes in the first half of the year were relatively strong and the latest statistics from the Luxembourg regulator show that Lombard's market share of Luxembourg business rose from 19% in 2011 to 24% in the first quarter of 2012.

The longer-term drivers of demand for compliant Privatbancassurance solutions remain compelling and it is anticipated that activity will improve over the second half of 2012 reflecting the natural shift in the focus of the sales force from developing leads to closing business. The second half of the year also traditionally benefits from the December fiscal year end applicable in most markets and it is anticipated that Lombard will attract a significant share of its target high and ultra-high net worth market segment in that period.

Strategy implementation

Lombard FUM have grown strongly with a compound annual growth rate greater than 20% over the last 10 years, reaching €22 billion at 30 June 2012. In order to strengthen its operations and client/ partner servicing, and to enhance competitiveness and underlying profitability, an in-depth review began in April 2012 to define Lombard's development and growth strategy with a view to significantly increasing sales and profitability over the next two to five years. This strategic review is being carried out alongside the wider Friends Life International Division review.

As a fundamental part of the company's transformation, Lombard has announced substantial investment in the business, in the form of strategic development plans. These will involve significant improvements in back-office efficiency and the introduction of system upgrades taking advantage of new technology. Ultimately, these modifications will lead to a reduction in staff numbers in some areas over 2012 and 2013. Total expenses in relation to the strategic development plans, incurred in the first half of the year, amount to £5 million.

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

An update on Lombard's strategic plans will be given as part of the Friends Life International Division strategy update before the end of 2012.

Key priorities

Whilst no significant improvements in market conditions are anticipated in the short-term, Lombard will continue to pursue a number of key sales initiatives currently underway, including the development of new products for selected core markets and the conclusion of revised strategy plans with key distribution partners. These are expected to derive maximum benefit from the natural shift to case closure in the second half of the year and the traditional increase in business towards fiscal year end. Benefits to operating profit from implementation of the strategic development plans are also expected for later in 2012 with the bulk of financial improvements being delivered over the next three years. In parallel, Lombard will continue to investigate the potential for greater market penetration and market/segment diversity with a view to maximising medium and longer-term profitability.

Financial performance

Lombard IFRS based operating profit

£m	**2012 Half year**	2011 Half year	2011 Full year
New business strain	**(18)**	(17)	(33)
In-force surplus	**28**	40	73
Investment return and other items	**–**	(1)	(1)
Development costs	**–**	(1)	(1)
IFRS based operating profit before tax	**10**	21	38

Lombard generated operating profit before tax of £10 million in the first half of 2012, 52% down on the same period in 2011. The period on period decrease is principally due to £9 million of one-off expenses as described below. Excluding these one-off items, operating profit is comparatively stable.

New business strain: reconciliation of new business cash strain to IFRS

£m	**2012 Half year**	2011 Half year	2011 Full year
New business cash strain	**(12)**	(11)	(20)
DAC/DFF adjustments	**(6)**	(6)	(13)
IFRS new business strain	**(18)**	(17)	(33)

New business cash strain is marginally higher than in 2011 despite sales volumes being at a similar level. This is the result of a reduced proportion of acquisition cost deferral on a regulatory basis but should not be extrapolated for the full year as with sales volumes expected to increase in the second part of the year, the proportion of deferred acquisition cost is also expected to increase.

In-force surplus: reconciliation of in-force cash surplus to IFRS

£m	**2012 Half year**	2011 Half year	2011 Full year
In-force cash surplus	**11**	22	41
DAC/DFF adjustments	**17**	18	32
IFRS in-force surplus	**28**	40	73

In-force cash surplus is down on 2011, affected by one-off costs and adverse exchange rate movements. Excluding these items, in-force cash surplus is stable on 2011; the higher income derived from the growing in-force book and expenses kept flat being offset by accelerated amortisation of deferred acquisition costs resulting from lapses.

Lombard funds under management

Average FUM have continued to increase in the first half of 2012. Continued positive net fund inflows over the last two years have driven this growth with FUM growing from £17.4 billion (€20.9 billion) at the end of 2011 to £17.8 billion (€22.0 billion) at 30 June 2012.

	€bn	**£bn**
31 December 2011	**20.9**	**17.4**
Inflows	1.2	0.9
Outflows	(0.7)	(0.6)
Net investment return	0.6	0.6
Foreign exchange	–	(0.5)
30 June 2012	**22.0**	**17.8**

Operating expenses

£m	**2012 Half year**	2011 Half year	2011 Full year
Acquisition	**20**	20	42
Maintenance	**21**	12	25
	41	32	67
Development	**–**	1	1
Total	**41**	33	68

The operating expenses set out above exclude both commission payments and non-recurring costs.

Included in maintenance expenses are £6 million in relation to Lombard incentive costs of which £4 million are one-off. Costs related to the strategic development plans, amounting to £5 million, have also been included in maintenance expenses with these included within operating experience variances in the MCEV operating result.

Lombard has retained tight control of recurring expense levels which, despite an increase in average funds under management, have remained in line with 2011 levels.

Lombard MCEV operating profit

£m	**2012 Half year**	2011 Half year	2011 Full year
Value of new business	**12**	18	52
Expected existing business contribution	**18**	21	49
Operating experience variances	**(10)**	2	(12)
Operating assumption changes	**5**	–	(4)
Other operating variances	**–**	–	(2)
Development costs	**–**	(1)	(1)
Life and pensions covered business operating profit before tax	**25**	40	82

MCEV operating profit of £25 million is below 2011, mainly driven by the lower contribution from new business, a lower expected existing business contribution due to reduced rates of return and one-off expenses in relation to the incentive scheme. The results also reflect the early impacts of the strategic development plans including the costs incurred to date of £5 million recognised in operating variances and a capitalised benefit of £5 million recognised in operating assumption changes.

Expected existing business contribution

Lower expected existing business contribution reflects the lower opening in-force book coupled with reduced economic assumptions.

	Rates of return	
%	**2012**	2011
Reference rate	**1.61**	1.40
Best estimate returns:		
Corporate bonds	**3.55**	4.46
Equity	**5.55**	6.46

Operating experience variances

Adverse operating experience variances of £(10) million include a £(2) million persistency charge relating to surrenders and a negative expense variance as a result of the incentive charge referred to above together with one-off costs of the strategic development plans of £(5) million, partly compensated by positive mortality experience.

Operating assumption changes and other operating variances

As referred to above, the operating assumptions changes of £5 million represent expected benefits from the strategic development plans. Further benefits are anticipated to be recognised by the end of 2012 as additional savings are realised.

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 costs of financing these for the period ended 30 June 2012 are presented below.

£m	Principal	Clean market value of debt[(i)]	Finance cost[(ii)] IFRS	Finance cost[(ii)] MCEV
Internal LT2 subordinated debt 2020	200	200	(9)	(9)
External LT2 subordinated debt 2021	162	178	(11)	(7)
External LT2 subordinated debt 2022	500	440	(18)	(17)
STICS 2003	210	133	(5)	(5)
STICS 2005	268	165	(6)	(6)
Total			**(49)**	**(44)**

(i) Market value is based on listed ask price, at 30 June 2012, excluding accrued interest and before tax on market valuation

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

The finance 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	MCEV Non-covered
Corporate segment	4	(35)	(9)
UK operating segment	(53)	–	–
	(49)	**(35)**	**(9)**

FLG corporate IFRS based operating result

£m	**2012 Half year**	2011 Half year	2011 Full year
Investment return and other items excluding external debt	**58**	40	91
Expected return on external debt	**(49)**	(57)	(112)
Other corporate net income/(costs)	**1**	(3)	(7)
IFRS based operating profit/(loss) before tax	**10**	(20)	(28)

The corporate result is primarily driven by the expected return on the external debt held in the Friends Life group, offset by the investment return on internal debt and other shareholder assets.

Other corporate net income of £1 million includes a £4 million benefit relating to the FLG long-term incentive scheme ("LTIP"). The LTIP credit reflects the change in the expected cost of the scheme driven by lapsed awards and changes to valuation assumptions to reflect current market conditions. This benefit is offset by £3 million in corporate overhead costs, being holding company 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.

£m	**2012 Half year**	2011 Half year	2011 Full year
Expected existing business contribution on debt	**(35)**	(21)	(46)
Other operating variances	**–**	–	19
Life and pensions covered business operating loss before tax	**(35)**	(21)	(27)
Other income and charges	**(7)**	(22)	(33)
Operating loss before tax	**(42)**	(43)	(60)

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.

The expected existing business contribution on debt amounted to £35 million in the first half of 2012 (30 June 2011: £21 million), reflecting the higher external interest payable following the raising of £500 million external LT2 debt by FLG in April 2011. This increased cost is offset by reduced interest payable to RHG following the subsequent repayment of £500 million internal LT2 debt in 2011.

The £7 million of other net charges principally reflects the £9 million interest on the remaining £200 million internal LT2 debt issued to RHG. This is partially offset by the £1 million expected return on the pension asset and £1 million corporate net income (in line with the IFRS results).

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.

£m	**2012 Half year**	2011 Half year	2011 Full year
Interest on internal LT2 subordinated debt issued by FLG	9	24	33
Financing and interest costs	(13)	(26)	(40)
Other operating items	(11)	(14)	(34)
Total	**(15)**	**(16)**	(41)

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 half year to 30 June 2012, representing 9% interest on the outstanding principal of £200 million, was £9 million.

Financing and interest costs of £13 million are analysed in the following section.

Other operating items mainly comprise fees payable to ROL of £9 million, directors fees and other corporate costs, net of external investment income, of £2 million.

Financing and interest costs

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

£m	**30 Jun 2012 carrying amount**	**2012 Half year finance cost**	30 Jun 2011 carrying amount	2011 Half year finance cost	31 Dec 2011 carrying amount	2011 Full year finance cost
Deferred consideration notes	**363**	**13**	437	16	423	30
Acquisition finance facility	**–**	**–**	–	10	–	10
Total	**363**	**13**	437	26	423	40

Deferred consideration notes of £500 million were issued in September 2010 in connection with the acquisition of the AXA UK Life Business. Repayments to date comprise scheduled repayments of £63 million in June 2011 and £60 million in May 2012 and an additional accelerated repayment of £14 million in August 2011, 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 the AXA UK Life Business; this loan was repaid in April 2011.

Cash and capital

Introduction

The Group remains committed to the optimisation of capital within the business and the return of excess capital to shareholders. The Group has established cash and capital frameworks which are used to evaluate and monitor excess cash and capital, driven by strong governance and subject to regulatory approval. The cash and capital position of the Group at 30 June 2012 remains robust with available shareholder cash ("ASC") of £619 million and an estimated FLG IGCA surplus[(i)] of £1.9 billion resulting in a coverage ratio, excluding WPICC, of 204%. At the end of 2011, the Group was on the cusp of economic capital (based on UK life companies' Pillar 2 requirements) being the biting constraint. Significant progress has been made in the first half of the year to improve the economic capital position, resulting in an estimated surplus[(i)] at the FLG level of £3.0 billion corresponding to a coverage ratio of 174% at 30 June 2012.

Capital management policies and monitoring buffers

Principles

The Group has established capital management policies ("CMPs"), which are set out in detail below. In addition to the CMPs, the Group also considers the following when managing capital:

- the maintenance of financial strength within the life operating 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;
- management of the with-profits business of the Group in accordance with agreed risk appetites and all regulatory requirements; and
- the availability of transfers from long-term business funds and dividends from entities that support the cash generation requirements of the Group.

Capital management policies

The Group's CMPs that apply at a life company level and at the Group level are set out below.

Life companies CMP:

The CMP of FLL, the principal UK life company, is to meet the higher of:

- 150% of Pillar 1 requirements, excluding with-profits insurance capital component ("WPICC")(ii) and FPIL; and
- 125% of economic capital(iii) requirements, including any Individual Capital Guidance ("ICG") and specifically excluding FPIL.

The CMPs of the other main life companies in the Group (including FPIL and Lombard) are aligned with that of FLL. The International and Lombard businesses, whilst not regulated by the FSA, are each included in the FLG IGCA surplus and the FLG economic capital surplus on an equivalent Pillar 1 or Pillar 2 basis respectively.

Group CMP:

A capital management policy also operates at FLG level, as FLG is the ultimate European Economic Area ("EEA") parent insurance undertaking. The CMP at FLG level is to meet 150% of IGCA requirements, excluding WPICC. In order to protect the CMP in the highly remote event that payment of debt costs would lead to a breach of the policy, the Group has introduced an additional requirement in respect of debt servicing costs. This new requirement is to hold excess capital, over 150%, in the form of cash or cash equivalents at FLG holding company level sufficient to pay at least the next year's gross annual FLG interest cost (currently £110 million per annum) and any repayments of principal that fall due on FLG debt in the next year. A similar requirement has also been introduced at the FLL level and is discussed below.

(i) FLG IGCA and the economic capital position of FLG and its subsidiaries (including FLL on an economic capital basis, see (iii) below) at 30 June 2012 are estimated and unaudited.

(ii) WPICC represents the difference between the surplus capital calculated on a regulatory basis and that on a realistic basis, in accordance with FSA rules, and is excluded from both capital resources and capital resources requirements under the CMP.

(iii) Economic capital is based on the individual Pillar 2 capital assessments for the UK life companies. FLL's economic capital is derived from consolidating the individual life companies' Pillar 2 capital requirements including making appropriate allowance for the diversification of risk between the companies. Pillar 2 strictly only applies at individual life company level and is the Individual Capital Assessment "ICA" determined by management including any amounts set by the FSA as Individual Capital Guidance "ICG".

Capital monitoring buffers

The Group has a robust monitoring system and in addition to the amounts held to meet its CMPs, it holds a prudence buffer in the Friends Life holding companies as well as amounts for working capital in both the holding companies and the life companies.

An additional requirement has been implemented for FLL, similar to that introduced for the Group, to ensure that additional capital is held in FLL over and above the CMP in order to cover at least one year of the FLL debt servicing costs (currently £107 million per annum). Immediately following the payment of any dividend by FLL, this amount must be held in cash or cash equivalents in its shareholder fund. This requirement provides additional protection to the FLL CMP for the potential impact of debt costs.

In light of this requirement and reflecting the Group's perception of the hardening of the overall regulatory approach, the Group has allocated resources from within working capital as specific monitoring buffers to enable all appropriate capital requirements to be met. Previously the Group assumed that the amounts carried as working capital (but not specifically allocated) were sufficient to avoid a breach of the CMPs. The monitoring buffers are as follows:

- for FLL (excluding FPIL): 20% of Pillar 1 requirements (excluding WPICC and FPIL) and 10% of economic capital requirements (including any ICG and excluding FPIL); and
- for FLG: 10% of IGCA requirements (excluding WPICC).

The monitoring buffers for FLL are designed to provide broadly similar levels of protection against the risk of breach of the CMP minimums plus debt servicing requirements. In addition to these monitoring buffers held within the life companies, £400 million of ASC is currently held as a prudence buffer in the Friends Life holding companies. This amount is sufficient to cover one year's external dividend costs, DCN debt repayments and interest and Resolution corporate costs. The requirement to hold cash at FLG level in respect of FLG debt costs is covered by the prudence buffer as the Group expects the internal loan arrangements between FLG and FLL to provide sufficient funding to meet FLG's debt servicing requirements.

Consideration of return of capital

IGCA is currently the biting solvency constraint for the Group, with the FLG economic capital surplus, net of CMP and working capital, approximately £0.3 billion stronger than the equivalent IGCA surplus. This reflects actions taken in the first half of 2012 to improve the economic capital position of FLL (excluding FPIL), including:

- enhanced economic capital modelling capabilities resulting in the identification and release of unintended prudence margins at the life company level;
- implementation of equity hedges within certain with-profits funds;
- selective derisking of corporate bond portfolios backing shareholder business; and
- improved UK financial systems and controls resulting in a release of operational risk capital.

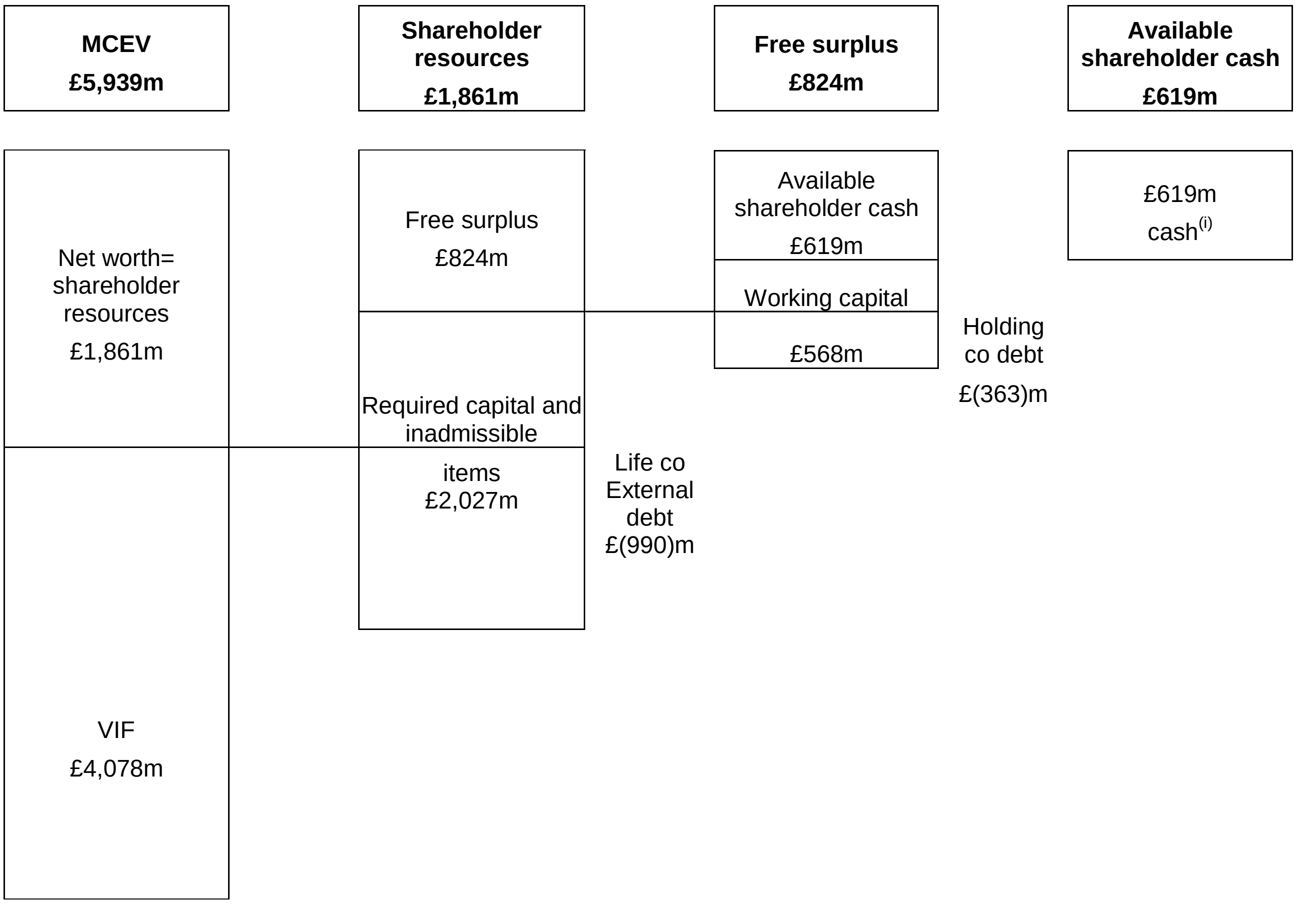
The Group continues to take actions to optimise the capital position of the Group. However, the current weak and uncertain economic environment, which the Group believes has worsened since December, remains a concern. The Group believes that the economic uncertainty has the potential to materially increase investment volatility and corporate bond spreads. Whilst the Group has a highly rated corporate bond portfolio, with minimal direct exposure to higher risk sovereign debt, an increase in corporate bond spreads would have a material impact on the capital position. For example, a 200 bps widening in corporate bond spreads would reduce FLG's IGCA surplus by £0.4 billion but would reduce the FLL economic capital surplus (excluding FPIL), above CMP, by approximately £1.0 billion as at 30 June 2012. The impact of the sensitivity assumes that one-third of the widening in spreads is in respect of defaults, with the remainder representing a movement in the illiquidity premium. This demonstrates the potential for the biting constraint on capital to change in stress scenarios and the fact that, despite significant progress in improving the Group's economic capital position, the uncertain economic environment continues to be a key factor in the Group's capital management activities and underpins the Group's decision to cancel the second £250 million return of capital to shareholders.

In addition to the economic environment, the decision not to return capital reflects the ongoing working capital assessment including the establishment of monitoring buffers designed to take account of requirements emerging from a perceived hardening of the regulatory environment and to facilitate compliance with the Group's CMPs. However, despite the continuing economic and regulatory uncertainty, in the light of the Group's robust capital position and current cash flow assessments, the Board has increased the interim dividend by 5%.

Looking forward, the Group believes there is heightened uncertainty around the future requirements of Solvency II both as regards its structure and timing of implementation. The implementation date for Solvency II has been delayed to 1 January 2014 and the Group expects that it will be delayed further. The capital requirements of the regime for UK life businesses have increased as the framework has developed and the outcome in some of the remaining areas of debate could materially impact the Group's future capital requirements. Hence prudence is required in assessing likely future capital requirements.

Cash and capital management framework

The Group's cash and capital 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 30 June 2012, reconcile to ASC.



(i) Incorporating requirement for FLG to hold one year's debt servicing costs in cash

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 most onerous CMP for the Group, currently the IGCA. For Resolution and Friends Life holding companies and other non-regulated businesses, 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 £355 million, LT2 subordinated debt 2021 of £175 million and LT2 subordinated debt 2022 of £460 million (debt values include accrued interest and the tax impact of any market valuation). DCNs of £363 million issued by Resolution Limited to AXA UK as part of the acquisition of the AXA UK Life Business are offset against free surplus.

The following table outlines the key movements in each of the components of total MCEV during the period:

	Shareholder resources			
£m	Value in-force	Required capital	Free surplus	Total MCEV
Opening MCEV at 1 January 2012	3,844	1,023	929	5,796
FLG operating result	63	4	120	187
FLG non-operating result	185	15	(76)	124
FLG result after tax	248	19	44	311
RSL result after tax	–	–	(15)	(15)
Capital and dividend flows	(14)	(5)	(134)	(153)
Closing MCEV at 30 June 2012	**4,078**	**1,037**	**824**	**5,939**

The closing free surplus balance of £824 million comprises £619 million of ASC and £568 million of amounts designated as working capital, offset by the DCNs liability of £363 million. ASC consists of cash held by the Friends Life and Resolution holding companies, together with any dividends declared and approved by the operating companies that are yet to be remitted. As such, ASC is stated after the deduction of regulatory and other restrictions on the availability of cash resources. Working capital represents assets set aside to cover known future requirements and amounts necessary to maintain sufficient flexibility to facilitate compliance with the Group capital policy and additional regulatory requirements. In addition, any assets subject to restriction in their availability to shareholders will be designated as working capital.

