18 March 2014

Resolution Limited

Results for the year ended 31 December 2013

Strong financial performance

- Sustainable free surplus £331 million, up 10% (2012: £300 million)
- Value of new business up 5% to £204 million (2012: £194 million), including 30% increase in the UK division
- IFRS based operating profit before tax of £436 million, up 59% (2012: £274 million)
- MCEV operating profit before tax of £489 million, up 28% (2012: £382 million)

Improved cash generation, strong capital base, increased dividend cover

- Available shareholder assets £917 million
- IGCA surplus(i) £2.2 billion, coverage ratio 238%
- Economic capital surplus(ii) £3.9 billion, coverage ratio 193%
- Full year dividend of 21.14 pence per share subject to shareholder approval (2012: 21.14 pence per share)
- Full year dividend covered 1.1 times by sustainable free surplus (31 December 2012: 1.0 times)

Operational highlights

- Successful restructuring of the business over the last three years is complete, £160 million of cost savings secured
- Successful delivery of key 2013 financial targets
- It is appropriate in this new phase to move away from a restructuring brand and therefore the Company will seek approval from shareholders to change the Company's name at the AGM to Friends Life Group Limited
- Completion of circa £2 billion with-profits annuity reallocation
- Investment mandates placed for commercial real estate and infrastructure loans

Strategic update

- A leading scale player in the attractive UK Life and Pensions market, primarily focused on the fast growing retirement market and skilled management of closed books
- Continued, disciplined focus on generation of cash and returns
- Progressive dividend to be considered when sustainable free surplus coverage of the ordinary dividend exceeds 1.3 times
- Major new strategic partnership with Schroders announced; £12.2 billion of equity and multi-asset funds to be managed on behalf of Resolution customers
- The Company will seek approval from shareholders to change the Company's name to Friends Life Group Limited
- Discussions regarding potential sale of Lombard are ongoing

Andy Briggs, Group Chief Executive said:

"The restructuring of the business is now complete. We have a sustainable business with a profitable base for future growth. We operate in attractive growth markets, focused on managing legacy life and pension products, and capturing value in the fast-growing retirement provision market. The Company continues to seek to maximise value from each part of the Group while retaining its focus on rigorous financial discipline. We remain focused on generating growth in both cash and returns while maintaining our strong capital base."

(i) Estimated
(ii) Estimated and unaudited

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Forward-looking statements

This announcement may contain certain "forward-looking statements" with respect to certain of Resolution's (and its subsidiaries) plans and current goals and expectations relating to future financial condition, performance, results, strategy and objectives. Statements containing the words "believes", "intends", "expects", "plans", "seeks", "aims", "may", "could", "outlook", "estimates" and "anticipates", and words of similar meanings, are forward-looking statements. By their nature, all forward-looking statements involve risk and uncertainty. Accordingly, Resolution's (and its subsidiaries) actual future financial condition, performance or other indicated results may differ materially from those indicated in any forward-looking statement.

Any forward-looking statements contained in this announcement are made only as of the date hereof. Resolution undertakes no obligation to update the forward-looking statements contained in this announcement or any other forward-looking statements it may make.

No statement contained in this announcement should be construed as a profit forecast.

Media

There will be a conference call today for wire services at 07:30am (GMT) hosted by Andy Briggs, GCE. Dial in telephone numbers: 0800 358 5263, UK Standard International +44 20 8515 2313

Analyst/Investors

A full year results presentation followed by an Investor Day update from management will take place at 09.00am (GMT) at the London Stock Exchange, 10 Paternoster Square, London EC4M 7LS. Dial in telephone number: 020 3059 8125 (UK) +44 20 3059 8125 (all other locations), Participant password*: "Resolution".

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 full year results announcement later today.

Financial calendar	
First quarter 2014 interim management statement	9 May 2014
Half year 2014 results	6 August 2014
Third quarter 2014 interim management statement	11 November 2014

2013