ASC represents cash available to cover Resolution's corporate costs, to service debt issued by Resolution holding companies and, subject to shareholder approval, to pay dividends or return to shareholders. The generation of ASC therefore represents a key performance metric of the Group, and accordingly the significant components and drivers of ASC for the first half of 2012 are detailed in the following sections.

a) Free surplus - £824 million

The generation of free surplus, net of movements in required capital, underpins the declaration of future dividends. The table below analyses the free surplus result after tax for the year.

£m	**2012 Half year**	2011 Half year	2011 Full year
Opening free surplus	**929**	728	728
Expected return from in-force business, net of finance costs	**313**	330	662
Add back coupon on FLG external debt(i)	**35**	24	58
Investment in new business	**(157)**	(185)	(325)
Underlying free surplus generation	**191**	169	395
Development costs and operating experience variances	**(43)**	4	(51)
Deduct coupon on FLG external debt	**(35)**	(24)	(58)
Operating assumption changes	**–**	(1)	204
Other operating variances(ii)	**16**	158	242
Other income and charges	**(9)**	(23)	(35)
FLG operating free surplus generated in the period	**120**	283	697
Economic variances and non-operating items	**(76)**	(63)	(243)
FLG free surplus generated in the period	**44**	220	454
RSL income and charges	**(15)**	(16)	(41)
Total free surplus generated in the period	**29**	204	413
Net capital and dividend flows	**(134)**	173	(212)
Closing free surplus	**824**	1,105	929
Comprised of:			
Covered business free surplus	**566**	560	821
IFRS net assets of non-covered business	**518**	819	384
Required capital and inadmissible assets of non-covered business	**(260)**	(274)	(276)
Total free surplus	**824**	1,105	929

(i) The expected return from in-force business is shown net of the expected return on FLG external LT2 subordinated debt. In order to provide greater clarity on the impact of debt on free surplus generation, the coupon on this debt of £35 million has been added back to underlying free surplus generation in the analysis above.

(ii) The 2011 other operating variances included a £161 million benefit arising from the implementation of certain elements of PS06/14.

Total free surplus of the Group amounts to £824 million at 30 June 2012, reduced from £929 million at the end of 2011. This movement reflects the free surplus generated in the period of £29 million offset by net capital and dividend flows of £(134) million, described below.

Operating free surplus generation

FLG operating free surplus generated in the period was £120 million (30 June 2011: £283 million). The reduction of £163 million compared to the prior year is principally the result of the implementation of certain aspects of PS06/14 in 2011, which accelerated the recognition of £161 million of free surplus in that year.

The key driver of the free surplus generation is the expected return from in-force business net of the investment in new business ("underlying free surplus generation"). This has contributed £191 million of free surplus generation in the period (30 June 2011: £169 million) reflecting the progress made in the UK business to reduce new business cash strain (discussed further below), partially offset by the reduced contribution from the in-force book as a result of lower expected rates of return in a challenging economic environment. The improved underlying free surplus result has been broadly offset by the net adverse impact of operating experience and other operating items which include a £(9) million free surplus impact of the increase in development costs, and £(9) million of one-off project costs, including set-up costs for FLI and costs of the International and Lombard strategic reviews.

Economic variances and non-operating items

In the period to 30 June 2012, economic variances and non-operating items reduced free surplus generation by £76 million, principally driven by non-recurring costs of £(103) million. The impact of economic variances on free surplus has been £6 million positive in the period, with other net positive non-operating items of £21 million principally reflecting the free surplus impact of management actions taken to reduce capital requirements in the life companies.

The positive MCEV non-operating result after tax of £124 million reflects the free surplus impacts described above, together with the positive economic variances on the VIF and required capital components as a result of narrowing corporate bond spreads in the period, marginally better than expected equity performance and lower inflation assumptions.

Net capital and dividend flows

The net capital and dividend outflows in the period to 30 June 2012 of £(134) million comprise £(150) million of external cash dividends, a £7 million inflow in respect of the reduction in the number of Company shares held by subsidiaries (where the disposal increases the equity of the Company) and £9 million net positive impact of other reserve movements, primarily actuarial gains on the Group pension scheme.

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	(157)	44	(7)	(120)
In-force surplus(i)	348	(47)	(75)	226
	191	**(3)**	**(82)**	**106**

(i) Movement in required capital for in-force surplus is shown before the impact of the £35 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	(98)	38	(60)
International	(47)	(1)	(48)
Lombard	(12)	–	(12)
Total strain	**(157)**	**37**	**(120)**
In-force surplus			
UK	269	(103)	166
International	65	(16)	49
Lombard	14	(3)	11
Total surplus	**348**	**(122)**	**226**
Net strain/surplus	**191**	**(85)**	**106**

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 against a full year baseline of £392 million, of which the UK accounted for £303 million. The UK new business cash strain of £60 million in the period represents an annualised reduction of £183 million compared to this baseline, equivalent to 92% of the £200 million target. The remaining gap in achieving this targeted reduction is expected to be achieved through the continued migration of new business to target platforms and synergy delivery as set out in the UK operating section. International and Lombard have not been set specific targets for reductions in new business strain, but are targeted to deliver annual dividends of £30 million by the end of 2014 for Lombard and £20 million by the end of 2013 for International.

Segmental analysis of sustainable free surplus generation

The Company has set a distributable cash target of £400 million per annum at Friends Life group level, 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.

As discussed above, the Group expects to reduce UK 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 that in the future, the £400 million DCT will be met predominantly from operational cash flows and related releases of required capital. However, under current economic conditions, it is expected to be particularly challenging for this target to be met from sustainable sources in the short term.

To demonstrate the progress in delivery of the DCT, the Group reports a "sustainable free surplus" measure so as to provide a baseline for measuring the growth of operational cash flows towards the Group's targets. As dividends from the life operating companies are normally only expected to be declared on an annual basis following the completion and approval of actuarial valuations, sustainable free surplus provides an indication of the Friends Life group DCT contribution by showing the movements in free surplus which would be expected to be available to fund future dividends. Sustainable free surplus reflects the FLG operating free surplus generation metric, adjusted so as to remove the impact of operating assumption changes and any other items considered to be one-off in nature.

A segmental analysis of sustainable free surplus generation for the period is provided below together with a reconciliation to FLG operating free surplus generation:

Half year ended 30 June 2012 (£m)	**UK**	**Int'l**	**Lombard**	**Corporate**	**30 Jun 2012 FLG Total**	30 Jun 2011 FLG Total	31 Dec 2011 FLG Total
Expected return from in-force business net of finance costs	269	65	14	(35)	**313**	330	662
Add back coupon on FLG external debt	–	–	–	35	**35**	24	58
Investment in new business	(98)	(47)	(12)	–	**(157)**	(185)	(325)
Underlying free surplus generation	171	18	2	–	**191**	169	395
Development costs and operating experience variances	(27)	(11)	(5)	–	**(43)**	4	(51)
Deduct coupon on external debt	–	–	–	(35)	**(35)**	(24)	(58)
Other operating items[(i)]	16	–	–	(9)	**7**	(27)	46
Deduct GOF/TIP result	–	–	–	–	**–**	–	(41)
Sustainable free surplus generation	**160**	**7**	**(3)**	**(44)**	**120**	122	291
Impact of PS06/14	–	–	–	–	–	161	161
Add back GOF/TIP result	–	–	–	–	–	–	41
Operating assumption changes	–	–	–	–	–	–	204
Operating free surplus generation	**160**	**7**	**(3)**	**(44)**	**120**	283	697

(i) Excluding PS06/14 impact in 2011.

Sustainable free surplus generated of £120 million (30 June 2011: £122 million) has decreased by £2 million compared to the prior period, principally as a result of improvements in new business strain being more than offset by the impact of lower expected economic rates of return, higher development costs and one-off strategic costs. WLUK contributed £14 million to sustainable free surplus in the period, but this is offset by the non-recurrence of £14 million of sustainable free surplus included in the half year 2011 result for the GOF and TIP businesses that were disposed of in the second half of 2011.

b) Working capital and other assets and liabilities

The £824 million of free surplus at 30 June 2012 comprises £619 million of available shareholder cash and £568 million of working capital, net of the DCNs of £363 million.

Working capital is held to cover monitoring buffers and known future requirements or illiquid assets.

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

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

£m	Working capital (gross)	RSL holding company debt	Net working capital
Opening position at 1 January 2012	499	(423)	76
Friends Life group free surplus generated in the period	44	–	44
FLG debt cost timing difference	19	–	19
Movement in RSL working capital	28	–	28
Reserve movements and other items	21	–	21
DCN repayment	–	60	60
Transfer from ASC	57	–	57
Dividend from FLL	(100)	–	(100)
Group closing position at 30 June 2012	**568**	**(363)**	**205**

The free surplus generated in the life companies is recognised in working capital until it is declared as dividends, consequently the Friends Life group free surplus generated in the period of £44 million has increased working capital. Friends Life holding company operating cash flows are generally funded by the life companies; however, timing differences of £19 million relating to debt costs have taken place in the period. These reflect the excess of finance costs borne by the life companies (which reduces free surplus) over the related movement in ASC, leading to an increase in working capital. The movement in Resolution holding companies working capital reflects the disposal of Company shares held by subsidiaries (which were previously a £7 million deduction to RSL net assets) and the difference between finance and corporate costs incurred in the period and cash payments in respect of these costs. This difference primarily reflects the payment in May of a full year's interest on the DCNs as well as the settlement of expenses relating to the previous year. Reserve movements and other items of £21 million comprise reserve movements of £12 million and the elimination of the £9 million internal loan interest paid by FLG to to the Company. The reserve movements include the impact of share based payment transactions and the actuarial gain on the FLG pension scheme. The elimination of the internal loan interest (which is not a movement in RSL working capital as it was due and paid in the period) is offset by the interest cost included in the FLG free surplus result of £44 million.

As described previously, the Group has performed a full assessment of its working capital requirements in response to a perceived hardening of the regulatory environment with regard to the retention of capital in the UK Life industry and continued uncertainty in the economic environment. This has identified the amounts of working capital required to be held in respect of the following items:

- the necessary funding to protect against any temporary shortfall in delivery of cash generation relative to Group targets;
- the amounts required to meet current estimates of future non-recurring costs, offset by related benefits that are expected in the short-term; and
- an appropriate monitoring buffer to facilitate ongoing compliance with the Group's Capital Management Policies and funding of debt servicing costs.

As a result of these considerations and in order to ensure a robust capital position is held in respect of each of the requirements, it has been deemed appropriate to transfer £57 million from ASC to working capital during the period.

Finally, a dividend of £100 million has been proposed by FLL, and accordingly this represents a transfer out of working capital and into ASC during the period.

Components of working capital

As indicated above, the working capital requirements of the Group have been updated during the period, and the key components of the balance as at 30 June 2012 are set out in the table below.

£m	**2012 Half year**	2011 Half year	2011 Full year
Restricted assets	**103**	174	26
Cash generation smoothing	**213**	n/a	n/a
Amounts retained to support separation, integration and service company costs, net of related benefits	**70**	140	233
Monitoring buffer over capital management policy	**182**	n/a	n/a
Life company amounts retained for flexibility	**–**	385	265
Other operating businesses working capital	**–**	50	(25)
Total working capital (gross of debt)	**568**	749	499

Restricted assets comprise amounts relating to shareholder support of the FLC With Profits Fund and certain intangible assets.

Friends Life group has retained working capital to the extent expected short term cash flows fall below the expected contribution to DCT. In light of the current economic environment, the working capital being held to cover this shortfall is based on delivering the current £350 million annual cash dividends expected to be paid by FLG to the Resolution holding companies and which funds Resolution's dividends to shareholders, debt servicing and other corporate costs. Friends Life group also retains working capital in respect of the contribution to the 2012 final dividend in the first half of the year. These amounts are included in the £213 million of working capital retained for cash generation smoothing.

The monitoring buffer held as at 30 June 2012 of £182 million is calculated as 10% of the FLG IGCA capital requirements, Pillar 1 being the relevant biting constraint for the Group's CMPs at that date.

Working capital held by other operating businesses comprises the current assets and liabilities of the Group's non-life businesses, net nil as at 30 June 2012.

c) Available shareholder cash – £619 million

Available shareholder cash comprises £514 million of shareholder cash at Friends Life holding company level (including £100 million of dividends proposed by FLL), together with £105 million held by Resolution holding companies.

30 June 2012 (£m)	
Friends Life holding companies cash	414
Proposed dividend from FLL	100
Friends Life available shareholder cash	514
Resolution holding companies cash	105
Group available shareholder cash	**619**

The movements in ASC are summarised below:

£m	
1 January 2012	853
Net transfer from working capital (DCT contribution)	43
2011 final dividend	(150)
DCN repayment	(60)
DCN interest costs	(28)
FLG debt cost timing difference	(19)
Corporate costs and other items	(20)
30 June 2012	**619**

Performance against the DCT is reviewed annually at year end following the completion of actuarial valuations and declaration of full year dividends by life companies and FLG. The contribution to the DCT in the period was £43 million, comprising the net cash transferred from working capital to ASC, being the £100 million dividend from FLL partially offset by the £57 million transfer from ASC to meet strengthened working capital requirements. The operating free surplus generated in the period and retained in working capital to fund the final 2012 dividend is not included in the contribution to DCT for the period.

The FLG debt cost timing difference represents the excess of the FLG external debt interest payments made by the FLG holding companies in the period over the internal interest cash receipts received from the life companies as at 30 June 2012. These amounts will be settled by the life companies during the second half of the year.

Corporate costs and other items include £(17) million of Resolution holding companies operating cash flows, and net £(3) million of FLG holding companies cash flows, comprising £(4) million for the purchase of Company shares used to settle vesting awards under the Lombard equity based compensation scheme and £(1) million of credit facility fees, partially offset by £2 million of deposit interest income.

Components of available shareholder cash

The following table outlines the key components of ASC by reference to the expected utilisation of the cash balances:

£m	**30 June 2012**	30 June 2011	31 December 2011
Settlement of final dividend	**–**	–	185
Settlement of interim dividend	**98**	92	–
Prudence buffer in accordance with Group policy	**400**	400	400
Non-specified ASC holdings	**121**	301	268
Available shareholder cash	**619**	793	853

The ASC balance as at 30 June 2012 is held to cover the costs of the 2012 interim dividend and to maintain a prudence buffer, within FLG ASC, of £400 million to cover an additional year of the Company's dividend cost, DCN repayments and interest and Resolution holding companies corporate costs. This prudence buffer will also cover the Group CMP requirement to hold cash at FLG sufficient to meet one year of FLG's debt servicing costs. As this is expected to be met from capital retained in the life companies, this is not considered to be a restriction on the availability of FLG cash.

As at 30 June 2012, there is ASC of £121 million (2011: £268 million) not allocated for scheduled payments and in excess of the Group prudence buffer. The Board does not consider it prudent to return this cash to shareholders given the current volatile economic conditions to which the Group is exposed on an economic capital basis, and the current uncertainty around the impact of regulatory developments.

Solvency II

The implications of Solvency II and preparations for the application of its requirements remain a key focus for the Group. The Group is monitoring the ongoing debate in Europe in respect of the regulations. Given that agreement on some substantial points, including the treatment of long term guarantees and third country equivalence, has yet to be achieved the Group's view is that the currently proposed implementation date for the Directive of 1 January 2014 is unlikely to be achievable. In line with this it has concluded that it is in the Group's best interests to delay its internal model application to allow time for any further changes in the Solvency II implementation timetable and to help smooth the Group's overall change agenda. Accordingly FLG has withdrawn from FSA's internal model pre-application process and is now targeting obtaining internal model approval in January 2015.

FLG's Solvency II programme has made substantial progress and the Group will continue to finalise its internal model and to engage with the FSA on its preparations. The longer timetable and reduced focus on the FSA application process is enabling the Group to reduce its reliance on external resource, thereby saving cost, and prioritise obtaining the business benefits of embedding the risk management culture and economic capital management ethos that underpin Solvency II. If the Directive is implemented in 2014, FLG will be ready to comply with its requirements through the use of the Standard Formula. Use of the Standard Formula, pending obtaining internal model approval is not expected to lead to any significant disadvantage in terms of capital requirements.

The impact of Solvency II on the Group's capital requirements remains unclear. In particular the ongoing debate around the treatment of long term guarantees (which includes the currently proposed provision for 'matching adjustment') has the potential to materially impact future capital requirements. Elements of the proposed Directive, particularly the requirement to hold a risk margin as part of the liabilities, mean that, absent management actions, Solvency II in the Group's view is likely to be more onerous for UK firms than current Pillar 2 capital requirements. The position in comparison to Pillar 1 capital requirements (the biting constraint at the half year) is less clear and whilst there is significant scope for management actions to optimise FLG's capital position on a Solvency II basis, the full extent of the net impact has yet to be fully determined due to the continued uncertainty around the Directive requirements.

Economic capital position

Under FSA rules, the UK life operations are required to perform a risk-based assessment of economic capital, incorporating management's estimate of the capital required to mitigate the risk of insolvency to a minimum of a 99.5% confidence level over a one year period ("the ICA"). At individual life company level, this is referred to as the Pillar 2 basis of capital management.

The Group's CMP is to maintain capital resources at the life company level to cover 125% of the capital requirements on an economic capital basis. This is based on the Pillar 2 position of individual life companies, and for FLL is the consolidated position (excluding FPIL) with appropriate allowance for the diversification of risk between individual companies.

The Group also monitors a pro forma economic capital position at the FLG level, which comprises:

- the surplus of FLL, excluding FPIL, on an economic capital basis;
- the surpluses of the International life companies on an economic capital basis;
- the fungible net assets of the other operating and holding companies.

As noted in the "Capital management policies and monitoring buffers" section above, a number of actions have been taken in the period to improve the FLL economic capital position, and as a result, the estimated FLG economic capital surplus as at 30 June 2012 is robust at £3.0 billion (a coverage ratio of 174%).

Group capital resources were estimated to be £2.0 billion in excess of the amount required to satisfy the Group's economic capital CMP. This £2.0 billion includes the £0.4 billion prudence buffer, £0.8 billion of working capital (representing the 10% monitoring buffer on an economic capital basis for the UK life companies, together with amounts required to fund anticipated future non-recurring costs and the necessary funding to ensure future cash generation targets are met), £0.1 billion funding for the 2012 interim dividend and £0.4 billion of restricted assets (representing the equivalent economic capital surplus of the International businesses as these entities are not subject to the UK Pillar 2 regime). The remaining £0.3 billion represents capital surplus to restrictions, working capital requirements and Group CMPs on an economic capital basis.

The economic capital surplus of FLL (excluding FPIL), above CMP, would reduce by an estimated £0.4 billion in the event of a 40% fall in equity markets, with 21% of economic capital capital resource requirements, post-diversification, being allocated to this risk. The FLL economic capital surplus (above CMP) is relatively insensitive to interest rates; a 200bps fall in interest rates across the yield curve being estimated to reduce surplus by £0.1 billion and 9% of post-diversification capital resource requirements allocated to this risk. However, economic capital surplus (above CMP) is more sensitive to corporate bond spreads. A 200bps widening of corporate bond spreads would lead to an estimated £1.0 billion decrease in economic capital surplus, for which 31% of post-diversification risk capital resources requirements are allocated. The impact of the sensitivity assumes that one-third of the widening in spreads is in respect of defaults, with the remainder representing a movement in the illiquidity premium, that is an offset against the fall in asset values when valuing annuity liabilities. The majority of the Group's corporate bond portfolio is backing non-profit liabilities and shareholder funds, and over 80% of the sensitivity derives from these assets.

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 or liabilities 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 remains strong at the Friends Life group level, with an estimated IGCA surplus of £1.9 billion at 30 June 2012, with Group capital resources being 204% of Group CRR (excluding WPICC of £2.9 billion).

Group capital resources were £1.0 billion in excess of the amount required to satisfy the Friends Life group CMP. The components of this £1.0 billion surplus comprise the £0.4 billion prudence buffer, £0.5 billion of working capital (reflecting the £0.6 billion of working capital as per the cash framework, less the £0.1 billion of restricted assets that are already excluded when calculating the FLG IGCA surplus) and £0.1 billion to be paid from FLG to RSL to fund the 2012 interim dividend.

The IGCA surplus would reduce by around £0.2 billion for a 40% fall in equity markets or if interest rates were to fall by 200bps across the yield curve from 30 June 2012 levels. The IGCA surplus would reduce by approximately £0.4 billion if corporate bond spreads were to rise by 200bps.

The movement in IGCA surplus over the period largely reflects the £250 million dividend paid to Resolution holding companies. The surplus emerging includes £289 million of in force surplus (net of £7 million of interest costs on the internal LT2 debt with RHG) partially offset by £141 million of new business strain, positive economic variances of £11 million and adverse other non-operating items of £129 million (mainly non-recurring costs).

Finance costs and other movements comprises £35 million of interest costs on the external LT2 subordinated debt and STICS, partially offset by positive other reserve movements of £7 million.

Movement in IGCA surplus	**£m**
1 January 2012	**2,139**
Surplus emerging	**30**
Dividend to RSL	**(250)**
Finance costs and other movements	**(28)**
30 June 2012	**1,891**

At 30 June 2012 the capital held to meet FLG CMPs was £912 million (1 January 2012: £902 million) and the excess over the CMPs was £979 million (1 January 2012: £1,237 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. The IGCA surplus excludes £400 million of UK with-profits funds surpluses.

Management of the with-profits funds

Friends Life manages six with-profit funds, with the five significant funds shown below. Asset allocation within these with-profits funds is actively managed with the proportion of equities and property backing assets shares (equity backing ratio or "EBR") managed to the target levels shown below:

%	Target EBR level	2012 Half year	2011 Full year
Friends Life Limited (pre-demutualisation business)	**45**	**46**	48
Friends Life Limited (post-demutualisation business)	**55**	**56**	53
Friends Life Company Limited	**60**	**61**	66
Friends Life Assurance Society Limited	**50**	**50**	52
Friends Life WL Limited	**50**	**48**	48

These apply to the funds as a whole, although sub-funds within these may have different allocations.

The allocation for assets backing guarantees and options within the with-profit funds comprises a range of assets including gilts, bonds and hedging derivatives (equity put and call options, sold equity futures, interest rate swaps and swaptions). These apply to the funds as a whole and within companies individual policies may have different allocations.

Non-profit business in the with-profits funds, 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).

Asset quality and exposure

The Group's financial assets as at 30 June 2012, excluding cash, are summarised as follows:

£bn	Unit-linked	With-profit	Non-profit	Shareholder	30 June 2012 Total	31 December 2011 Total
Shares, unit trusts and OEICs	53.3	6.3	0.1	–	**59.7**	60.6
Government securities	8.0	8.7	2.3	0.1	**19.1**	19.5
Corporate bonds and asset-backed securities	5.9	8.9	7.5	0.3	**22.6**	22.2
Derivatives	–	1.0	0.1	–	**1.1**	0.9
Deposits	0.4	–	–	–	**0.4**	0.4
Total 30 June 2012	**67.6**	**24.9**	**10.0**	**0.4**	**102.9**	–
Total 31 December 2011	68.0	25.4	9.6	0.6	–	103.6

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	30 Jun 2012 Total	31 Dec 2011 Total
Corporate bonds and asset-backed securities	5.9	8.9	7.5	0.3	**22.6**	22.2
less: policyholder exposure	5.9	7.8	–	–	**13.7**	13.6
Shareholder exposure	–	1.1	7.5	0.3	**8.9**	8.6
AAA	–	0.2	1.0	–	**1.2**	1.1
AA	–	0.1	2.7	0.1	**2.9**	3.0
A	–	0.4	2.7	0.1	**3.2**	3.0
BBB	–	0.3	0.9	0.1	**1.3**	1.3
Sub-BBB or rating not available	–	0.1	0.2	–	**0.3**	0.2
% Investment Grade					**97.2%**	96.9%

Over 97% 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.

No defaults have been experienced in the period to 30 June 2012. 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 30 June 2012 was £0.6 billion (31 December 2011: £0.6 billion). This represents a haircut of 36% of the overall corporate bond spreads over gilts of equivalent term (31 December 2011: 35%).

The vast majority of the Group's exposure to sovereign debt holdings is to UK gilts. The Group has £7 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 2011: £6 million).

In addition the Group's shareholder exposure to various corporate securities issued by companies domiciled in Spain, Portugal, Italy, and Ireland is £365 million (31 December 2011: £370 million). The Group's shareholder exposure to Greek corporate securities is less than £1 million. Some 65% 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, 37% 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.

Sovereign and corporate exposure to these countries is shown here with further detail provided in note 7 of the IFRS financial statements:

£m	Total	Spain	Portugal	Italy	Ireland	Greece
Sovereign debt	**7**	–	–	7	–	–
Corporate exposure	**365**	168	8	152	37	–
Total 30 June 2012	**372**	168	8	159	37	–
Total 31 December 2011	376	167	10	160	39	–

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	14	113	13	15	–	5	160
	AA	31	67	–	5	–	51	154
	A	197	1	283	2	19	27	529
	BBB	1	–	–	–	–	–	1
	Below BBB/NR	1	3	–	–	–	–	4
	Senior Total	**244**	**184**	**296**	**22**	**19**	**83**	**848**
Secured	AAA	321	–	–	35	32	7	395
	AA	7	2	–	–	–	–	9
	A	5	–	11	–	–	–	16
	BBB	1	–	12	–	–	–	13
	Below BBB/NR	–	–	–	–	–	3	3
	Secured Total	**334**	**2**	**23**	**35**	**32**	**10**	**436**
Subordinated	AA	–	9	–	–	–	18	27
	A	162	21	27	17	–	23	250
	BBB	222	–	35	14	44	66	381
	Below BBB/NR	66	16	–	–	9	10	101
	Subordinated Total	**450**	**46**	**62**	**31**	**53**	**117**	**759**
Cash	**Cash Total**	**809**	**310**	**749**	**263**	**39**	**251**	**2,421**
Grand Total		**1,837**	**542**	**1,130**	**351**	**143**	**461**	**4,464**

(i) Portugal, Ireland, Italy, Greece, Spain
(ii) Holding in supranational banks totalling £497 million (31 December 2011: £495 million) have been excluded from the above analysis.
(iii) The disclosure above excludes a £1.8 billion collateralised HSBC Amortising Note set up as part of an annuity reinsurance transaction which took effect 1 January 2007.

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.

Dividend policy

The Company's dividend policy remains unchanged and 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. The Board has declared an increase in the dividend of 5% such that the interim dividend will be 7.05 pence per share. The full year dividend guidance is similarly for an increase of 5% which would equate to 14.09 pence per share, subject to shareholder approval. The increase in dividend reflects the Board's confidence in the operational cash generation and robust capital position of the Group.

The Company envisages moving to a progressive dividend and will consider doing so when sustainable cash generation meets its £400 million per annum distributable cash target.

Principal risks and uncertainties

The Group actively manages its risk profile and the Group's risk appetite framework drives the identification and mitigation of strategic, financial and operational risks to support the achievement of its objectives. The principal risks and uncertainties to which the Group has been exposed during the first six months of 2012 are unchanged from those described in the 2011 Annual Report and Accounts; that is:

- economic conditions;
- integration and restructuring;
- completion of the UK Life Project;
- regulatory change and compliance;
- changes in taxation law;
- mortality and other assumption uncertainties;
- FLG reliance on outsourcing; and
- reliance on Resolution Operations LLP.

All of these remain relevant and applicable for the remainder of 2012.

Economic conditions remain volatile and uncertain and this is expected to continue in coming months given there appears no immediate solution to the Eurozone's financial instability issues and the UK economy continues to be depressed. Whilst the Group actively manages its exposure to market risk, its performance remains sensitive to factors such as the level of equity markets, interest rates and credit spreads which impact the investment return earned by the group and the valuation of its liabilities.

Economic uncertainty also acts to depress demand for the Group's products. Eurozone instability is expected to continue to reduce the total market for the investment products offered by the Group's international businesses. In the UK the position going forward is more difficult to predict as the impact of adverse economic conditions is going to be combined with the impending effects of regulatory changes such as auto-enrolment in work based pensions and the prohibition of payment of commission to advisers under the Retail Distribution Review. Auto-enrolment is expected to increase the corporate pensions market and so offers significant opportunities to the group whereas prospects for growth in the protection market remain modest.

Overall the Group's integration and restructuring work is continuing to plan, but this taken with the regulatory change agenda faced by UK life insurers means that the Group is facing a challenging change agenda and this is expected to continue into 2013. The Group has strong project management disciplines to mitigate the risks to delivery, in particular to monitor delivery relative to plan and budget, to identify and manage interdependencies between projects and to escalate any delivery issues. However there remain operational risks to the delivery of the change agenda to the expected timetable and budget.

Proposals for Solvency II continue to be the subject of debate and whilst the Directive is proposed for implementation from 1 January 2014, however, in the Group's view, this date is unlikely to be achievable. The Group is monitoring developments closely but while key legislative requirements remain to be agreed it is difficult to assess the capital implications for the Group and the scope for optimising the Solvency II capital position.

While the reliance of Friends Life group on outsource service providers is unchanged, the transitional risks associated with commencement of service delivery in March of the outsourcing arrangements agreed with Diligenta in 2011 have reduced. Processes for managing this new outsourcing contract are embedding and it is expected that working relationships will continue to mature over the coming months.

The strategic decision by the Group to simplify its governance arrangements and move to a conventional governance structure reduces the regulatory risk associated with proposed changes to the listing rules but poses transitional operational risks. In particular, ending the Operating Agreement between the Company and ROL will increase the risk of the loss of access to the skills and expertise that has been provided by ROL. Pending the conclusion of negotiations with ROL and implementation of the Group's proposed new governance arrangements there will be a risk that key staff within ROL do not transfer to the Group.

Going concern and Directors' responsibility statement

Going concern

Notwithstanding the Company's incorporation in Guernsey, the Directors have undertaken a going concern assessment in accordance with "Going Concern and Liquidity Risk: Guidance for UK directors of UK Companies 2009", published by the Financial Reporting Council in October 2009. As a result of this assessment, the Directors are satisfied that the Group and the Company have adequate resources to continue to operate as a going concern for the foreseeable future and have prepared the financial statements on that basis. In assessing whether the going concern basis is appropriate, the Directors have considered the information contained in the financial statements, the latest business plan profit forecasts, the latest working capital forecasts and estimated forecast solvency of the regulated subsidiaries of the Group. These forecasts have been subject to sensitivity tests and the Directors are satisfied that the Group and Company have adequate resources to continue in operational existence for the foreseeable future. Key information in respect of the Group's business activities, financial performance (including cash generation and financial strength) and risks is set out on pages 14 to 62.

Directors' responsibilities

Each of the Directors of the Company confirms that to the best of their knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34: *Interim financial reporting* as adopted by the European Union;
- the interim results statement includes a fair review of the information required by Disclosure and Transparency Rule 4.2.7, namely important events that have occurred during the period and their impact on the condensed set of financial statements, as well as a description of the principal risks and uncertainties faced by the Company and the undertakings included in the condensed consolidated financial statements taken as a whole for the remaining six months of the financial year; and
- the interim results statement includes a fair review of material related party transactions and any material changes in the related party transactions described in the last annual report as required by Disclosure and Transparency Rule 4.2.8.

By order of the Board

Peter Niven
Director

14 August 2012

Independent review report to Resolution Limited

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the interim results statement for the six months ended 30 June 2012 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of IFRS based operating profit, the condensed consolidated statement of financial position, the condensed consolidated statement of changes in equity, the condensed consolidated statement of cash flows and the related notes 1 to 12. We have read the other information contained in the interim results statement and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The interim results statement is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the interim results statement in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this interim results statement has been prepared in accordance with International Accounting Standard 34: *Interim financial reporting*, as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the interim results statement based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim results statement for the six months ended 30 June 2012 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

Ernst & Young LLP
London

14 August 2012

1. The maintenance and integrity of the Resolution Limited web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial information since it was initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

IFRS FINANCIAL INFORMATION
Condensed consolidated income statement
For the half year ended 30 June 2012

	Notes	**2012 Half year £m**	2011[(ii)] Half year £m	2011[(iii)] Full year £m
Revenue				
Gross earned premiums	2	**982**	1,069	2,128
Premiums ceded to reinsurers	2	**(325)**	(296)	(599)
Net earned premiums	2	**657**	773	1,529
Fee and commission income and income from service activities		**373**	410	771
Investment return		**2,541**	2,579	1,804
Total revenue		**3,571**	3,762	4,104
Other income	2	**–**	78	134
Claims, benefits and expenses				
Gross claims and benefits paid		**(2,125)**	(1,824)	(3,859)
Amounts receivable from reinsurers		**340**	318	643
Net claims and benefits paid		**(1,785)**	(1,506)	(3,216)
Change in insurance contract liabilities		**335**	69	216
Change in investment contract liabilities		**(1,055)**	(928)	495
Transfer (to)/from unallocated surplus		**(71)**	(49)	484
Movement in net asset value attributable to unit–holders		**(25)**	(30)	48
Movement in policyholder liabilities		**(816)**	(938)	1,243
Acquisition expenses		**(274)**	(300)	(591)
Administrative and other expenses		**(750)**	(954)	(1,776)
Finance costs		**(77)**	(80)	(165)
Total claims, benefits and expenses		**(3,702)**	(3,778)	(4,505)
Share of (loss)/profit of associates and joint venture		**(2)**	1	(1)
(Loss)/profit before tax from continuing operations		**(133)**	63	(268)
Policyholder tax	5	**(34)**	(165)	(220)
Loss before shareholder tax from continuing operations		**(167)**	(102)	(488)
Total tax credit/(charge)	5	**75**	(18)	237
Policyholder tax	5	**34**	165	220
Shareholder tax	5	**109**	147	457
(Loss)/profit for the period		**(58)**	45	(31)
Attributable to:				
Equity holders of the parent[(i)]		**(74)**	29	(62)
Non–controlling interests		**16**	16	31
(Loss)/profit for the period		**(58)**	45	(31)

Earnings per share from continuing operations		**2012 Half year pence**	2011 Half year pence	2011 Full year pence
Basic and diluted earnings per share	4	**(5.37)**	2.00	**(4.35)**

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

(ii) The condensed consolidated income statement for the half year ended 30 June 2011 includes the results of BHA from the date of acquisition on 31 January 2011.

(iii) The condensed consolidated income statement for the year ended 31 December 2011 includes the results of BHA from 31 January 2011, the results of WLUK from the date of acquisition on 7 November 2011 and the business of the GOF and TIP portfolios up to the date of disposal on 1 November 2011.

The notes on pages 72 to 95 form an integral part of these financial statements.

Condensed consolidated statement of comprehensive income

For the half year ended 30 June 2012

For the half year ended 30 June 2012	**Equity holders of the parent £m**	**Non-controlling interests £m**	**Total £m**
(Loss)/profit for the period	**(74)**	**16**	**(58)**
Actuarial gains on defined benefit schemes	**6**	**–**	**6**
Foreign exchange adjustments(i)	**(13)**	**–**	**(13)**
Revaluation of owner occupied properties	**(1)**	**–**	**(1)**
Shadow accounting(ii)	**1**	**–**	**1**
Aggregate tax effect of above items	**2**	**–**	**2**
Other comprehensive loss, net of tax	**(5)**	**–**	**(5)**
Total comprehensive (loss)/income, net of tax	**(79)**	**16**	**(63)**

For the half year ended 30 June 2011	Equity holders of the parent £m	Non–controlling interests £m	Total £m
Profit for the period	29	16	45
Actuarial losses on defined benefit schemes	(25)	–	(25)
Foreign exchange adjustments(i)	20	–	20
Revaluation of owner occupied properties	–	–	–
Shadow accounting(ii)	2	–	2
Aggregate tax effect of above items	1	–	1
Other comprehensive loss, net of tax	(2)	–	(2)
Total comprehensive income, net of tax	27	16	43

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)
Revaluation of owner occupied properties	(3)	–	(3)
Shadow accounting(ii)	2	–	2
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)

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

(ii) Shadow accounting comprises a gain of £1 million (30 June 2011: £nil, 31 December 2011: gain of £3 million) relating to the revaluation of owner occupied properties and £nil (30 June 2011: gain of £2 million, 31 December 2011: loss of £1 million) in respect of foreign exchange adjustments on translation of overseas subsidiaries held by the with-profits fund of FLL.

Condensed consolidated statement of IFRS based operating profit

For the half year ended 30 June 2012

	Notes	**2012 Half year £m**	2011 Half year £m	2011 Full year £m
(Loss)/profit before tax from continuing operations	2	**(133)**	63	(268)
Policyholder tax	5	**(34)**	(165)	(220)
Loss before shareholder tax		**(167)**	(102)	(488)
Non-recurring items	2	**118**	12	180
Amortisation and impairment of acquired present value of in-force business	6	**204**	453	675
Amortisation of other intangible assets	6	**42**	41	84
Interest payable on STICS		**(16)**	(16)	(31)
Short-term fluctuations in investment return		**(18)**	2	261
IFRS based operating profit before tax		**163**	390	681
Tax on operating profit		**(7)**	(57)	38
IFRS based operating profit after tax attributable to equity holders of the parent[(i)]		**156**	333	719

Earnings per share		**2012 Half year pence**	2011 Half year pence	2011 Full year pence
Operating earnings per share	4	**11.32**	23.02	50.43

(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.

Condensed consolidated statement of financial position

At 30 June 2012

	Notes	**30 June 2012 £m**	30 June 2011 £m	31 December 2011 £m
Assets				
Pension scheme surplus	8	**37**	3	20
Intangible assets	6	**4,585**	4,870	4,847
Property and equipment		**56**	58	58
Investment properties		**2,897**	3,128	3,015
Investments in associates and joint venture		**35**	33	37
Financial assets	7	**102,945**	101,088	103,636
Deferred acquisition costs		**751**	490	643
Reinsurance assets		**3,332**	2,614	3,213
Current tax assets		**6**	27	6
Insurance and other receivables		**1,478**	1,411	1,140
Cash and cash equivalents		**8,672**	8,962	8,791
Assets of operations classified as held for sale		**–**	1,268	–
Total assets		**124,794**	123,952	125,406
Liabilities				
Insurance contracts		**37,064**	35,071	37,264
Unallocated surplus		**723**	1,148	652
Financial liabilities:				
– investment contracts		**75,066**	73,537	75,191
– loans and borrowings	9	**1,115**	1,244	1,195
– amounts due to reinsurers		**1,795**	1,650	1,800
Net asset value attributable to unit-holders		**900**	1,199	1,173
Provisions		**212**	227	228
Deferred tax liabilities		**756**	1,126	872
Current tax liabilities		**5**	29	20
Insurance payables, other payables and deferred income		**1,375**	1,319	1,016
Liabilities of operations classified as held for sale		**–**	984	–
Total liabilities		**119,011**	117,534	119,411
Equity attributable to equity holders of the parent				
Share capital		**4,170**	4,343	4,128
Other reserves		**1,283**	1,762	1,544
		5,453	6,105	5,672
Attributable to non-controlling interests		**330**	313	323
Total equity		**5,783**	6,418	5,995
Total equity and liabilities		**124,794**	123,952	125,406

The financial statements were approved by the Board of Directors on 14 August 2012.

Peter Niven
Director

Condensed consolidated statement of changes in equity

For the half year 30 June 2012

	Attributable to equity holders of the parent				
For the half year ended 30 June 2012	**Share capital £m**	**Other reserves £m**	**Total £m**	**Non-controlling interests £m**	**Total £m**
At 1 January 2012	**4,128**	**1,544**	**5,672**	**323**	**5,995**
(Loss)/profit for the period	**–**	**(74)**	**(74)**	**16**	**(58)**
Other comprehensive loss	**–**	**(5)**	**(5)**	**–**	**(5)**
Total comprehensive (loss)/income	**–**	**(79)**	**(79)**	**16**	**(63)**
Dividends paid	**–**	**(185)**	**(185)**	**–**	**(185)**
Interest paid on STICS	**–**	**–**	**–**	**(7)**	**(7)**
Appropriations of profit	**–**	**(185)**	**(185)**	**(7)**	**(192)**
Tax relief on STICS interest	**–**	**3**	**3**	**–**	**3**
Shares issued in lieu of dividend	**35**	**–**	**35**	**–**	**35**
Reduction in own shares held by the Group	**7**	**–**	**7**	**–**	**7**
Share-based payments, net of settlements[i]	**–**	**–**	**–**	**(2)**	**(2)**
At 30 June 2012	**4,170**	**1,283**	**5,453**	**330**	**5,783**

	Attributable to equity holders of the parent				
For the half year ended 30 June 2011	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
Profit for the period	–	29	29	16	45
Other comprehensive loss	–	(2)	(2)	–	(2)
Total comprehensive income	–	27	27	16	43
Dividends paid	–	(182)	(182)	–	(182)
Interest paid on STICS	–	–	–	(25)	(25)
Appropriations of profit	–	(182)	(182)	(25)	(207)
Tax relief on STICS interest	–	4	4	–	4
Shares issued in lieu of dividend	41	–	41	–	41
Reduction in own shares held by the Group	19	–	19	–	19
Share repurchase	(34)	–	(34)	–	(34)
Share-based payments[i]	–	3	3	–	3
At 30 June 2011	4,343	1,762	6,105	313	6,418

Condensed consolidated statement of changes in equity (continued)

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(i)	–	6	6	–	6
At 31 December 2011	4,128	1,544	5,672	323	5,995

(i) The other reserves movement for share based payment transactions is net nil for the period (30 June 2011: £3 million, 31 December 2011: £6 million) and comprises £(4) million in respect of the cost of RSL shares acquired to settle obligations arising from Lombard long-term incentive plan ("LTIP") awards that have vested in the period (30 June 2011: £nil, 31 December 2011: £nil), offset by the reserves credit for the resultant reduction in Lombard non-controlling interest (£2 million), (30 June 2011: £nil, 31 December 2011: £nil) and the LTIP charge for the period (£2 million), (30 June 2011: £3 million, 31 December 2011: £6 million).

Condensed consolidated statement of cash flows

For the half year ended 30 June 2012

	2012 Half year £m	2011 Half year £m	2011 Full year £m
Operating activities			
(Loss)/profit for the period	**(58)**	45	(31)
Adjusted for:			
– other income	**–**	(68)	(116)
– net realised and unrealised (gains)/ losses on assets at fair value	**(734)**	(1,041)	1,595
– finance costs	**77**	80	165
– amortisation and impairment of intangible assets	**246**	494	759
– depreciation of property and equipment	**2**	2	4
– movement in deferred acquisition costs	**(110)**	(130)	(285)
– total tax (credit)/charge	**(75)**	18	(237)
– purchase of shares and other variable yield securities	**(7,733)**	(8,600)	(22,585)
– proceeds from sale of shares and other variable yield securities	**8,145**	8,275	22,705
– purchase of loans, debt securities and other fixed income securities	**(12,212)**	(14,712)	(33,973)
– proceeds from sale of loans, debt securities and other fixed income securities	**12,748**	15,071	34,380
– purchase of investment properties	**(34)**	(18)	(43)
– proceeds from sale of investment properties	**108**	116	305
– decrease in insurance contract liabilities	**(200)**	(167)	(101)
– increase/(decrease) in investment contract liabilities	**475**	501	(2,057)
– increase/(decrease) in unallocated surplus	**71**	50	(484)
– (decrease)/increase in provisions	**(16)**	5	(1)
– net movement in receivables and payables	**(367)**	58	(51)
Pre-tax cash inflow/(outflow) from operating activities	**333**	(21)	(51)
Tax paid	**(46)**	(33)	(25)
Net cash inflow/(outflow) from operating activities	**287**	(54)	(76)
Investing activities			
Acquisition of subsidiaries, net of cash acquired	**–**	(78)	12
Disposal of held for sale assets, net of cash transferred	**–**	–	285
Investment in associate	**–**	–	(6)
Additions to internally generated intangible assets	**(1)**	(2)	(4)
Net additions of property and equipment	**–**	(14)	(17)
Net cash (outflow)/ inflow from investing activities	**(1)**	(94)	270
Financing activities			
Shares purchased in settlement of incentive schemes	**(4)**	–	–
Proceeds from increase in non-controlling interests	**–**	–	1
Share repurchase	**–**	(25)	(250)
Proceeds from issue of long-term debt	**–**	497	496
Repayment of long-term debt	**(60)**	(463)	(477)
Finance costs	**(124)**	(77)	(131)
STICS interest	**(7)**	(25)	(31)
Net movement in other borrowings, net of expenses	**(19)**	(4)	(36)
Dividends paid to equity holders of the parent	**(150)**	(141)	(226)
Net cash outflow from financing activities	**(364)**	(238)	(654)
Decrease in cash and cash equivalents	**(78)**	(386)	(460)
Balance at beginning of period	**8,791**	9,288	9,288
Exchange adjustments on the translation of foreign operations	**(41)**	60	(37)
Balance at end of period	**8,672**	8,962	8,791

Notes to the condensed consolidated accounts

1. Basis of preparation

The interim financial statements of the Company as at and for the half year ended 30 June 2012 comprise the condensed 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.

The annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the EU. The condensed consolidated interim financial statements as at and for the half year ended 30 June 2012 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority, IAS 34: *Interim financial reporting* as adopted by the European Union (“EU”), and with accounting policies adopted in respect of the financial statements for the year ended 31 December 2011, as updated by changes that are intended to be made in the full year 2012 financial statements as a result of changes to IFRS. These condensed interim financial statements have been reviewed by Ernst & Young LLP and their review opinion appears on page 64.

An amendment to IAS 12: *Income taxes* was issued in December 2010. This amendment introduces a rebuttable assumption that where certain assets (including investment property and intangible assets) are measured either at 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 accounting periods beginning on or after 1 January 2012. The adoption of the amendment does not have a material impact on the Group.

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

The 2011 comparatives include the following:

- the business of the GOF and TIP portfolios up to the date of disposal on 1 November 2011;
- the business of BHA from the date of acquisition on 31 January 2011; and
- the business of WLUK from the date of acquisition on 7 November 2011.

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 and net income for the half year ended 30 June 2011 includes BHA from 31 January 2011. Segmental information relating to revenue and net income for the full year ended 31 December 2011 includes BHA from 31 January 2011, WLUK from the date of acquisition on 7 November 2011 and the business of the GOF and TIP portfolios until the date of disposal on 1 November 2011. For the half year ended 30 June 2012 the results of both BHA and WLUK are included for a full six months.

The Group’s reportable segments under IFRS 8: *Operating segments* are as follows:

- UK comprising the former Friends Provident UK life and pensions business, the acquired AXA UK Life Business (including WLUK), BHA and Sesame Bankhall;
- 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

For the half year ended 30 June 2012	**UK £m**	**Int'l £m**	**Lombard £m**	**FLG corporate £m**	**RSL corporate £m**	**Total £m**
Life and pensions operating profit	**182**	**27**	**10**	**–**	**–**	**219**
Longer-term shareholder investment return	**(26)**	**–**	**–**	**9**	**–**	**(17)**
Other (expense)/income	**(1)**	**(2)**	**–**	**1**	**(15)**	**(17)**
Development costs	**(18)**	**(4)**	**–**	**–**	**–**	**(22)**
IFRS based operating profit/(loss) before tax	**137**	**21**	**10**	**10**	**(15)**	**163**
Tax on operating profit						**(7)**
IFRS based operating profit after tax attributable to equity holders of the parent						**156**
Operating earnings per share (pence)						**11.32**

For the half year ended 30 June 2011	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Total £m
Life and pensions operating profit	370	43	23	–	–	436
Longer-term shareholder investment return	4	–	(1)	(17)	–	(14)
Other income/(expense)	–	1	–	(3)	(16)	(18)
Development costs	(10)	(3)	(1)	–	–	(14)
IFRS based operating profit/(loss) before tax	364	41	21	(20)	(16)	390
Tax on operating profit						(57)
IFRS based operating profit after tax attributable to equity holders of the parent						333
Operating earnings per share (pence)						23.02

For the 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 equity holders of the parent						719
Operating earnings per share (pence)						50.43

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

For the half year ended 30 June 2012	**UK £m**	**Int'l £m**	**Lombard £m**	**FLG corporate £m**	**RSL corporate £m**	**Total £m**
IFRS based operating profit/(loss) before tax	**137**	**21**	**10**	**10**	**(15)**	**163**
Non-recurring items[(i)]	**(127)**	**–**	**(1)**	**10**	**–**	**(118)**
Amortisation of acquired value of in-force business	**(132)**	**(44)**	**(28)**	**–**	**–**	**(204)**
Amortisation of other intangible assets	**(23)**	**(4)**	**(14)**	**(1)**	**–**	**(42)**
Interest payable on STICS	**16**	**–**	**–**	**–**	**–**	**16**
Short-term fluctuations in investment return[(iv)]	**30**	**(5)**	**–**	**(7)**	**–**	**18**
(Loss)/profit before policyholder and shareholder tax	**(99)**	**(32)**	**(33)**	**12**	**(15)**	**(167)**
Policyholder tax	**34**	**–**	**–**	**–**	**–**	**34**
(Loss)/profit before tax from continuing operations	**(65)**	**(32)**	**(33)**	**12**	**(15)**	**(133)**

For the half year ended 30 June 2011	UK £m	Int'l £m	Lombard £m	FLG corporate £m	RSL corporate £m	Total £m
IFRS based operating profit/(loss) before tax	364	41	21	(20)	(16)	390
Non-recurring items[(ii)]	(12)	–	–	–	–	(12)
Amortisation and impairment of acquired present value of in-force business	(353)	(67)	(33)	–	–	(453)
Amortisation of other intangible assets	(22)	(4)	(15)	–	–	(41)
Interest payable on STICS	16	–	–	–	–	16
Short-term fluctuations in investment return[(iv)]	3	(1)	–	(4)	–	(2)
Loss before policyholder and shareholder tax	(4)	(31)	(27)	(24)	(16)	(102)
Policyholder tax	165	–	–	–	–	165
Profit/(loss) before tax from continuing operations	161	(31)	(27)	(24)	(16)	63

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

For the 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(iii)	(178)	(1)	(1)	–	–	(180)
Amortisation and impairment of acquired value of in-force business	(483)	(126)	(66)	–	–	(675)
Amortisation of other intangible assets	(45)	(8)	(30)	(1)	–	(84)
Interest payable on STICS	31	–	–	–	–	31
Short-term fluctuations in investment return(iv)	(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)

(i) UK non-recurring items for the half year ended 30 June 2012 include £(39) million of separation and integration costs in respect of the UK Life project, £(47) million in respect of Solvency II and finance system developments, £(40) million of costs in respect of the transition and service improvement elements of the outsourcing arrangement with Diligenta offset partially by £13 million release of reserves, non-recurring costs of £(13) million related to capital restructuring and £(1) million of other costs. Lombard non-recurring costs relate to £(1) million of Solvency II costs. Corporate non-recurring items of £10 million represent curtailment gains arising on the defined benefit pension scheme relating to reduced future anticipated costs of the scheme due to the Diligenta outsourcing arrangement.

(ii) UK non-recurring items for the half year ended 30 June 2011 include £68 million (£67 million net of stamp duty expenses) in respect of the gain on acquisition of BHA. This is offset by £(80) million of non-recurring costs comprising £(41) million of separation and integration costs in respect of the UK Life Project, £(24) million in respect of Solvency II and finance system developments, and £(15) million of other costs.

(iii) UK non-recurring items for the year ended 31 December 2011 include £68 million (£67 million net of stamp duty expenses) in respect of the gain an acquisition of BHA and £48 million (£46 million net of stamp duty expenses) in respect of the gain on acquisition of WLUK. This is offset by non-recurring costs of £(293) million comprising £(128) million of separation and integration costs in respect of the UK Life Project, £(55) million in respect of Solvency II and other finance system developments, £(84) million of reserve impact in respect of the outsourcing arrangement with Diligenta and £(26) million of other costs.

(iv) Short term fluctuations in investment return include 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 half year ended 30 June 2012	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	**2,842**	**610**	**948**	**–**	**–**	**–**	**4,400**
Investment contract premiums[(i)]	**(1,904)**	**(566)**	**(948)**	**–**	**–**	**–**	**(3,418)**
Gross earned premiums	**938**	**44**	**–**	**–**	**–**	**–**	**982**
Premiums ceded to reinsurers	**(325)**	**–**	**–**	**–**	**–**	**–**	**(325)**
Net earned premiums	**613**	**44**	**–**	**–**	**–**	**–**	**657**
Fee and commission income	**273**	**48**	**52**	**–**	**–**	**–**	**373**
Investment return	**1,890**	**32**	**607**	**51**	**9**	**(48)**	**2,541**
Total revenue	**2,776**	**124**	**659**	**51**	**9**	**(48)**	**3,571**
Intersegment revenue	**1**	**–**	**–**	**38**	**9**	**(48)**	**–**
Total external revenue	**2,775**	**124**	**659**	**13**	**–**	**–**	**3,571**
Net claims and benefits paid	**(1,782)**	**(3)**	**–**	**–**	**–**	**–**	**(1,785)**
Movement in insurance and investment contract liabilities	**(116)**	**(40)**	**(564)**	**–**	**–**	**–**	**(720)**
Transfer to unallocated surplus	**(71)**	**–**	**–**	**–**	**–**	**–**	**(71)**
Movement in net assets attributable to unit-holders	**(25)**	**–**	**–**	**–**	**–**	**–**	**(25)**
Acquisition expenses	**(216)**	**(37)**	**(21)**	**–**	**–**	**–**	**(274)**
Administrative and other expenses	**(563)**	**(70)**	**(106)**	**–**	**(11)**	**–**	**(750)**
Finance costs	**(68)**	**(4)**	**(1)**	**(39)**	**(13)**	**48**	**(77)**
Total claims, benefits and expenses	**(2,841)**	**(154)**	**(692)**	**(39)**	**(24)**	**48**	**(3,702)**
Intersegment expenses	**(38)**	**(1)**	**–**	**(9)**	**–**	**48**	**–**
Total external claims, benefits and expenses	**(2,803)**	**(153)**	**(692)**	**(30)**	**(24)**	**–**	**(3,702)**
Share of loss of associates and joint venture	**–**	**(2)**	**–**	**–**	**–**	**–**	**(2)**
(Loss)/profit before tax from continuing operations	**(65)**	**(32)**	**(33)**	**12**	**(15)**	**–**	**(133)**
Policyholder tax	**(34)**	**–**	**–**	**–**	**–**	**–**	**(34)**
Shareholder tax	**98**	**5**	**14**	**(8)**	**–**	**–**	**109**
Segmental result after tax	**(1)**	**(27)**	**(19)**	**4**	**(15)**	**–**	**(58)**

(i) Accounted for as deposits under IFRS.

(ii) Eliminations include intersegment loan interest. Intersegment transactions are undertaken on an arm's length basis.

For the half year ended 30 June 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	2,604	545	969	–	–	–	4,118
Investment contract premiums[i]	(1,540)	(540)	(969)	–	–	–	(3,049)
Gross earned premiums	1,064	5	–	–	–	–	1,069
Premiums ceded to reinsurers	(296)	1	–	–	–	(1)	(296)
Net earned premiums	768	6	–	–	–	(1)	773
Fee and commission income	273	80	57	–	–	–	410
Investment return	2,792	(76)	(140)	21	24	(42)	2,579
Total revenue	3,833	10	(83)	21	24	(43)	3,762
Intersegment revenue	1	1	–	17	23	(42)	–
Total external revenue	3,832	9	(83)	4	1	(1)	3,762
Other income[iii]	78	–	–	–	–	–	78
Net claims and benefits paid	(1,504)	(2)	–	–	–	–	(1,506)
Movement in insurance and investment contract liabilities	(1,123)	80	184	–	–	–	(859)
Transfer to unallocated surplus	(47)	(2)	–	–	–	–	(49)
Movement in net assets attributable to unit-holders	(30)	–	–	–	–	–	(30)
Acquisition expenses	(257)	(20)	(23)	–	–	–	(300)
Administrative and other expenses	(741)	(95)	(104)	(1)	(14)	1	(954)
Finance costs	(48)	(3)	(1)	(44)	(26)	42	(80)
Total claims, benefits and expenses	(3,750)	(42)	56	(45)	(40)	43	(3,778)
Intersegment expenses	(17)	(1)	–	(1)	(24)	43	–
Total external claims, benefits and expenses	(3,733)	(41)	56	(44)	(16)	–	(3,778)
Share of profit of associates and joint venture	–	1	–	–	–	–	1
Profit/(loss) before tax from continuing operations	161	(31)	(27)	(24)	(16)	–	63
Policyholder tax	(165)	–	–	–	–	–	(165)
Shareholder tax	137	1	9	–	–	–	147
Segmental result after tax	133	(30)	(18)	(24)	(16)	–	45

(i) Accounted for as deposits under IFRS.

(ii) Eliminations include intersegment premiums and loan interest. Intersegment transactions are undertaken on an arm's length basis.

(iii) Includes gains on acquisition of BHA (£68 million).

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
Intersegment 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 from/(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)
Intersegment 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 intersegment loan interest. Intersegment transactions are undertaken on an arm's length basis.

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

(iv) Assets and liabilities

As at 30 June 2012	**UK £m**	**Int'l £m**	**Lombard £m**	**FLG corporate £m**	**RSL corporate £m**	**Elimination of inter-segment amounts[i] £m**	**Total £m**
Segment assets	**97,680**	**7,746**	**18,550**	**1,791**	**306**	**(1,314)**	**124,759**
Investments in associates and joint venture	**5**	**30**	**–**	**–**	**–**	**–**	**35**
Total assets	**97,685**	**7,776**	**18,550**	**1,791**	**306**	**(1,314)**	**124,794**
Total liabilities	**93,390**	**7,439**	**18,164**	**965**	**367**	**(1,314)**	**119,011**

As at 30 June 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	96,418	7,341	19,072	1,601	631	(1,144)	123,919
Investments in associate and joint venture	5	28	–	–	–	–	33
Total assets	96,423	7,369	19,072	1,601	631	(1,144)	123,952
Total liabilities	91,652	7,007	18,611	956	452	(1,144)	117,534

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

(i) Eliminations mainly comprise intercompany loans.

(c) Geographical segmental information

In presenting geographical 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 half year ended 30 June 2012	**UK £m**	**Rest of the world £m**	**Total £m**
Gross earned premiums	**937**	**45**	**982**
Fee and commission income	**281**	**92**	**373**
Revenue from external customers	**1,218**	**137**	**1,355**
Investment return			**2,541**
Premiums ceded to reinsurers			**(325)**
Total revenue			**3,571**

For the half year ended 30 June 2011	UK £m	Rest of the world £m	Total £m
Gross earned premiums	1,063	6	1,069
Fee and commission income	282	128	410
Revenue from external customers	1,345	134	1,479
Investment return			2,579
Premiums ceded to reinsurers			(296)
Total revenue			3,762

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

3. Appropriations of profit

a) Dividends paid on ordinary shares

A final dividend in respect of 2011 of 13.42 pence per share was paid on 21 May 2012 comprising £150 million of cash and £35 million of shares issued in lieu of dividends. As required by IFRS, the costs of these dividends are taken directly to reserves. An interim dividend of 7.05 pence per ordinary share will be paid to shareholders on the register at the close of business on 7 September 2012; this is expected to total £98 million if all dividends were to be taken in cash.

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

b) STICS interest

The STICS are accounted for as equity instruments under IFRS and consequently the interest on the STICS is recorded in the financial statements as though it were a dividend.

Interest on the 2003 STICS is paid in equal instalments in May and November each year at a rate of 6.875%. During the half year ended 30 June 2012, interest of £7 million (30 June 2011: £7 million, 31 December 2011: £14 million) was paid to the 2003 STICS holders.

Interest on the 2005 STICS is paid annually at a rate of 6.292%. During the half year ended 30 June 2012, interest of £nil (30 June 2011: £17 million, 31 December 2011: £17 million) was paid to the 2005 STICS holders. The annual interest payment of £17 million for 2012 was made on 2 July 2012.

4. 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 equity holders of the parent and the weighted number of shares in issue. The Directors consider that operating earnings per share provides a better indication of the performance of the Group.

	2012 Half year Earnings £m	**2012 Half year per share pence**	2011 Half year Earnings £m	2011 Half year per share pence	2011 Full year Earnings £m	2011 Full year per share pence
(Loss)/profit after tax attributable to equity holders of the parent	**(74)**	**(5.37)**	29	2.00	(62)	(4.35)
Short-term fluctuations in investment return	**(18)**	**(1.30)**	2	0.14	261	18.31
Non-recurring items	**118**	**8.56**	12	0.83	180	12.62
Amortisation and impairment of acquired intangible assets	**246**	**17.85**	494	34.15	759	53.23
Tax credit on items excluded from operating profit	**(116)**	**(8.42)**	(204)	(14.10)	(419)	(29.38)
Operating profit after tax attributable to equity holders of the parent	**156**	**11.32**	333	23.02	719	50.43

b) Diluted basic earnings per share from continuing operations

There were no dilutive factors for the half years ended 30 June 2012 and 2011, or for the full year ended 31 December 2011.

c) Weighted average number of ordinary shares

For the half year ended 30 June 2012	**Actual**	**Weighted**
Issued ordinary shares at beginning of period	**1,376,188,989**	**1,376,188,989**
Own shares held by the Group	**(2,661,384)**	**(2,661,384)**
	1,373,527,605	**1,373,527,605**
Effect of:		
– scrip dividend (final 2011)	**15,484,945**	**3,441,099**
– reduction in own shares held by the Group	**2,661,384**	**1,345,477**
Number of ordinary shares at end of period	**1,391,673,934**	**1,378,314,181**

For the half year ended 30 June 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	2,652,088
– share repurchase	(11,243,352)	(62,463)
– reduction in own shares held by the Group	8,079,419	44,886
Number of ordinary shares at end of period	1,454,460,459	1,446,619,590

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 by the Group	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

5. Taxation

(a) Tax recognised in the income statement

	2012 Half year £m	2011 Half year £m	2011 Full year £m
Current tax			
UK corporation tax at 24.5% (2011: 26.5%)	**24**	45	52
Adjustments in respect of prior periods	**(1)**	(6)	(11)
Overseas taxation	**12**	11	18
Total current tax charge	**35**	50	59
Deferred tax			
Origination and reversal of temporary differences	**(113)**	(32)	(322)
Adjustments in respect of prior periods	**3**	–	26
Total deferred tax credit	**(110)**	(32)	(296)
Total tax (credit)/charge	**(75)**	18	(237)
Analysis:			
– policyholder tax	**34**	165	220
– shareholder tax	**(109)**	(147)	(457)
Total tax (credit)/charge	**(75)**	18	(237)

Policyholder tax is tax on the income and investment returns charged to policyholders of linked and with-profits funds. Shareholder tax is tax charged to shareholders on the profits of the Group.

During the period legislation was enacted to bring in a decrease in the rate of corporation tax from 26% on 1 April 2011 to 24% 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 24% rate has been taken into account in deferred tax balances.

The average rate of corporation tax for the full calendar year is 24.5%.

Finance Act 2012 was substantively enacted on 17 July 2012 and included a further rate reduction to 23% effective from 1 April 2013. The benefit to the Group's net assets of this reduction is estimated to be approximately £33 million in total and will be recognised in the financial statements at year end.

A further incremental rate reduction was announced during the period that will reduce the rate to 22% from 1 April 2014. The benefit to the Group's net assets is estimated to be approximately £33 million in total and will be recognised upon substantive enactment of the legislation.

(b) Factors affecting tax recognised in the period

	2012 Half year £m	2011 Half year £m	2011 Full year £m
(Loss)/profit before tax from continuing operations	**(133)**	63	(268)
(Loss)/profit before tax from continuing operations determined with reference to the average rate of corporation tax in the UK of 24.5% (2011: 26.5%)	**(33)**	17	(71)
Effects of:			
– non-taxable income	**(22)**	(147)	(232)
– shareholder tax charge in respect of provisions	**5**	3	22
– tax on reserving adjustments	**6**	31	41
– overseas tax	**(6)**	(1)	(6)
– valuation of excess expenses	**12**	12	–
– valuation of tax losses	**(30)**	(16)	(123)
– valuation of unrealised capital losses	**(14)**	(1)	–
– adjustments in respect of prior periods	**(1)**	(1)	(8)
– non-taxable gain on acquisition	**–**	(18)	(31)
– reduction in corporation tax rate to 24% (HY 2011: 26%, FY 2011: 25%)	**(30)**	(30)	(60)
– non taxable result of Resolution Holding Companies	**4**	4	11
– policyholder tax	**34**	165	220
Total tax (credit)/charge	**(75)**	18	(237)

(c) Impact of new life tax regime

Legislation in respect of the new life tax regime is included in Finance Act 2012, which received Royal Assent on 17 July 2012. However, as at 30 June 2012 this legislation had not been substantively enacted. As a result the impact of the change in the new tax regime has not been taken into account in IFRS as at 30 June 2012.

The Group has analysed the impact of the new legislation on the deferred tax assets and liabilities as at 30 June 2012. The net overall impact is an estimated additional deferred tax asset of £4 million.

6. Intangible assets

Movements in intangible assets are as follows:

For the half year ended 30 June 2012	AVIF £m	Other £m	Total £m
Cost			
At 1 January 2012	**5,521**	**560**	**6,081**
Additions	**–**	**1**	**1**
Foreign exchange adjustments	**(19)**	**(5)**	**(24)**
At 30 June 2012	**5,502**	**556**	**6,058**
Amortisation and impairment			
At 1 January 2012	**1,084**	**150**	**1,234**
Amortisation charge for the period[(i)]	**204**	**42**	**246**
Foreign exchange adjustments	**(5)**	**(2)**	**(7)**
At 30 June 2012	**1,283**	**190**	**1,473**
Carrying amounts at 30 June 2012	**4,219**	**366**	**4,585**

For the half year ended 30 June 2011	AVIF £m	Other £m	Total £m
Cost			
At 1 January 2011	5,107	528	5,635
Acquisition of subsidiaries[(ii)]	172	8	180
Other additions	–	2	2
Foreign exchange adjustments	33	10	43
At 30 June 2011	5,312	548	5,860
Amortisation and impairment			
At 1 January 2011	422	73	495
Amortisation charge for the period[(i)]	382	41	423
Impairment charge for the period[(i)]	71	–	71
Foreign exchange adjustments	(2)	3	1
At 30 June 2011	873	117	990
Carrying amounts at 30 June 2011	4,439	431	4,870

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[(ii)]	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[(i)]	604	84	688
Impairment charge for the period[(i)]	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

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

(ii) Acquisitions in 2011 related to BHA and WLUK.

An analysis of intangible assets by significant cash generating unit ("CGU") is shown below.

As at 30 June 2012	**Cost £m**	**Amortisation and Impairment £m**	**Net book value £m**
UK	**4,247**	**(913)**	**3,334**
International	**1,076**	**(315)**	**761**
Lombard	**735**	**(245)**	**490**
Total	**6,058**	**(1,473)**	**4,585**

As at 30 June 2011	Cost £m	Amortisation and impairment £m	Net book value £m
UK	3,979	(603)	3,376
International	1,059	(204)	855
Lombard	822	(183)	639
Total	5,860	(990)	4,870

As at 31 December 2011	Cost £m	Amortisation and impairment £m	Net book value £m
UK	4,247	(758)	3,489
International	1,076	(266)	810
Lombard	758	(210)	548
Total	6,081	(1,234)	4,847

Impairment

All identifiable intangible assets are reviewed at each reporting date to assess whether there are any circumstances that might indicate that they are impaired. If such circumstances exist, impairment testing is performed and any resulting impairment losses are charged to the income statement. As at 30 June 2012, based on an impairment review of each of the CGUs, the Directors are satisfied that none of the Group's intangible assets are impaired.

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 an updated MCEV VIF balance for pre-acquisition business only, which represents a reasonable basis for determining future profits generated by the asset acquired.

7. Financial assets

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

	30 June 2012 £m	30 June 2011 £m	31 December 2011 £m
Fair value through profit or loss (note 7(a))	**102,939**	101,082	103,631
Loans at amortised cost (note 7 (c))	**6**	6	5
Total financial assets	**102,945**	101,088	103,636

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

As at 30 June 2012	**With-profits £m**	**Unit-linked £m**	**Non-linked annuities £m**	**Non-linked other £m**	**Shareholder £m**	**Total £m**
Shares and other variable yield securities	**6,332**	**53,333**	**–**	**107**	**10**	**59,782**
Debt securities and other fixed income securities:						
Government securities:						
– Loaned government securities[i]	**–**	**–**	**–**	**205**	**–**	**205**
– Other government securities	**8,723**	**7,970**	**1,104**	**962**	**156**	**18,915**
Corporate bonds	**8,923**	**5,899**	**6,234**	**1,227**	**277**	**22,560**
Derivative financial instruments	**915**	**52**	**110**	**10**	**–**	**1,087**
Deposits with credit institutions	**–**	**390**	**–**	**–**	**–**	**390**
Total financial assets held at fair value	**24,893**	**67,644**	**7,448**	**2,511**	**443**	**102,939**

As at 30 June 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	7,771	53,708	–	202	7	61,688
Debt securities and other fixed income securities:						
Government securities:						
– Loaned government securities[i]	–	–	–	201	–	201
– Other government securities	7,168	7,664	642	567	76	16,117
Corporate bonds	9,230	5,703	5,774	991	542	22,240
Derivative financial instruments	406	26	38	5	(6)	469
Deposits with credit institutions	–	349	–	18	–	367
Total financial assets	24,575	67,450	6,454	1,984	619	101,082

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[(i)]	–	–	–	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 the balance sheet as substantially all risks and rewards of ownership are retained by the Group. The Group holds collateral in respect of these arrangements of £206 million (30 June 2011: £203 million, 31 December 2011: £210 million).

The unit-linked column and with-profits column include £879 million (30 June 2011: £1,058 million; 31 December 2011: £1,129 million) of financial assets comprising £706 million of shares and other variable yield securities, £100 million of corporate bonds and £73 million of government securities (30 June 2011: £794 million of shares and other variable yield securities, £77 million of corporate bonds and £187 million of government securities; 31 December 2011: £818 million of shares and other variable yield securities, £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.

Asset backed securities (excluding those held by the linked funds) amount to £3,218 million (30 June 2011: £2,420 million; 31 December 2011: £3,060 million) and 95% (30 June 2011: 91%; 31 December 2011: 94%) of these are at investment grade as set out in 7 (b).

b) Creditworthiness of financial assets

The following table gives an indication of the level of credit worthiness of those categories of assets which are neither past due nor impaired and are most exposed to credit risk using principally ratings prescribed by Standard & Poor's and Moody's. Assets held within unit-linked funds have been excluded from the tables below as the credit risk on these assets is borne by the policyholders rather than the shareholders. The carrying amount of assets included in the statement of financial position represents the maximum credit exposure.

As at 30 June 2012	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**BB £m**	**B £m**	**Not rated £m**	**Total £m**
Corporate bonds	**1,966**	**2,906**	**4,856**	**3,297**	**312**	**36**	**70**	**13,443**
Asset backed securities	**1,017**	**864**	**758**	**420**	**136**	**14**	**9**	**3,218**
Derivative financial instruments	**–**	**16**	**993**	**–**	**–**	**–**	**26**	**1,035**
Reinsurance assets	**–**	**3,196**	**135**	**–**	**–**	**–**	**1**	**3,332**
Cash and cash equivalents	**1,864**	**675**	**1,663**	**–**	**19**	**–**	**9**	**4,230**
Total	**4,847**	**7,657**	**8,405**	**3,717**	**467**	**50**	**115**	**25,258**
%	**19%**	**30%**	**33%**	**15%**	**2%**	**0%**	**1%**	**100%**

As at 30 June 2011	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Corporate bonds	3,055	3,147	4,308	2,965	338	46	258	14,117
Asset backed securities	529	709	618	344	120	2	98	2,420
Derivative financial instruments	66	139	244	–	–	–	(6)	443
Reinsurance assets	–	2,377	237	–	–	–	1	2,615
Deposits with credit institutions	–	18	–	–	–	–	–	18
Cash and cash equivalents	1,679	1,180	1,619	38	–	–	97	4,613
Total	5,329	7,570	7,026	3,347	458	48	448	24,226
%	22%	31%	29%	14%	2%	0%	2%	100%

As at 31 December 2011	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Corporate bonds	2,081	3,189	4,328	3,360	212	33	227	13,430
Asset backed securities	819	907	705	431	135	14	49	3,060
Derivative financial instruments	–	68	800	–	–	–	–	868
Reinsurance assets	–	3,129	83	–	–	–	1	3,213
Deposits with credit institutions	–	–	–	–	–	–	–	–
Cash and cash equivalents	1,278	1,079	1,631	19	–	–	5	4,012
Total	4,178	8,372	7,547	3,810	347	47	282	24,583
%	17%	34%	31%	15%	1%	0%	1%	100%

The direct exposure of the Group to the debt of the governments of Ireland, Italy, Portugal and Spain (being countries where the risk of credit default has been perceived as higher) in shareholder and annuity funds is set out in the table below. There is no exposure to Greece. Where the Group holds securities issued by financial companies, it has considered the company's financial strength and the ability of the domicile government to provide financial support in the event of stress.

	30 June 2012			30 June 2011			31 December 2011		
	Govt debt £m	**Corporate debt £m**	**Total £m**	Govt debt £m	Corporate debt £m	Total £m	Govt debt £m	Corporate debt £m	Total £m
Ireland	**–**	**37**	**37**	–	38	38	–	39	39
Portugal	**–**	**8**	**8**	–	12	12	–	10	10
Italy	**7**	**152**	**159**	8	217	225	6	154	160
Spain	**–**	**168**	**168**	–	172	172	–	167	167
Total	**7**	**365**	**372**	8	439	447	6	370	376
Total all countries	**2,427**	**7,738**	**10,165**	1,285	7,307	8,592	2,534	7,470	10,004

	Ireland £m	Portugal £m	Italy £m	Spain £m	Total £m
Corporate exposure:					
- Domestic banks	**–**	**–**	**30**	**26**	**56**
- Domestic non-bank financials	**13**	**–**	**12**	**–**	**25**
- Non-domestic banks	**–**	**–**	**–**	**48**	**48**
- Domestic non-financials	**24**	**8**	**110**	**58**	**200**
- Non-domestic non-financials	**–**	**–**	**–**	**36**	**36**
Total 30 June 2012	**37**	**8**	**152**	**168**	**365**
Total 30 June 2011	38	12	217	172	439
Total 31 December 2011	39	10	154	167	370

c) Loans

	2012 Half year £m	2011 Half year £m	2011 Full year £m
Mortgage loans	**2**	3	2
Other loans	**4**	3	3
Total loans	**6**	6	5

d) 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 condensed consolidated statement of financial position and are analysed as follows:

	2012 Half year £m	2011 Half year £m	2011 Full year £m
Shares and other variable yield securities	**53,333**	53,708	53,487
Debt securities and other fixed income securities	**13,869**	13,367	14,172
Derivative financial instruments	**52**	26	7
Deposits with credit institutions	**390**	349	381
Total financial assets held at fair value	**67,644**	67,450	68,047
Investment properties	**1,592**	1,759	1,688
Insurance and other receivables	**457**	582	875
Cash and cash equivalents	**4,443**	4,350	4,779
Total assets	**74,136**	74,141	75,389
Other payables	**(319)**	(647)	(124)
Net asset value attributable to unit-holders[(i)]	**(888)**	(1,124)	(1,137)
Total unit-linked net assets	**72,929**	72,370	74,128

(i) Represents 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"), to which a proportion of the Group's UK Life and Pensions employees belong. In addition, defined contribution schemes are operated by Friends Provident Management Services Limited ("FPMS"), FPIL and Sesame Bankhall Group. Lombard does not operate a pension scheme.

On an IAS 19: *Employee Benefits* basis, a gross surplus of £78 million has been recognised in respect of the FPPS at 30 June 2012 (30 June 2011: £36 million, 31 December 2011: £52 million). A curtailment gain of £10 million has been recognised in the period, as a result of the outsourcing agreement entered into with Diligenta, under which a number of staff who transferred employment became deferred members of the scheme, resulting in reduced future anticipated costs of funding as these (deferred) benefits are no longer linked to final salary.

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 following four years were subsequently agreed with the Trustee, and commenced in July 2010. An updated triennial valuation is being performed as at 30 September 2011 and is on track to be completed within the regulatory deadline of 15 months. The valuation will serve to assist the Trustee and Group in determining future levels of funding.

To help control the risks and cost to the Group of funding future service accrual, on 9 July 2012 the Group commenced consultation on proposed changes to the defined benefit pension scheme.

In summary, the proposed changes are as follows:

- From 31 December 2012, the FPPS defined benefits scheme will be closed for future service benefits. This means that current contributing members of the FPPS will no longer contribute to or build up future benefits in the FPPS; and
- from 1 January 2013, all UK based employees that were contributing members to the FPPS defined benefits scheme, will be offered membership of the Friends Pension Plan ("FPP") defined contribution scheme.

Consultation with UK based employees will run until 21 September 2012, with changes being confirmed to members by the end of September 2012. No anticipated impacts of the proposed changes to the defined benefit pension scheme have been taken account of in the 30 June 2012 scheme valuation.

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 £41 million has been recognised (30 June 2011: £33 million, 31 December 2011: £32 million), reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £118 million (£40 million deficit reduction contributions plus the current surplus of £78 million). A deferred tax asset of £10 million (30 June 2011: £16 million, 31 December 2011: £10 million) has also been recognised to reflect tax relief at a rate of 24% (2011: 25%) 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 obligations 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 UK Life and Pensions employees from the acquired Friends Provident business belong. The scheme's assets, which are administered by four 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 and three are member nominated trustee directors.

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

(i) Amounts recognised in the condensed consolidated statement of financial position

	30 June 2012 £m	30 June 2011 £m	31 December 2011 £m
IAS 19 pension surplus (excluding deficit reduction contribution)	**78**	36	52
Authorised payments surplus charge (penal tax) at 35% of available surplus following deficit reduction contributions.	**(41)**	**(33)**	(32)
Net pension scheme surplus (excluding deficit reduction contribution)	**37**	3	20

(ii) Movement in IAS 19 pension surplus

	2012 Half year £m	2011 Half year £m	2011 Full year £m
Pension surplus at 1 January	**52**	66	66
Service cost(i)	**(4)**	(4)	(7)
Interest cost(i)	**(30)**	(29)	(57)
Expected return on pension assets(i) (ii)	**32**	31	63
Curtailment gain (i) (iii)	**10**	–	–
Employer contributions	**3**	8	33
Actuarial gains/(losses)	**15**	(36)	(46)
Pension surplus at period end (excluding authorised payments surplus charge)	**78**	36	52
Deficit reduction contributions	**40**	60	40
Available surplus subject to authorised payments surplus charge	**118**	96	92

(i) Recognised in the condensed consolidated income statement. The total gain recognised in the income statement for the half year ended 30 June 2012 is £8 million (30 June 2011: loss of £(2) million, 31 December 2011: loss of £(1) million).

(ii) The actual return on plan assets was £19 million (30 June 2011: £12 million, 31 December 2011: £185 million).

(iii) The curtailment gain arises as a result of the outsourcing agreement entered into with Diligenta (see 8a)

(iii) Analysis of pension surplus and related deferred tax asset

As at 30 June 2012	**Pension surplus £m**	**Deferred tax £m**
Gross IAS 19 pension surplus and related deferred tax liability	**78**	**(19)**
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	**(41)**	**–**
Restriction of liability to authorised payments surplus charge	**–**	**19**
Tax relief available on deficit reduction contributions	**–**	**10**
Net pension surplus and related deferred tax asset	**37**	**10**

As at 30 June 2011	Pension surplus £m	Deferred tax £m
Gross IAS 19 pension surplus and related deferred tax liability	36	(9)
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	(33)	–
Restriction of liability due to authorised payments surplus charge	–	9
Tax relief available on deficit reduction contributions	–	16
Net pension surplus and related deferred tax asset	3	16

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

(iv) Amounts recognised in the condensed consolidated statement of comprehensive income

	2012 Half year £m	2011 Half year £m	2011 Full year £m
Actuarial gains/(losses)	**15**	(36)	(46)
Reverse authorised payments surplus charge on opening surplus	**32**	44	44
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	**(41)**	(33)	(32)
Actuarial gains/(losses) on defined benefit schemes	**6**	(25)	(34)
Taxation	**2**	1	2
Actuarial gains/(losses) on defined benefit schemes after tax	**8**	(24)	(32)

A tax charge of £nil (30 June 2011: £nil, 31 December 2011: £6 million) in respect of deficit reduction contributions and credits of £2 million (30 June 2011: £1 million, 31 December 2011: £8 million) in respect of other movements in the pension scheme are included in the aggregate tax line of the condensed consolidated statement of comprehensive income.

9. Loans and borrowings

The Group's loans and borrowings are as follows:

	Coupon %	**30 June 2012 £m**	30 June 2011 £m	31 December 2011 £m
Subordinated liabilities:				
Lombard undated subordinated loans	Various	**2**	3	2
£162 million lower tier 2 subordinated debt 2021	12.00	**182**	184	183
£500 million lower tier 2 subordinated debt 2022	8.25	**496**	497	496
Deferred consideration notes:				
Series A deferred consideration notes	6.00	**174**	240	232
Series B deferred consideration notes	7.25–6.50	**189**	197	191
Reinsurance:				
Lombard financial reinsurance treaties	Various	**6**	13	8
International financial reinsurance treaties	Various	**53**	50	64
Other:				
Amounts owed to credit institutions (overdrafts)		**13**	60	19
Total loans and borrowings		**1,115**	1,244	1,195

Unless otherwise stated below, the carrying values of interest bearing loans and borrowings closely approximate fair value.

Subordinated liabilities

The FLG lower tier 2 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 as at 30 June 2012 is £178 million.

On 21 April 2011, FLG issued a £500 million lower tier 2 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 as at 30 June 2012 is £440 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 period, 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 period no accelerated repayment was made (30 June 2011: £nil, 31 December 2011: £14.4 million). Following the accelerated repayments made in 2011, the scheduled repayments in the Series A DCNs are reduced to £58 million per annum until 2015; 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.

Scheduled repayments of £60.4 million were made in the half year ended 30 June 2012.

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 from 2010 onwards. The total amount owed to Munich Re under these financial reinsurance arrangements as at 30 June 2012 was £31 million (30 June 2011: £42 million, 31 December 2011: £40 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 30 June 2012 was £22 million (30 June 2011: £8 million, 31 December 2011: £24 million).

Other

Amounts owed to credit institutions (overdrafts) includes £4 million (30 June 2011: £47 million, 31 December 2011: £7 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 (2011: £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 FLG, acquires such control, FLG 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.

10. Contingent liabilities

In the normal course of its business, the Group is subject to matters of litigation or dispute or regulatory uncertainty. 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.

11. Related parties

In the ordinary course of business, the Company and its subsidiary undertakings carry out transactions with related parties, as defined by IAS 24: *Related party disclosures*. Loans from related parties are made on normal arm's length commercial terms.

Material related party transactions and/or changes to previously described related party transactions, which have taken place during the six months to 30 June 2012 are set out below.

a) Services provided to related parties

During the half year, FLG acquired 1.8 million shares in Resolution Limited in the market for a total value of £4 million which were awarded to participants of the Lombard LTIP equity based incentive scheme.

b) Services provided by related parties

	2012 Half year		2011 Half year		2011 Full year	
	Income earned in period £m	**Receivable at period end £m**	Income earned in period £m	Receivable at period end £m	Income earned in period £m	Receivable at period end £m
Joint venture	**2**	**–**	–	–	4	–
Total	**2**	**–**	–	–	4	–

c) Other related parties

Details of the Group's pension schemes are provided in note 8.

The Company has entered into certain contracts with related parties as described below:

- With effect from 13 January 2012, the Company entered into an amended Operating Agreement with ROL. Subject to certain exceptions, the Operating Agreement remains in force unless either party gives the other notice in writing, with such notice not being less than 12 months and not expiring until the later of 10 December 2013 and the date falling 12 months from the date on which the Company publicly declares the UK Life Project complete. Under the Operating Agreement:
  - the Company outsources the majority of its operating functions to ROL. The Company pays ROL an annual operating fee based on 0.5% of the value of the Company (subject to (i) a minimum payment of £10 million and (ii) a maximum reduction in any year of up to £2 million if ROL manages, advises or provides similar services to any new projects outside the UK Life Project). In addition, the Company pays ROL amounts for additional accounting services and certain company secretarial services. The total amount charged under the Operating Agreement for the six month period ended 30 June 2012 was £9 million, of which £1 million was incurred by the Company and £8 million was incurred by Resolution Holdco No. 1 LP (a direct wholly-owned subsidiary of the Company);
  - subject to certain conditions, the Company may advance funds up to an aggregate of £20 million to ROL for development work on new projects outside the UK Life Project. The 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 its shareholders) if ROL successfully launches a new project. Any amounts that are reimbursed by ROL replenish the aggregate amount of funding that may be advanced to ROL to fund development work on new projects. The total amount of funding advanced under the Operating Agreement to ROL for development work on new projects is £1 million, of which no funds were advanced during the six month period ended 30 June 2012;

- Subject to the outcome of the FSA proposals for “externally managed companies” set out in consultation paper CP12/2, amendments and/or termination of the Operating Agreement may be required.

- With effect from 13 January 2012, the Company entered into a new Lock-Up Agreement with RCAP GP Limited (acting in its capacity as general partner of RCAP Guernsey LP) and Resolution Capital Limited (a limited parent of RCAP Guernsey LP and a member of ROL). Under the Lock-Up Agreement:
  - subject to certain customary exceptions, members of The Resolution Group (which includes ROL, RCAP Guernsey LP and Resolution Capital Limited and, for the avoidance of doubt, does not include the Company or any of its subsidiary undertakings) are restricted from selling or pledging as security for a loan any of their shares in the Company held as at 13 January 2012 until completion of the UK Life Project. The total number of locked-up shares is 8,247,184;
  - the Resolution Group may sell or pledge as security for a loan certain of the locked-up shares for the purpose of co-investing in a new project, provided that the value of the remaining locked-up shares is not less than the largest investment made by The Resolution Group in any new project using the proceeds of a sale or pledge of locked-up shares (taking into account the new project itself).

12. Post balance sheet events

On 17 July 2012, the Finance Act 2012 received Royal Assent. The most significant impacts on the Group in this regard are anticipated to be changes in the taxation regime for life insurance companies and revisions to corporate tax rates. The accounting implications of these amendments are detailed in note 5.

The Company has agreed with ROL that the Operating Agreement with ROL will end on 10 December 2013 at the latest. The Company is proposing a change to its structure to simplify its governance arrangements and move to a conventional governance structure. Shareholder and regulatory approvals will be sought for the proposed changes as appropriate. Further details of the changes to the governance arrangements and relationship with ROL are under discussion and implementation of the agreed changes is expected to be completed in the next six months.

Statement of Directors’ responsibilities in respect of the Market Consistent Embedded Value (MCEV) basis

The Directors of Resolution Limited have chosen to prepare supplementary information in accordance with European Insurance CFO Forum (“MCEV Principles”), issued in October 2009. When compliance with the MCEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the methodology contained in the MCEV Principles and to disclose and explain any non-compliance in the guidance included in the MCEV Principles.

In preparing the MCEV supplementary information, the Directors have:

- done so in accordance with the MCEV Principles and fully complied with the guidance included therein;
- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent; and
- described the basis on which business that is non-covered has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group condensed consolidated IFRS financial statements.

By order of the Board

Peter Niven
Director

14 August 2012

Independent review report to Resolution Limited

Introduction

We have been engaged by the Company to review the set of MCEV financial statements in the interim results statement for the six months ended 30 June 2012 which comprises the consolidated income statement – MCEV basis, the earnings per share – MCEV basis, the consolidated statement of comprehensive income – MCEV basis, the consolidated statement of changes in equity – MCEV basis, the consolidated statement of financial position – MCEV basis, the Group MCEV analysis of earnings and the related notes 1 to 11. We have read the other information contained in the interim results statement and considered whether it contains any apparent misstatements or material inconsistencies with the information in the MCEV financial statements.

We have reported separately on the condensed financial statements of Resolution Limited prepared on an IFRS basis for the six months ended 30 June 2012. The information contained in the MCEV financial statements should be read in conjunction with the condensed set of financial statements prepared on an IFRS basis.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The MCEV financial statements in the interim results statement are the responsibility of, and have been approved by, the Directors. The Directors are responsible for preparing the MCEV financial statements in accordance with the Market Consistent Embedded Value Principles issued in October 2009 by the CFO forum ("the MCEV Principles") and the basis of preparation set out in note 1.

Our responsibility

Our responsibility, as set out in our engagement letter with you dated 8 August 2012, is to express to the Company a conclusion on the MCEV financial statements based on our review.

Scope of review

We conducted our review in accordance with ISRE 2410. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the set of MCEV financial statements in the interim results statement for the six months ended 30 June 2012 is not prepared, in all material respects, in accordance with the MCEV Principles and the basis of preparation set out in note 1.

Ernst & Young LLP
London

14 August 2012

1. The maintenance and integrity of the Resolution Limited web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial information since it was initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

MCEV FINANCIAL INFORMATION
Consolidated income statement – MCEV basis
For the half year ended 30 June 2012

	Notes	**RSL 2012 Half year £m**	RSL 2011(ii) Half year £m	RSL 2011(iii) Full year £m	FLG 2012 Half year £m	FLG 2011(ii) Half year £m
Life and pensions						
Value of new business	6	**97**	66	151	97	66
Expected existing business contribution		**165**	181	360	165	181
Operating experience variances		**(15)**	(6)	(28)	(15)	(6)
Operating assumption changes		**14**	(2)	140	14	(2)
Other operating variances		**19**	(7)	6	19	(7)
Development costs	9	**(22)**	(14)	(36)	(22)	(14)
Life and pensions covered business operating profit before tax	3	**258**	218	593	258	218
Other income and charges		**(8)**	(22)	(35)	(8)	(22)
Life and pensions operating profit before tax		**250**	196	558	250	196
Corporate income and charges		**(15)**	(16)	(41)	-	-
Operating profit before tax		**235**	180	517	250	196
Economic variances	3	**242**	(48)	(600)	242	(48)
Amortisation of non-covered business acquired intangible assets	3	**(1)**	(1)	(3)	(1)	(1)
Non-recurring items and non-operating variances	3	**(91)**	(46)	(282)	(91)	(46)
Profit/(loss) from continuing operations before tax		**385**	85	(368)	400	101
Tax on operating profit		**(63)**	(50)	(150)	(63)	(50)
Tax on other activities		**(26)**	19	223	(26)	19
Profit/(loss) for the period(i)		**296**	54	(295)	311	70

(i) Profit/(loss) for the period is attributable to equity holders of the parent.
(ii) The consolidated income statement for the half year ended 30 June 2011 includes the results of BHA from 31 January 2011.
(iii) The consolidated income statement for the year ended 31 December 2011 includes the results of BHA from 31 January 2011, WLUK from 7 November 2011 and the business of the Guaranteed Over Fifties ("GOF") and Trustee Investment Plan ("TIP") portfolios up to the date of disposal on 1 November 2011.

The notes on pages 103 to 135 form an integral part of these financial statements.

Earnings per share – MCEV basis

For the half year ended 30 June 2012

	Notes	**RSL 2012 Half year pence**	RSL 2011 Half year pence	RSL 2011 Full year pence
Earnings per share				
Operating earnings per share on MCEV basis after tax, attributable to equity holders of the parent				
– Basic and diluted	4	**12.48**	8.99	25.74
Earnings per share on MCEV basis after tax, attributable to equity holders of the parent				
– Basic and diluted	4	**21.48**	3.73	(20.69)

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 half year ended 30 June 2012

	RSL 2012 Half year £m	RSL 2011 Half year £m	RSL 2011 Full year £m	FLG 2012 Half year £m	FLG 2011 Half year £m
Profit/(loss) for the period	**296**	54	(295)	311	70
Actuarial gains/(losses) on defined benefit pension schemes, net of tax	**8**	(24)	(32)	8	(24)
Foreign exchange adjustments	**(18)**	31	(15)	(18)	31
Other comprehensive (loss)/income for the period, net of tax	**(10)**	7	(47)	(10)	7
Total comprehensive income/(loss) for the period[(i)]	**286**	61	(342)	301	77

(i) Total comprehensive income/(loss) for the period is attributable to equity holders of the parent.

Consolidated statement of changes in equity – MCEV basis

For the half year ended 30 June 2012

	RSL	RSL	RSL	FLG	FLG
	2012 Half year £m	2011 Half year £m	2011 Full year £m	2012 Half year £m	2011 Half year £m
Opening ordinary shareholders' equity	**5,796**	6,515	6,515	5,949	6,514
Acquired value of BHA as at 31 January 2011	**–**	226	226	–	226
Cost of acquisition of BHA(i)	**–**	(168)	(168)	–	(168)
Acquired value of WLUK as at 7 November 2011	**–**	–	271	–	–
Cost of acquisition of WLUK(i)	**–**	–	(248)	–	–
Total comprehensive income/(loss) for the period	**286**	61	(342)	301	77
Issue of share capital (net of capitalised expenses and movement in RSL shares held by subsidiaries)	**42**	60	61	–	–
Share repurchase	**–**	(34)	(250)	–	
Dividends on equity shares	**(185)**	(182)	(274)	(250)	(350)
Share-based payments	**–**	4	5	–	4
Increase/(decrease) in MCEV reserves for the period	**143**	(33)	(719)	51	(211)
Closing ordinary shareholders' equity	**5,939**	6,482	5,796	6,000	6,303

(i) Transaction costs incurred in FLG relating to the acquisitions of BHA and WLUK are included in non-operating earnings in half year 2011 (£1 million in respect of BHA) and full year 2011 (£3 million, comprising £1 million in respect of BHA and £2 million in respect of WLUK). No transaction costs were incurred in half year 2012.

Consolidated statement of financial position – MCEV basis

At 30 June 2012

	RSL	RSL	RSL	FLG	FLG
	30 Jun 2012 £m	30 Jun 2011 £m	31 Dec 2011 £m	30 Jun 2012 £m	31 Dec 2011 £m
Assets					
Pension scheme surplus	**37**	3	20	37	20
VIF covered business excluding assets of operations classified as held for sale	**4,078**	4,007	3,844	4,078	3,844
Intangible assets	**26**	29	25	26	25
Property and equipment	**56**	58	58	56	58
Investment properties	**2,897**	3,128	3,015	2,897	3,015
Investment in associates and joint venture	**30**	27	31	30	31
Financial assets	**102,945**	101,094	103,636	102,945	103,643
Deferred acquisition costs	**91**	115	105	91	105
Reinsurance assets	**3,332**	2,614	3,213	3,332	3,213
Current tax assets	**6**	27	6	6	6
Insurance and other receivables	**1,500**	1,462	1,175	1,500	1,175
Cash and cash equivalents	**8,672**	8,962	8,791	8,567	8,690
Assets of operations classified as held for sale					
– value of in-force covered business	**–**	222	–	–	–
– other assets	**–**	1,046	–	–	–
Total assets	**123,670**	122,794	123,919	123,565	123,825
Liabilities					
Insurance contracts	**37,121**	35,126	37,326	37,121	37,326
Unallocated surplus	**710**	1,138	640	710	640
Financial liabilities					
– investment contracts	**74,060**	72,665	74,224	74,060	74,224
– loans and borrowings	**1,330**	1,622	1,440	1,165	1,201
– amounts due to reinsurers	**1,795**	1,650	1,800	1,795	1,800
Net asset value attributable to unit holders	**900**	1,199	1,173	900	1,173
Provisions	**214**	231	230	214	230
Deferred tax liabilities	**273**	379	304	273	304
Current tax liabilities	**5**	29	20	5	20
Insurance payables, other payables and deferred income	**1,320**	1,285	961	1,319	953
Liabilities of operations classified as held for sale	**–**	984	–	–	–
Total liabilities	**117,728**	116,308	118,118	117,562	117,871
Equity attributable to:					
– Equity holders of the parent	**5,939**	6,482	5,796	6,000	5,949
– Non-controlling interests	**3**	4	5	3	5
Total equity	**5,942**	6,486	5,801	6,003	5,954
Total equity and liabilities	**123,670**	122,794	123,919	123,565	123,825

Group MCEV analysis of earnings

For the half year ended 30 June 2012

	FLG 2012 Half year			RSL (ex. FLG)[i] 2012 Half year	RSL 2012 Half year	RSL 2011 Half year	RSL 2011 Full year	FLG 2011 Half year
	Covered business £m	Non-covered business £m	Total £m	Non-covered business £m	Total business £m	Total business £m	Total business £m	Total £m
Opening Group MCEV	**5,412**	**537**	**5,949**	**(153)**	**5,796**	6,515	6,515	6,514
Opening adjustments:								
acquired businesses:								
– acquired value of BHA	**–**	**–**	**–**	**–**	**–**	226	226	226
– cost of acquisition of BHA [ii]	**–**	**–**	**–**	**–**	**–**	(168)	(168)	(168)
– acquired value of WLUK	**–**	**–**	**–**	**–**	**–**	–	271	–
– cost of acquisition of WLUK[ii]	**–**	**–**	**–**	**–**	**–**	–	(248)	–
Adjusted opening Group MCEV	**5,412**	**537**	**5,949**	**(153)**	**5,796**	6,573	6,596	6,572
Operating MCEV earnings	**201**	**(14)**	**187**	**(15)**	**172**	130	367	146
Non-operating MCEV earnings	**117**	**7**	**124**	**–**	**124**	(76)	(662)	(76)
Total MCEV earnings	**318**	**(7)**	**311**	**(15)**	**296**	54	(295)	70
Other movements in IFRS net equity	**–**	**8**	**8**	**7**	**15**	(5)	(19)	(24)
Closing adjustments:								
– capital and dividend flows	**(291)**	**41**	**(250)**	**100**	**(150)**	(171)	(471)	(346)
– foreign exchange variances	**(18)**	**–**	**(18)**	**–**	**(18)**	31	(15)	31
Closing Group MCEV	**5,421**	**579**	**6,000**	**(61)**	**5,939**	6,482	5,796	6,303

(i) 'RSL (ex. FLG)' refers to the Resolution holding companies

(ii) Transaction costs incurred in FLG relating to the acquisitions of BHA and WLUK are included in non-operating earnings in half year 2011 (£1 million in respect of BHA) and full year 2011 (£3 million, comprising £1 million in respect of BHA and £2 million in respect of WLUK). No transaction costs were incurred in half year 2012.

Notes to the MCEV results

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.

This MCEV supplementary information presents results for the Group and the Friends Life group.

The 2011 comparatives include the following:

- the business of the GOF and TIP portfolios up to the date of disposal on 1 November 2011;
- the business of BHA from 31 January 2011; and
- the business of WLUK from 7 November 2011.

The MCEV results were approved by the Board of Directors on 14 August 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 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 Resolution Limited, 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.

Whilst the management services businesses are classified as non-covered, the expenses and cash flows of those businesses are linked to the life and pensions businesses via service agreements. The cash flows of the companies are calculated on the "look-through" principle and are allowed for when setting appropriate expense and tax assumptions.

[(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, external LT2 subordinated debt 2021, the external LT2 subordinated debt 2022, internal 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 group pensions 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 9.

(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 (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 9.

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 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 and hedgeable risks; and
- no allowance for diversification between covered and non-covered business.

The CNHR impacts both the value of existing business and new business.

Participating business
Future regular bonuses on participating business are projected in a manner consistent with current bonus rates and expected future market consistent returns on assets deemed to back the policies.

Future terminal bonuses are assumed to be set at a level to exhaust all the assets deemed to back the policies over the future lifetime of the in-force with-profit policies.

The PVFP includes the shareholders' share of future profits from the with-profits funds, based on the assumed bonus rates.

There may be some extreme future economic scenarios in which total assets in each of the with-profits funds are not sufficient to pay all policyholder claims and the resulting shortfall would be met by shareholders. Stochastic modelling techniques are used to assess the impact of future economic scenarios on the with-profits funds' ability to pay all policyholder claims and to determine the average additional cost to shareholders arising from future projected shortfalls. This cost to shareholders has been included in the TVOG.

Consolidation adjustments
The effect of transactions and reinsurance arrangements between life insurance subsidiary companies has been included in the results split by segment in a consistent manner. No elimination is required on consolidation.

Goodwill and intangibles

Goodwill and intangibles relating to the non-covered business are included on an IFRS basis. Intangible assets recognised under IFRS relating to the value of future new business, such as distribution relationships and brand value, have been excluded from the Group MCEV.

Exchange rates

The results and cash flows of overseas subsidiaries and joint ventures have been translated at the average exchange rates for the period and the assets and liabilities have been translated at the period end rates. Translation differences are shown as foreign exchange adjustments in the consolidated statement of comprehensive income. Exchange rate driven movements in MCEV earnings are reported within economic variances.

Details of the exchange rates used are shown in note 9.

2. Analysis of MCEV earnings

The following tables show the movement in the MCEV of the Group including the results for BHA and WLUK from the dates of their 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 half year ended 30 June 2012

	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	**821**	**747**	**3,844**	**5,412**	**537**	**5,949**	**(153)**	**5,796**
Value of new business	**(157)**	**44**	**190**	**77**	**–**	**77**	**–**	**77**
Expected existing business contribution:								
– expected existing business contribution: reference rate	**13**	**(5)**	**30**	**38**	**–**	**38**	**–**	**38**
– expected existing business contribution: in excess of reference rate	**7**	**(22)**	**105**	**90**	**–**	**90**	**–**	**90**
Transfers from VIF and required capital to free surplus	**293**	**(12)**	**(281)**	**–**	**–**	**–**	**–**	**–**
Operating experience variances and development costs	**(43)**	**3**	**10**	**(30)**	**–**	**(30)**	**–**	**(30)**
Operating assumption changes	**–**	**–**	**11**	**11**	**–**	**11**	**–**	**11**
Other operating items	**17**	**–**	**(2)**	**15**	**(14)**	**1**	**(15)**	**(14)**
Operating MCEV earnings	**130**	**8**	**63**	**201**	**(14)**	**187**	**(15)**	**172**
Economic variances	**6**	**40**	**148**	**194**	**–**	**194**	**–**	**194**
Other non-operating items	**(82)**	**(32)**	**37**	**(77)**	**7**	**(70)**	**–**	**(70)**
Total MCEV earnings	**54**	**16**	**248**	**318**	**(7)**	**311**	**(15)**	**296**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**8**	**8**	**7**	**15**
Closing adjustments:								
– capital and dividend flows	**(308)**	**17**	**–**	**(291)**	**41**	**(250)**	**100**	**(150)**
– foreign exchange variances	**(1)**	**(3)**	**(14)**	**(18)**	**–**	**(18)**	**–**	**(18)**
Closing MCEV	**566**	**777**	**4,078**	**5,421**	**579**	**6,000**	**(61)**	**5,939**

For the half year ended 30 June 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/divested businesses	(165)	91	132	58	–	58	–	58
Adjusted opening MCEV	812	1,382	4,334	6,528	44	6,572	1	6,573
Value of new business	(185)	35	202	52	–	52	–	52
Expected existing business contribution:								
– expected existing business contribution: reference rate	4	3	27	34	–	34	–	34
– expected existing business contribution: in excess of reference rate	(17)	6	114	103	–	103	–	103
Transfers from VIF and required capital to free surplus	343	(37)	(306)	–	–	–	–	–
Operating experience variances and development costs	4	4	(22)	(14)	–	(14)	–	(14)
Operating assumption changes	(1)	(2)	1	(2)	–	(2)	–	(2)
Other operating variances	158	(11)	(156)	(9)	(18)	(27)	(16)	(43)
Operating MCEV earnings	306	(2)	(140)	164	(18)	146	(16)	130
Economic variances	(1)	(24)	(17)	(42)	–	(42)	–	(42)
Other non-operating items	(62)	3	26	(33)	(1)	(34)	–	(34)
Total MCEV earnings	243	(23)	(131)	89	(19)	70	(16)	54
Other movements in IFRS net equity	–	–	–	–	(24)	(24)	19	(5)
Closing adjustments:								
– capital and dividend flows	(494)	(490)	(1)	(985)	639	(346)	175	(171)
– foreign exchange variances	(1)	5	27	31	–	31	–	31
Closing MCEV	560	874	4,229	5,663	640	6,303	179	6,482

Transaction costs incurred in FLG of £1 million relating to the acquisition of BHA are included in other non-operating items.

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 half year ended 30 June 2012

	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	67	18	12	–	–	97	–	97
Expected existing business contribution	170	12	18	(35)	–	165	–	165
Operating experience variances	3	(8)	(10)	–	–	(15)	–	(15)
Operating assumption changes	9	–	5	–	–	14	–	14
Other operating variances	19	–	–	–	–	19	–	19
Development costs	(18)	(4)	–	–	–	(22)	–	(22)
Life and pensions covered business operating profit/(loss) before tax	250	18	25	(35)	–	258	–	258
Other income and charges	–	–	–	–	(8)	(8)	–	(8)
Life and pensions operating profit/(loss) before tax	250	18	25	(35)	(8)	250	–	250
Corporate income and charges	–	–	–	–	–	–	(15)	(15)
Operating profit/(loss) before tax	250	18	25	(35)	(8)	250	(15)	235
Economic variances	200	(2)	12	32	–	242	–	242
Other non-operating items	(102)	2	(1)	–	9	(92)	–	(92)
Profit/(loss) before tax	348	18	36	(3)	1	400	(15)	385
Attributed tax on operating profits	(61)	1	(6)	9	(6)	(63)	–	(63)
Attributed tax on other activities	(18)	2	(2)	(6)	(2)	(26)	–	(26)
Profit/(loss) after tax	269	21	28	–	(7)	311	(15)	296

(i) 'RSL (ex.FLG)' refers to the Resolution holding companies.

For the half year ended 30 June 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	28	20	18	–	–	66	–	66
Expected existing business contribution	167	14	21	(21)	–	181	–	181
Operating experience variances	(7)	(1)	2	–	–	(6)	–	(6)
Operating assumption changes	–	(2)	–	–	–	(2)	–	(2)
Other operating variances	6	(13)	–	–	–	(7)	–	(7)
Development costs	(10)	(3)	(1)	–	–	(14)	–	(14)
Life and pensions covered business operating profit/(loss) before tax	184	15	40	(21)	–	218	–	218
Other income and charges	–	–	–	–	(22)	(22)	–	(22)
Life and pensions operating profit/(loss) before tax	184	15	40	(21)	(22)	196	–	196
Corporate income and charges	–	–	–	–	–	–	(16)	(16)
Operating profit/(loss) before tax	184	15	40	(21)	(22)	196	(16)	180
Economic variances	49	(12)	(49)	(35)	(1)	(48)	–	(48)
Other non-operating items	(47)	1	–	–	(1)	(47)	–	(47)
Profit/(loss) before tax	186	4	(9)	(56)	(24)	101	(16)	85
Attributed tax on operating profits	(50)	–	(10)	5	5	(50)	–	(50)
Attributed tax on other activities	2	(2)	11	8	–	19	–	19
Profit/(loss) after tax	138	2	(8)	(43)	(19)	70	(16)	54

(i) 'RSL (ex.FLG)' refers to the Resolution holding companies.

UK covered business

The life and pensions covered business operating profit before tax for the UK segment was £250 million in the period to 30 June 2012 (30 June 2011: £184 million).

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 90bps (30 June 2011: 75bps) at the beginning of the period.

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 £170 million (30 June 2011: £167 million) comprises £145 million (30 June 2011: £152 million) from applying expected rates of return to the value of in-force at the start of the period and £25 million (30 June 2011: £15 million) of expected return on shareholders' net assets.

The expected contribution from the value of in-force of £145 million (30 June 2011: £152 million) reflects the expected rates of return applied to the opening value of in-force of £2,885 million at 1 January 2012 (£3,271 million at 1 January 2011, adjusted for the value of in-force of the acquired BHA and WLUK businesses during the period).

The UK expected contribution on shareholders' net assets of £25 million (30 June 2011: £15 million) reflects the return based on the reference rate. The increase in the contribution reflects a higher proportion of shareholder assets invested in corporate bonds, an increase in the reference rate and an increase in opening shareholder net assets.

Operating experience variances
Operating experience variances relate to variances between actual experience and that anticipated in the projection assumptions.

Operating experience variances totalled £3 million (30 June 2011: £(7) million) and comprise the following elements:

- a £6 million benefit from better than assumed mortality experience in particular on the life protection business;
- a £6 million benefit from better than assumed morbidity experience, in particular on the income protection business;
- a £4 million benefit from better than assumed persistency experience, in particular on the unit linked bonds business. At 31 December 2011 there was a provision of £88 million to cover adverse persistency experience as a result of the RDR. £16 million of this provision has been used to meet the adverse experience on unit linked pension business during the first half of 2012; and
- a £(13) million charge from actual expenses being higher than long-term expense assumptions, the majority of which relates to costs incurred during the year that will not form part of the the on-going cost base, such as cash associated with the establishment of Friends Life Investments ("FLI").

Operating assumption changes
An operating assumptions benefit of £9 million has been recognised during the period (30 June 2011: Nil) reflecting anticipated VAT savings on future investment expenses following the agreement to manage certain asset portfolios internally through FLI. Other operating variances

Other operating variances of £19 million (30 June 2011: £6 million) comprise:

- a £17 million net benefit from the impact of updates to the estimates of annuity rebates between With-Profits funds and shareholder funds; and
- a £2 million net benefit from other sources, primarily due to the benefits arising from a revised reinsurance programme on the Group Life business, partially offset by the adverse impact of refinements to the reserving methodology for certain with profit conventional pensions business.

Development costs
Development costs of £18 million (30 June 2011: £10 million) relate to costs that are expected to enhance current propositions and generate future profits which are not captured in the MCEV. These costs relate principally to:

- the development and delivery of the retirement income annuity business strategy;
- the development of the corporate investment platform;
- the development of business systems in advance of the introduction of auto-enrolment; and
- the development of the business in advance of the RDR.

International covered business

The life and pensions covered business operating profit before tax for the International segment was £18 million (30 June 2011: £15 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 £12 million (30 June 2011: £14 million) reflects the expected return on the opening value of in-force of £502 million at 1 January 2012 (30 June 2011: £473 million at 1 January 2011).

Operating experience variances

Operating experience variances of £(8) million (30 June 2011: £(1) million) comprise:

- a £2 million benefit from mortality experience being better than anticipated;
- a £(4) million charge from expenses being higher than anticipated, the majority of which relates to costs incurred during the period that will not form part of the ongoing cost base, including £(2) million of strategic review costs;
- a £(3) million charge from the establishment of a mortgage protection mis-selling provision in AmLife;
- a £(1) million charge from persistency experience being worse than anticipated on OLAB and AmLife businesses; and
- a £(2) million charge from other operational elements and other minor variances.

Operating assumption changes

There have been no changes to operating assumption changes in the period to 30 June 2012 (30 June 2011: £(2) million).

Other operating variances

There are no other operating variances in the period to 30 June 2012 (30 June 2011: £(13) million).

Development costs

Development costs of £4 million (30 June 2011: £3 million) relate to the development of the International platform.

Lombard covered business

The life and pensions covered business operating profit before tax for the Lombard segment was £25 million (30 June 2011: £40 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 £18 million (30 June 2011: £21 million) reflects the expected return on the opening value of in force of £457 million at 1 January 2012 (30 June 2011: £497 million at 1 January 2011).

Operating experience variances

Operating experience variances of £(10) million (30 June 2011: £2 million) comprise:

- a £(5) million charge from the one-off costs of strategic development plans;
- a £(2) million charge resulting from persistency experience being worse than anticipated on business other than that from the Spanish and Belgian markets. At 31 December 2011, a £6 million provision was established for short-term adverse persistency experience in the Spanish and Belgian markets. £4 million of this provision has been used to meet the adverse experience on this business during the first half of 2012; and
- £(3) million net impact from other items, including £(4) million of costs relating to share based payments which are not expected to recur.

Operating assumption changes

An operating assumptions benefit of £5 million (30 June 2011: £nil) has arisen in respect of future expenses savings available to be recognised to date as a result of the strategic development plans.

Other operating variances
There are no other operating variances in the period to 30 June 2012 (30 June 2011: £nil).

Development costs
There have been no development costs in the period to 30 June 2012 (30 June 2011: £1 million).

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 £(35) million (30 June 2011: £(21) million) represents the expected interest costs arising on the debt held within the FLG life and pensions covered business.

Non-covered business

FLG non-covered business reported an operating loss of £(8) million (30 June 2011: £(22) million) primarily due to the interest payable on the lower tier 2 subordinated debt issued to Resolution holding companies and holding company costs, partially offset by a £4 million benefit for the change in the expected cost of the FLG long term incentive plan.

The Resolution holding companies reported an operating loss of £(15) million (30 June 2011: £(16) million). The loss comprises £(13) million of finance costs and £(11) 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 £9 million on the internal LT2 subordinated debt 2020 issued by FLG.

Economic variances

Economic variances combine the impact of changes to economic assumptions with the investment return variances to expected investment returns over the period. The total economic variances were £242 million (30 June 2011: £(48) million) and these comprise:

- £130 million in respect of the UK annuity business, after allowance for changes in economic assumptions, primarily due to the narrowing of credit spreads;
- £40 million due to the reduction in long term inflation reducing future anticipated expenses across the UK business;
- £22 million due to the net effect of better than expected investment returns on the UK unit-linked business;
- £10 million from International and Lombard segments, mainly as a result of better than expected investment returns on unit-linked business;
- £32 million from a decrease in the market value of debt; and
- £8 million from other impacts.

Other non-operating items

Total other non-operating items of £(92) million (30 June 2011: £(47) million) comprise:

- £(48) million of non-recurring project costs within the covered business in respect of Solvency II costs and financial reporting improvements;
- £(39) million of non-recurring project costs within the covered business in respect of separation and integration of UK businesses ;
- £(24) million from the initial costs associated with the outsourcing agreement with Diligenta; partially offset by the utilisation of the provision established against these costs (discussed in note 9);
- £(13) million of restructuring costs associated with the capital optimisation programme;
- £10 million from curtailment gains arising on the Group's defined benefit pension scheme resulting from the DIligenta outsourcing agreement;
- £23 million from tax related non-operating items including £36 million from the impact of the reduction in corporation tax rate announced in March 2012. The corporation tax rate has been assumed to be reduced by 1% to 24% in April 2012, and then by 1% each year until it reaches the ultimate rate of 22% from April 2014; and
- £(1) million of other non-recurring items, including amortisation of non-covered business acquired intangible assets.

4. Earnings per share

Basic and operating earnings per share

Half year ended 30 June 2012	**Earnings £m**	**Per share pence**
Profit after tax attributable to ordinary equity holders of the parent	**296**	**21.48**
Economic variances	**(242)**	**(17.56)**
Amortisation of non-covered business acquired intangible assets	**1**	**0.07**
Non-recurring items and non-operating variances	**91**	**6.60**
Tax credit on items excluded from operating profit	**26**	**1.89**
Operating profit after tax attributable to ordinary equity holders of the parent	**172**	**12.48**

Half year ended 30 June 2011	Earnings £m	Per share pence
Profit after tax attributable to ordinary equity holders of the parent	54	3.73
Economic variances	48	3.32
Amortisation of non-covered business acquired intangible assets	1	0.07
Non-recurring items and non-operating variances	46	3.18
Tax credit on items excluded from operating profit	(19)	(1.31)
Operating profit after tax attributable to ordinary equity holders of the parent	130	8.99

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

Diluted earnings per share from continuing operations

There were no dilutive factors for the half years ended 30 June 2012 and 30 June 2011, or for the full year ended 31 December 2011.

Weighted average number of ordinary shares

	2012 Half year Actual	**2012 Half year Weighted**
Issued ordinary shares at beginning of period	**1,376,188,989**	**1,376,188,989**
Own shares held by the Group at the beginning of the period	**(2,661,384)**	**(2,661,384)**
Effect of:		
– scrip dividend (final 2011)	**15,484,945**	**3,441,099**
– reduction in own shares held by the Group	**2,661,384**	**1,345,477**
Number of ordinary shares at end of period	**1,391,673,934**	**1,378,314,181**

	2011 Half year Actual	2011 Half year Weighted
Issued ordinary shares at beginning of period	1,452,564,371	1,452,564,371
Own shares held by the Group at the beginning of the period	(8,579,292)	(8,579,292)
Effect of:		
– scrip dividend (final 2010)	13,639,313	2,652,088
– share repurchase	(11,243,352)	(62,463)
– reduction in own shares held by the Group	8,079,419	44,886
Number of ordinary shares at end of period	1,454,460,459	1,446,619,590

	2011 Full year Actual	2011 Full year 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

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	RSL	FLG	FLG
	30 Jun 2012 £m	30 Jun 2011 £m	31 Dec 2011 £m	30 Jun 2012 £m	30 Jun 2011 £m
Equity attributable to ordinary shareholders on an IFRS basis	**5,453**	6,105	5,672	5,514	5,926
Less items only included on an IFRS basis (net of tax):					
– IFRS reserving and other IFRS adjustments	**527**	500	463	527	500
– Deferred front end fees	**42**	37	33	42	37
– Deferred acquisition costs	**(620)**	(346)	(500)	(620)	(346)
– Acquired present value of in-force ("AVIF")	**(3,305)**	(3,422)	(3,442)	(3,305)	(3,422)
– Other intangible assets	**(271)**	(315)	(305)	(271)	(315)
Other(i)	**–**	(222)	–	–	(222)
Add items only included on a MCEV basis (net of tax):					
– Adjustment for long-term debt to market value	**35**	(84)	31	35	(84)
Net worth on a MCEV basis	**1,861**	2,253	1,952	1,922	2,074
Value of in-force covered business(i)	**4,078**	4,229	3,844	4,078	4,229
Equity attributable to ordinary shareholders on a MCEV basis	**5,939**	6,482	5,796	6,000	6,303

(i) The GOF and TIP businesses were classified as held for sale assets and liabilities at 30 June 2011 in both the Group's IFRS and MCEV balance sheets with a net value of £284 million. Within the MCEV statement of financial position, the held for sale assets are further split between value of in-force covered business of £222 million and other assets. The value of in-force covered business for the GOF and TIP businesses was included in the Group's total value of in-force covered business of £4,229 million at 30 June 2011. There were no held for sale assets and liabilities as at 30 June 2012 or 31 December 2011.

6. New business

The tables below set out the analysis of new business in terms of volumes and profitability.

New business volumes have been shown using two measures:

- Present Value of New Business Premiums ("PVNBP"). PVNBP is equal to the total single premium sales received in the period plus the discounted value of regular premiums expected to be received over the lifetime of new contracts, and is expressed at point of sale; and
- Annual Premium Equivalent ("APE"). APE is calculated as the new regular premium sales 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 30 June 2011 table below excludes new business in relation to the GOF and TIP businesses disposed of in November 2011.

New business value for the half year ended 30 June 2012

	New business premiums							
	Single £m	Regular £m	APE £m	Average annual premium multiplier (i)	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
UK Corporate								
– Group pensions	**556**	**251**	**306**	**4.2**	**1,604**	**1**	**1**	**0.1**
– Group protection	**–**	**19**	**19**	**6.3**	**120**	**9**	**12**	**10.0**
UK Individual								
– Individual protection	**16**	**27**	**29**	**7.0**	**206**	**19**	**25**	**12.1**
– Individual pensions	**269**	**6**	**33**	**3.2**	**288**	**5**	**7**	**2.4**
Annuities(ii)	**226**	**–**	**23**	**–**	**226**	**17**	**22**	**9.7**
Investments	**39**	**–**	**4**	**–**	**38**	**–**	**–**	**–**
UK total	**1,106**	**303**	**414**	**4.5**	**2,482**	**51**	**67**	**2.7**
International	**286**	**75**	**104**	**5.5**	**697**	**17**	**18**	**2.6**
Lombard	**948**	**–**	**95**	**–**	**948**	**9**	**12**	**1.3**
Non-UK total	**1,234**	**75**	**199**	**5.5**	**1,645**	**26**	**30**	**1.8**
Total	**2,340**	**378**	**613**	**4.7**	**4,127**	**77**	**97**	**2.4**

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).

(ii) The value of new business for annuities shown in the table above has been valued assuming an average illiquidity premium of 90 bps over the six months to 30 June 2012.

New business value for the half year ended 30 June 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								
– Group pensions	327	208	242	4.3	1,199	(1)	(1)	(0.0)
– Group protection	–	12	12	5.8	74	1	2	3.5
UK Individual								
– Individual protection	–	44	44	6.5	287	3	4	1.2
– Individual pensions	246	9	33	2.8	288	2	3	1.2
Annuities(ii)	189	–	19	–	189	12	16	8.8
Investments	220	–	22	–	220	3	4	1.8
UK total	982	273	372	4.6	2,257	20	28	1.2
International	362	96	132	4.7	828	19	20	2.5
Lombard	968	–	97	–	969	13	18	1.8
Non-UK total	1,330	96	229	4.7	1,797	32	38	2.1
Total	2,312	369	601	4.6	4,054	52	66	1.6

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).

(ii) The value of new business for annuities shown in the table above has been valued assuming an average illiquidity premium of 75bps over the six months to 30 June 2011.

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 that 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 table below shows the new business value under this revised business unit structure.

New business value for the half year ended 30 June 2012 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	**579**	**233**	**291**	**4.2**	**1,552**	**8**	**10**	**0.6**
Protection	**–**	**44**	**44**	**6.4**	**282**	**21**	**28**	**9.9**
Retirement Income(ii)	**187**	**–**	**19**	**–**	**187**	**19**	**25**	**13.4**
UK Heritage	**340**	**26**	**60**	**4.7**	**461**	**3**	**4**	**0.9**
UK total	**1,106**	**303**	**414**	**4.5**	**2,482**	**51**	**67**	**2.7**
International	**286**	**75**	**104**	**5.5**	**697**	**17**	**18**	**2.6**
Lombard	**948**	**–**	**95**	**–**	**948**	**9**	**12**	**1.3**
Non-UK total	**1,234**	**75**	**199**	**5.5**	**1,645**	**26**	**30**	**1.8**
Total	**2,340**	**378**	**613**	**4.7**	**4,127**	**77**	**97**	**2.4**

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums).

(ii) The value of new business for annuities shown in the table above has been valued assuming an average illiquidity premium of 90bps over the six months to 30 June 2012.

UK

The pre-tax VNB from the UK segment was £67 million (30 June 2011: £28 million), includes a £5 million contribution from the WLUK business acquired in the second half of 2011 and comprises:

- UK Corporate Benefits VNB of £10 million, reflecting strong overall volumes and reduced expenses following the Diligenta outsourcing deal;
- UK Protection VNB of £28 million, a significant improvement in VNB 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 £25 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.

International

International VNB was £18 million (30 June 2011: £20 million) for the period; the marginal decrease resulted from reduced sale volumes which have been impacted by market uncertainty across Europe, partially offset by a favourable take up of recently launched products carrying higher margins.

Lombard

Lombard VNB of £12 million (30 June 2011: £18 million) has decreased despite volumes remaining stable. This reflects a changing product mix from IFA led business to Private Banks business, with this shift expected to impact short-term margins whilst distribution channels mature.

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

	Half year ended 30 June 2012			Half year ended 30 June 2011		
	Pre-tax value of new business £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						
– Group pensions	**1**	**4.8**	**15**	(1)	5.3	15
– Group protection	**12**	**10.7**	**10**	2	7.0	12
UK Individual						
– Individual protection	**25**	**11.8**	**7**	4	5.0	12
– Individual pensions	**7**	**9.7**	**9**	3	8.2	10
Annuities	**22**	**>25.0**	**5**	16	23.8	6
Investments	**–**	**–**	**–**	4	9.4	8
UK total	**67**	**9.4**	**10**	28	7.0	12
International	**18**	**10.5**	**8**	20	13.5	7
Lombard [(i)]	**12**	**14.1**	**8**	18	19.0	6
Non-UK total	**30**	**11.4**	**8**	38	14	7
Total	**97**	**10.0**	**10**	66	9.6	10

(i) The Lombard IRR (and therefore the blended group IRR) 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

	Half year ended 30 June 2012		
	Pre-tax value of new business £m	**Internal rate of return on new business %**	**Cash payback on new business Years**
UK Corporate Benefits	**10**	**6.8**	**12**
UK Protection	**28**	**9.8**	**9**
UK Retirement Income	**25**	**>25.0**	**1**
UK Heritage	**4**	**4.2**	**15**
UK total	**67**	**9.4**	**10**
International	**18**	**10.5**	**8**
Lombard	**12**	**14.1**	**8**
Non-UK total	**30**	**11.4**	**8**
Total	**97**	**10.0**	**10**

7. Segmental analysis of Group MCEV

	30 June 2012									31 December 2011
	Free surplus £m	**Required capital £m**	**Total net worth £m**	**PVFP £m**	**TVOG £m**	**Frictional costs £m**	**CNHR £m**	**Total VIF £m**	**Total £m**	Total £m
UK	**517**	**1,645**	**2,162**	**3,458**	**(99)**	**(103)**	**(181)**	**3,075**	**5,237**	5,341
International	**46**	**48**	**94**	**553**	**(3)**	**(4)**	**(18)**	**528**	**622**	571
Lombard	**3**	**74**	**77**	**501**	**–**	**(4)**	**(22)**	**475**	**552**	541
FLG Corporate[i]										
– IFA and distribution	**19**	**–**	**19**	**–**	**–**	**–**	**–**	**–**	**19**	61
– Pension asset of FPPS	**47**	**–**	**47**	**–**	**–**	**–**	**–**	**–**	**47**	30
– Other	**713**	**(74)**	**639**	**–**	**–**	**–**	**–**	**–**	**639**	564
Gross MCEV of FLG[ii]	**1,345**	**1,693**	**3,038**	**4,512**	**(102)**	**(111)**	**(221)**	**4,078**	**7,116**	7,108
FLG corporate– external STICS	**–**	**(298)**	**(298)**	**–**	**–**	**–**	**–**	**–**	**(298)**	(327)
FLG corporate– external LT2 subordinated debt 2021,2022	**–**	**(618)**	**(618)**	**–**	**–**	**–**	**–**	**–**	**(618)**	(632)
FLG corporate – internal LT2 subordinated debt 2020	**(200)**	**–**	**(200)**	**–**	**–**	**–**	**–**	**–**	**(200)**	(200)
Net MCEV of FLG	**1,145**	**777**	**1,922**	**4,512**	**(102)**	**(111)**	**(221)**	**4,078**	**6,000**	5,949
Resolution [iii] corporate net assets	**302**	**–**		**–**	**–**	**–**	**–**	**–**	**302**	270
Resolution Limited DCNs	**(363)**	**–**		**–**	**–**	**–**	**–**	**–**	**(363)**	(423)
Net Group MCEV of Resolution Limited attributable to equity holders of parent	**1,084**	**777**	**1,922**	**4,512**	**(102)**	**(111)**	**(221)**	**4,078**	**5,939**	5,796

(i) FLG corporate excludes external STICS, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022

(ii) 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.

(iii) 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 9.

ii) PVFP

The PVFP at 30 June 2012 includes a deduction of £54 million net of tax (31 December 2011: £65 million) from the UK, as a provision against worsening short-term persistency as a result of the Retail Distribution Review, and a £7 million (31 December 2011: £10 million) deduction in respect of a short term persistency provision established in Lombard relating to the Spanish and Belgian markets.

iii) TVOG

The TVOG at 30 June 2012 of £102 million (31 December 2011: £101 million), is split between £70 million (31 December 2011: £69 million) market risk and £32 million (31 December 2011: £32 million) non-market risk. The non-market risks include lapses, annuitant longevity, and operational risk within the with-profits fund. The allowance for non-market risks is made by consideration of the impact of extreme scenarios from the Group's economic capital model.

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% 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 (31 December 2011: 150%). The cost of holding any additional capital is shown in the FLG covered business segment.

v) CNHR

The cost of residual non-hedgeable risk of £221 million (31 December 2011: £223 million) is presented as an equivalent annual cost of capital charge of 2% (31 December 2011: 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 tables below show a further breakdown of the Group 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.

Half year ended 30 June 2012

	FLG						RSL	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FLG Corporate £m	Non-covered business £m	Total £m	RSL (ex.FLG) Non-covered business[(i)] £m	Total £m
Opening Group MCEV	**5,341**	**571**	**541**	**(1,041)**	**537**	**5,949**	**(153)**	**5,796**
Operating MCEV earnings	**190**	**19**	**19**	**(27)**	**(14)**	**187**	**(15)**	**172**
Non-operating MCEV earnings	**79**	**2**	**9**	**27**	**7**	**124**	**–**	**124**
Total MCEV earnings	**269**	**21**	**28**	**–**	**(7)**	**311**	**(15)**	**296**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**8**	**8**	**7**	**15**
Closing adjustments:								
– capital and dividend flows	**(373)**	**31**	**–**	**51**	**41**	**(250)**	**100**	**(150)**
– foreign exchange variances	**–**	**(1)**	**(17)**	**–**	**–**	**(18)**	**–**	**(18)**
Closing Group MCEV	**5,237**	**622**	**552**	**(990)**	**579**	**6,000**	**(61)**	**5,939**

(i) 'RSL (ex. FLG)' refers to the Resolution holding companies

Other movements in IFRS net equity reflect £8 million of actuarial gains on the Group's defined benefit pension scheme and £7 million in respect of the reduction in Company shares held by the Group during the period.

Half year ended 30 June 2011

	FLG						RSL	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FLG Corporate £m	Non-covered business £m	Total £m	RSL (ex.FLG) 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)
Adjusted opening Group MCEV	6,053	557	577	(659)	44	6,572	1	6,573
Operating MCEV earnings	135	15	30	(16)	(18)	146	(16)	130
Non-operating MCEV earnings	3	(13)	(39)	(26)	(1)	(76)	–	(76)
Total MCEV earnings	138	2	(9)	(42)	(19)	70	(16)	54
Other movements in IFRS net equity	–	–	–	–	(24)	(24)	19	(5)
Closing adjustments:								
– capital and dividend flows	(506)	(7)	(2)	(470)	639	(346)	175	(171)
– foreign exchange variances	–	–	31	–	–	31	–	31
Closing Group MCEV	5,685	552	597	(1,171)	640	6,303	179	6,482

(i) 'RSL (ex. FLG)' refers to the Resolution holding companies.

Year ended 31 December 2011

	FLG						RSL	
	Covered business							
	UK £m	Int'l £m	Lombard £m	FLG Corporate £m	Non-covered business £m	Total £m	RSL (ex.FLG) Non-covered business £m	Total £m
Opening Group MCEV	5,995	557	577	(659)	44	6,514	1	6,515
Opening adjustments:								
– capital and dividend flows								
– 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

9. MCEV assumptions

9.1 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 the value of in-force 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		
	30 Jun 2012	30 Jun 2011	31 Dec 2011
	%	%	%
UK			
Long-term rate	**2.20**	3.70	2.40
Swap yield curve			
– Term 1 year	**1.06**	1.17	1.35
– Term 5 years	**1.27**	2.55	1.57
– Term 10 years	**2.17**	3.71	2.36
– Term 15 years	**2.68**	4.19	2.78
– Term 20 years	**2.97**	4.29	3.00
International long-term rate	**2.20**	3.70	2.40
Lombard long-term rate	**2.24**	3.53	2.55

Reference rate – Illiquidity premium adjustment

The updated MCEV Principles recognise that the inclusion of an illiquidity premium within the reference rate is appropriate where the liabilities are not liquid.

In this regard, the methodology adopted for the valuation of immediate annuities in the UK uses a reference rate that has been increased above the swap yield curve to allow for an illiquidity premium. This reflects the fact that, for these products, the backing asset portfolio can be held to maturity and earns risk-free returns in excess of swaps. Any illiquidity premia in respect of assets backing other product types are recognised within the MCEV as and when they are earned.

The illiquidity premium has been evaluated by considering a number of different sources of information and methodologies. There are two main approaches being commonly used to determine the illiquidity premium within the life insurance industry:

- a “negative basis trade”, which attributes a component of the difference between the spread on a corporate bond and a credit default swap (for the same issuing entity, maturity, seniority and currency) as being the illiquidity premium; and
- structural models – such as that used by the Bank of England in their analysis of corporate bond spreads – that use option pricing techniques to decompose the spread into its constituent parts including default risk, credit risk premium and a residual illiquidity premium.

Both of these methods have been used to help inform the extent of the illiquidity premium within the asset portfolios backing immediate annuity business.

No illiquidity premium has been applied for any other covered business.

The reference rate has been adjusted for immediate annuities as set out in the table below.

	Embedded value			New business		
	30 Jun 2012	30 Jun 2011	31 Dec 2011	**30 Jun 2012**	30 Jun 2011	31 Dec 2011
UK immediate annuities	**90 bps**	75 bps	90 bps	**90 bps**	75 bps	80 bps

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 (3% at 30 June 2011 and 31 December 2011) and 2% for property (2% at 30 June 2011 and 31 December 2011).

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% per annum in excess of the assumed long-term rate of inflation. This is derived from the difference between the risk-free rate of return based on the FT Actuaries 15 year gilt index and the average of the FTSE Actuaries over five-year index-linked gilt yield at 5% and 0% inflation.

Maintenance expenses for Lombard are assumed to increase in the future at a rate of 0.75% per annum in excess of the assumed long-term rate of inflation. This is derived from an inflation swap curve based on a Euro-zone price index taking into account the run-off profile of the business.

	Expense inflation		
	30 Jun 2012 %	30 Jun 2011 %	31 Dec 2011 %
UK	**3.40**	4.50	3.70
International	**3.40**	4.50	3.70
Lombard	**2.70**	3.20	2.95

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		
	30 Jun 2012	30 Jun 2011	31 Dec 2011
Closing exchange rate			
– Euro	**0.809**	0.903	0.835
– Malaysian Ringgit	**0.203**	0.206	0.203
Average exchange rate			
– Euro	**0.823**	0.874	0.869
– Malaysian Ringgit	**0.203**	0.204	0.204

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”)
- FLWL With-Profits Fund (“FLWL 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 a 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.

With-profits policies where policyholders had elected to take part in the re-attribution 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 remaining RIE in the FLC NPFs is predominantly 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. The MCEV allows for best estimate projections of the amounts to be transferred in future.

9.2 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 historical data.

Swaption implied volatilities

	30 Jun 2012 Swap term				30 Jun 2011 Swap term				31 Dec 2011 Swap term			
Option term	**10 yrs %**	**15 yrs %**	**20 yrs %**	**25 yrs %**	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**	13.0	13.8	14.4	14.9	17.6	17.6	17.8	17.9
15 years	**15.4**	**15.6**	**15.8**	**15.8**	12.9	13.5	13.9	14.1	15.4	15.6	15.8	15.8
20 years	**14.1**	**14.3**	**14.3**	**14.2**	12.8	13.1	13.2	13.1	14.1	14.3	14.3	14.2
25 years	**13.3**	**13.0**	**13.0**	**12.7**	12.5	12.4	12.2	12.0	13.3	13.2	13.0	12.7

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% (30 June 2011: 15%, 31 December 2011: 15%) and a running yield of 4.3% (30 June 2011: 4.3%, 31 December 2011: 4.3%). Sample implied volatilities are shown in the table below.

	30 Jun 2012		30 Jun 2011		31 Dec 2011	
Option term	**Equity %**	**Property %**	Equity %	Property %	Equity %	Property %
5 years	**26.9**	**14.8**	24.5	15.8	26.9	14.8
10 years	**27.0**	**15.1**	24.6	16.1	27.0	15.1
15 years	**27.3**	**14.6**	24.7	16.1	27.3	14.6

9.3 Other assumptions

Required capital
Required capital under MCEV amounted to £777 million (£874 million at 30 June 2011, £747 million at 31 December 2011).

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% 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% of Group CRR excluding WPICC (30 June 2011: 160%, 31 December 2011: 150%), 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 period, and hence the rate applicable for 2012 reflects the reduction in corporation tax that took effect from April 2012.

For non-covered business, attributed tax is consistent with the IFRS financial statements.

	Tax rates		
	30 Jun 2012 %	30 Jun 2011 %	31 Dec 2011 %
UK	**24.5**	26.5	26.5
International			
– OLAB (UK)	**24.5**	26.5	26.5
– FPIL (Isle of Man)	**0.0**	0.0	0.0
– AmLife and AmFamily (Malaysia)	**25.0**	25.0	25.0
Lombard	**23.8**	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 reductions of 1% announced in each of the Budgets in April 2011 and April 2012. The MCEV allows for anticipated future annual reductions in corporation tax from 24% to 22% (31 December 2011: 26% to 23%) over the period to 2014 and for an ultimate rate of 22% (31 December 2011: 23%) from April 2014.

Changes to the corporation tax regime for UK long term insurance business will be introduced from 1 January 2013. These changes are not taken into account in the MCEV as at 30 June 2012. Although they were incorporated in legislation being considered by Parliament, there is further secondary legislation which is still subject to substantive change. Furthermore, a large proportion of the legislation is principles based with methodologies not yet agreed with HM Revenue & Customs, so that the legislation does not constitute a “known change” due to a high degree of uncertainty of tax outcome.

VAT in the UK of 20.0% (31 December 2011: 20.0%, 30 June 2011: 20.0%) less expected recoveries has been included on relevant investment management expenses and, where applicable, on 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) was recognised as at 31 December 2011, to cover negative variances expected on initial commission business pre-RDR in 2012 where long-term assumptions were expected to be temporarily inadequate. Following the release of £16 million against adverse experience in the first half of 2012, this provision has been reduced to £72 million (gross of tax) as at 30 June 2012.

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 (31 December 2011: 1.25%). At 30 June 2011, 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 Friends Life Services Limited ("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 has been allowed for by reducing the PVFP by £0.6 million for a projected overrun to 2013 (30 June 2011: £2 million for a projected overrun to 2012, 31 December 2011: £1 million for a projected overrun to 2013).

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 these functions. This agreement resulted in significant longer term cost reductions and an overall increase to MCEV of £76 million in 2011. In addition, allowance was made in 2011 for the initial significant development expenditure of £(124) million, considered to be non-recurring and shown within other non-operating items in the 2011 full year results. In the first half of 2012, initial development costs of £(40) million have been incurred in relation to the Diligenta arrangement which have been partially offset by a £16 million utilisation of the £124 million provision set up in 2011. The net cost of £(24) million is shown in the consolidated income statement within other non-operating items.

Other one-off costs shown within non-recurring items can be categorised as:
- Solvency II and Finance Transformation 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 £22 million (30 June 2011: £14 million, 31 December 2011: £36 million) have been excluded from the calculation of unit costs and have been included 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 period's financial results until the value is realised.

Development costs

	FLG	FLG	FLG
	Half year ended 30 Jun 2012 £m	Half year ended 30 Jun 2011 £m	Year ended 31 Dec 2011 £m
UK	**18**	10	28
International	**4**	3	7
Lombard	**–**	1	1
Total	**22**	14	36

Non-hedgeable risks

A charge equivalent to 2% (2% at 30 June 2011 and 31 December 2011) 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.

30 June 2012	**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**
STICS 2003	**210**	**133**	**2**	**18**	**153**
STICS 2005	**268**	**165**	**17**	**20**	**202**
LT2 subordinated debt 2021	**162**	**178**	**2**	**(5)**	**175**
LT2 subordinated debt 2022	**500**	**440**	**8**	**12**	**460**
Total	**1,140**	**916**	**29**	**45**	**990**

30 June 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
STICS 2003	210	178	2	7	187
STICS 2005	268	229	–	10	239
LT 2 subordinated debt 2021	162	208	2	(13)	197
LT2 subordinated debt 2022	500	498	8	(2)	504
Total	1,140	1,113	12	2	1,127

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
STICS 2003	210	142	2	17	161
STICS 2005	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

(i) The value of debt included in the FLG corporate segment 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 30 June 2012 is £363 million (30 June 2011: £437 million; 31 December 2011: £423 million).

10. 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 half year ended 30 June 2012

	MCEV classification					
30 June 2012	**UK £m**	**Int'l £m**	**Lombard £m**	**FLG Corporate £m**	**Non-covered business £m**	**Total MCEV by IFRS segments £m**
IFRS segment						
UK	**5,237**	**–**	**–**	**–**	**21**	**5,258**
International	**–**	**622**	**–**	**–**	**(2)**	**620**
Lombard	**–**	**–**	**552**	**–**	**6**	**558**
FLG Corporate	**–**	**–**	**–**	**(990)**	**554**	**(436)**
Total MCEV (by MCEV segments)	**5,237**	**622**	**552**	**(990)**	**579**	**6,000**

FLG for the half year ended 30 June 2011

	MCEV classification					
30 June 2011	UK £m	Int'l £m	Lombard £m	FLG corporate £m	Non- covered business £m	Total MCEV by IFRS segments £m
IFRS segment						
UK	5,685	–	–	–	52	5,737
International	–	552	–	–	(2)	550
Lombard	–	–	597	–	8	605
FLG Corporate	–	–	–	(1,171)	582	(589)
Total MCEV (by MCEV segments)	5,685	552	597	(1,171)	640	6,303

FLG for the year ended 31 December 2011

	MCEV classification					
31 December 2011	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

11. FLG annualised return on embedded value

	Half year 2012 % p.a.	Half year 2011 % p.a.	Full year 2011 % p.a.
Value of new business	**2.8**	1.7	2.0
Expected existing business contribution(i)	**5.7**	5.2	5.3
Operating experience variances	**(0.4)**	(0.1)	(0.4)
Operating assumption changes	**0.4**	(0.1)	1.8
Other operating variance	**0.5**	(0.2)	0.1
Development costs	**(0.6)**	(0.4)	(0.4)
Other income and charges(ii)	**–**	0.1	–
MCEV operating profit before tax and financing	**8.4**	6.2	8.4
Impact of financing	**0.2**	(0.1)	0.5
Attributed tax charge on MCEV operating profit	**(2.2)**	(1.6)	(2.4)
MCEV operating profit after tax	**6.4**	4.5	6.5
Economic variances	**8.4**	(1.5)	(9.5)
Other non-operating items	**(3.2)**	(1.4)	(4.5)
Attributed tax on other activities	**(0.9)**	0.6	3.5
MCEV profit/(loss) after tax	**10.7**	2.2	(4.0)
Actuarial gains/(losses) on defined benefit pension schemes	**0.3**	(0.8)	(0.6)
Foreign exchange adjustments	**(0.7)**	1.0	(0.2)
Total return on MCEV over the period	**10.3**	2.4	(4.8)

(i) Excludes estimated impact of financing of covered debt of £35 million for half year 2012 (£21 million for half year 2011, £46 million for full year 2011).

(ii) Excludes £9 million impact of financing of non-covered internal debt of £200 million for half year 2012 (£24 million for half year 2011, £33 million for full year 2011).

The table above provides an analysis of the return on FLG embedded value. The starting embedded value for 2012 is £5,949 million, net of the market-consistent value of debt instruments of £1,159 million. The 2012 embedded value has been adjusted to allow for the timing of dividend payments. The starting embedded value for 2011 was £6,514 million, net of the market-consistent value of debt instruments of £1,296 million. The 2011 embedded value was 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

Period ended 30 June 2012 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
New Business APE	90	12	2	**104**
New Business PVNBP	601	77	19	**697**
VNB	14	2	2	**18**

IFRS based operating profit

Period ended 30 June 2012 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
New business strain	(17)	(7)	–	**(24)**
In-force surplus	48	3	–	**51**
Investment return and other items	–	–	–	**–**
Principal reserving changes and one-off items	–	–	–	**–**
Development costs	(4)	–	–	**(4)**
Other	–	–	(2)	**(2)**
IFRS based operating profit before tax	27	(4)	(2)	**21**

MCEV operating profit

Period ended 30 June 2012 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
Value of new business	14	2	2	**18**
Expected existing business contribution	10	1	1	**12**
Operating experience variance	(2)	(2)	(4)	**(8)**
Operating assumption changes	–	–	–	**–**
Other operating variances	–	–	–	**–**
Development costs	(4)	–	–	**(4)**
Other	–	–	–	**–**
MCEV operating profit before tax	**18**	**1**	**(1)**	**18**

MCEV

As at 30 June 2012 **£m**	**FPIL**	**OLAB**	**AmLife**	**TOTAL**
Total	**505**	**77**	**38**	**620**

Operating expenses

Period ended 30 June 2012 **£m**	**FPIL**	**OLAB**	**TOTAL**
Acquisition	(11)	(6)	(17)
Maintenance	(13)	(4)	(17)
Development	(3)	(1)	(4)
Total	(27)	(11)	(38)

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		
	H1[(i)] 2012 £m	H1[(ii)] 2011 £m	Change %	**H1[(i)] 2012 £m**	H1[(ii)] 2011 £m	Change %
Corporate Benefits	**233.5**	184.8	26	**579.3**	341.8	69
Protection	**43.5**	49.7	(12)	**–**	–	–
Retirement Income	**–**	–	–	**186.9**	157.5	19
UK Heritage	**26.4**	39.1	(32)	**340.3**	482.4	(29)
Total UK Life and Pensions	**303.4**	273.6	11	**1,106.5**	981.7	13
International	**75.1**	96.0	(22)	**285.8**	361.6	(21)
Lombard	**–**	–	–	**947.9**	968.7	(2)
Total International Life and Pensions	**75.1**	96.0	(22)	**1,233.7**	1,330.3	(7)
Total Life and Pensions	**378.5**	369.6	2	**2,340.2**	2,312.0	1

(i) Includes the trading results of the acquired WLUK business, acquired 1 November 2011.

(ii) Includes the trading results of the acquired BHA business for the five month period from 1 February 2011.

	Regular premiums			Single premiums		
	Q2 2012 £m	Q1 2012 £m	Change %	**Q2 2012 £m**	Q1 2012 £m	Change %
Corporate Benefits	**117.3**	116.2	1	**284.9**	294.4	(3)
Protection	**25.2**	18.3	38	**–**	–	–
Retirement Income	**–**	–	–	**95.5**	91.4	4
UK Heritage	**13.1**	13.3	(2)	**234.2**	106.1	121
Total UK Life and Pensions	**155.6**	147.8	5	**614.6**	491.9	25
International	**37.7**	37.4	1	**149.9**	135.9	10
Lombard	**–**	–	–	**505.2**	442.7	14
Total International Life and Pensions	**37.7**	37.4	1	**655.1**	578.6	13
Total Life and Pensions	**193.3**	185.2	4	**1,269.7**	1,070.5	19

Group new business - APE

APE represents annualised new regular premiums plus 10% of single premiums.

	H1[(i)] 2012 £m	H1[(ii)] 2011 £m	Change %	**Q2 2012 £m**	Q1 2012 £m	Change %
Corporate Benefits	**291.5**	219.0	33	**145.8**	145.7	–
Protection	**43.5**	49.7	(12)	**25.2**	18.3	38
Retirement Income	**18.7**	15.8	18	**9.6**	9.1	5
UK Heritage	**60.3**	87.3	(31)	**36.4**	23.9	52
Total UK Life and Pensions	**414.0**	371.8	11	**217.0**	197.0	10
International	**103.7**	132.2	(22)	**52.7**	51.0	3
Lombard	**94.8**	96.9	(2)	**50.5**	44.3	14
Total International Life and Pensions	**198.5**	229.1	(13)	**103.2**	95.3	8
Total Life and Pensions	**612.5**	600.9	2	**320.2**	292.3	10

(i) Includes the trading results of the acquired WLUK business, acquired 1 November 2011.

(ii) Includes the trading results of the acquired BHA business for the five month period from 1 February 2011.

International

APE by region (actual exchange rates)	**H1 2012 £m**	H1 2011 £m	Change %
North Asia	**32.1**	55.4	(42)
South Asia	**12.4**	13.2	(6)
Middle East	**23.9**	24.2	(1)
Europe (Excl UK)	**11.9**	15.5	(23)
UK	**10.4**	9.7	7
Rest of World	**10.7**	10.0	7
Malaysia (AmLife)	**2.3**	4.2	(45)
Total	**103.7**	132.2	(22)

Lombard

APE by region (actual exchange rates)	**H1 2012 £m**	H1 2011 £m	Change %
UK and Nordic	**29.6**	25.2	17
Northern Europe	**14.2**	18.0	(21)
Southern Europe	**41.1**	40.7	1
Rest of World	**9.9**	13.0	(24)
Total including large cases	**94.8**	96.9	(2)
Of which: Large cases (greater than €10m)	**32.8**	38.6	(15)
Total excluding large cases	**62.0**	58.3	6

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:

	H1 2012 £m	H1 2011 £m	Change %
International	**102.7**	132.2	(22)
Lombard	**101.0**	96.9	4

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.

	H1(i) 2012 £m	H1(ii) 2011 £m	Change %	Q2 2012 £m	Q1 2012 £m
Corporate Benefits	**1,552**	1,491	4	776	776
Protection	**282**	353	(20)	164	118
Retirement Income	**187**	183	2	96	91
UK Heritage	**461**	230	100	292	169
Total UK Life and Pensions	**2,482**	2,257	10	1,328	1,154
International	**697**	828	(16)	356	341
Lombard	**948**	969	(2)	505	443
Total International Life and Pensions	**1,645**	1,797	(8)	861	784
Total Life and Pensions	**4,127**	4,054	2	2,189	1,938

(i) Includes the trading results of the acquired WLUK business, acquired 1 November 2011.

(ii) Includes the trading results of the acquired BHA business for the five month period from 1 February 2011.

New UK management structure

The Company announced in 2011 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 period to 30 June 2012.

APE £m	New UK management structure				
Period to 30 June 2012	**Protection**	**Corporate Benefits**	**Retirement Income**	**Heritage**	**Total UK**
Corporate					
– pensions	–	282.4	–	23.4	**305.8**
– protection	19.4	–	–	–	**19.4**
Individual					
– protection	24.1	–	1.6	3.2	**28.9**
– pensions	–	9.1	–	24.3	**33.4**
– investments	–	–	–	3.9	**3.9**
Annuities	–	–	17.1	5.5	**22.6**
Sales across new UK management structure	43.5	291.5	18.7	60.3	**414.0**

Appendix 3: Additional cash analysis

The build up of MCEV from available shareholder cash to free surplus and shareholder resources is shown below.

30 June 2012 £m	Life operating businesses	Other operating businesses[i]	Friends Life holding companies	Resolution holding companies	Total
Available shareholder cash	**100**	**–**	**414**	**105**	**619**
Working capital and other resources	466	(32)	137	(3)	568
External debt	–	–	–	(363)	(363)
Intercompany debt	–	–	(200)	200	–
Total free surplus	**566**	**(32)**	**351**	**(61)**	**824**
Required capital and inadmissible items	1,767	120	140	–	2,027
External debt	(990)	–	–	–	(990)
Total shareholder resources	**1,343**	**88**	**491**	**(61)**	**1,861**
Value of in-force business	4,078	–	–	–	4,078
Total MCEV	**5,421**	**88**	**491**	**(61)**	**5,939**

(i) Other operating businesses comprise service companies and distribution companies.

Analysis of movement in shareholder resources

	Life operating businesses		Other operating businesses[i]		Friends Life 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	**821**	**747**	**6**	**114**	**255**	**162**	**(153)**	**929**	**1,023**
Expected return from in-force business	348	(47)	–	–	–	–	–	348	(47)
Investment in new business	(157)	44	–	–	–	–	–	(157)	44
Underlying shareholder resources generation	**191**	**(3)**	**–**	**–**	**–**	**–**	**–**	**191**	**(3)**
Coupon on external debt	(35)	8						(35)	8
Experience variances and development costs	(43)	3	–	–	–	–	–	(43)	3
Operating assumption changes	–	–	–	–	–	–	–	–	–
Other operating movements	17	–	(1)	7	(9)	(11)	(15)	(8)	(4)
Operating shareholder resources generation	130	8	(1)	7	(9)	(11)	(15)	105	4
Other non-operating variances	(76)	8	–	(1)	–	8	–	(76)	15
Shareholder resources generated in the businesses	54	16	(1)	6	(9)	(3)	(15)	29	19
Other capital/net asset adjustments	(309)	14	(37)	–	105	(19)	292	51	(5)
Shareholder dividend	–	–	–	–	–	–	(185)	(185)	–
Total movement	(255)	30	(38)	6	96	(22)	92	(105)	14
Closing shareholder resources	566	777	(32)	120	351	140	(61)	824	1,037

(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	821	747	3,844	261	276	537	(153)	5,796
Expected return from in-force business	348	(47)	(146)	–	–	–	–	155
Investment in new business	(157)	44	190	–	–	–	–	77
Underlying shareholder resources generation	191	(3)	44	–	–	–	–	232
Coupon on external debt	(35)	8	–	–	–	–	–	(27)
Experience variances	(43)	3	10	–	–	–	–	(30)
Operating assumption changes	–	–	11	–	–	–	–	11
Other operating movements	17	–	(2)	(10)	(4)	(14)	(15)	(14)
Operating shareholder resources generation	130	8	63	(10)	(4)	(14)	(15)	172
Other non-operating variances	(76)	8	185	–	7	7	–	124
Shareholder resources generated in the businesses	54	16	248	(10)	3	(7)	(15)	296
Other capital/net asset adjustments	(309)	14	(14)	68	(19)	49	292	32
Shareholder dividend	–	–	–	–	–	–	(185)	(185)
Total movement	(255)	30	234	58	(16)	42	92	143
Closing shareholder resources	566	777	4,078	319	260	579	(61)	5,939

(i) Other FLG businesses represent distribution businesses, service companies and FLG holding companies.

Appendix 4: 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, which resulted 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 below includes WLUK from the date of acquisition and the impacts of foreign exchange movements in 2012 on Lombard. In addition the run-off profile of the International business AVIF has been revised, reducing the amortisation in 2012 by £20 million, to reflect revised expectations for future surplus generation. The impact of this change has only impacted the timing of expected surplus generation and not the quantum expected to be release in total.

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	676	594	520	449	381	313	257	201	151
Lombard	522	445	375	326	285	248	218	194	173	155	140
FLG total	4,685	4,437	4,008	3,631	3,286	2,956	2,648	2,363	2,105	1,862	1,646
Amortisation for the period	364	675	429	377	345	330	308	285	258	243	216

Appendix 5: Friends Life group annualised operating ROEV

	2010 Baseline[i]		2011 Full year		2012 Half year	
£m MCEV operating returns and % ROEV	£m	%	£m	%	£m	%
Value of new business	153	2.0%	151	2.0%	97	2.8%
Expected existing business contribution[ii]	416	5.5%	406	5.3%	200	5.7%
Development & corporate costs [iii]	(21)	(0.3%)	(38)	(0.4%)	(21)	(0.6%)
Operating profit before variances	**548**	**7.2%**	**519**	**6.9%**	**276**	**7.9%**
Operating variances and assumption changes	–	–	118	1.5%	17	0.5%
Impact of financing	(87)	0.1%	(79)	0.5%	(44)	0.2%
MCEV operating profit (excluding RSL costs)	**461**	**7.3%**	**558**	**8.9%**	**249**	**8.6%**
Tax on operating profit	(111)	(1.8%)	(150)	(2.4%)	(62)	(2.2%)
MCEV operating return after tax	**350**	**5.5%**	**408**	**6.5%**	**187**	**6.4%**

(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 6: 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 £635 million of capital returned to Resolution Limited to date) is approximately £3,758 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 2011	3,844
31 March 2012	3,721
30 June 2012	3,758

(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 30 June 2012, the value share is theoretically "in the money" at a Company share price of 275.6 pence at that date. Therefore the implied value share at 30 June 2012 (based on a closing share price of 195.9 pence on 30 June) was nil (31 December 2011: nil).

Appendix 7: Annual debt servicing costs

The following table shows the expected annual debt servicing costs for the principal UK life company, FLL for the twelve months ending 31 December 2012.

FLL issued debt instruments: held by FLG	Principal £m	Coupon rate %	Annual debt servicing cost £m
Internal preference shares 2003	300	4.8125	**14**
Internal STICS 2005	500	6.302	**32**
Internal LT2 2022	500	8.25	**41**
Internal LT2 2021	200	10.00	**20**
Total FLL debt servicing costs			**107**

The expected annual debt servicing costs for FLG for the twelve months ending 31 December 2012 are shown in the table below.

FLG issued debt instruments	Principal £m	Coupon rate %	Annual debt servicing cost £m
External STICS 2003	210	6.875	**14**
External STICS 2005	268	6.292	**17**
External LT2 2021	162	12.00	**20**
External LT2 2022	500	8.25	**41**
Internal LT2 2020 held by Resolution Holdings (Guernsey Limited)	200	9.00	**18**
Total FLG debt servicing costs			**110**

Definitions

AmFamily means AmFamily Takaful Berhad

AmLife means AmLife Insurance 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 Limited
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	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 Ringgit
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	Friends Life WL Limited (formerly Winterthur Life UK Limited)
WPF	With-Profit Fund
WPICC	With Profits Insurance Capital Component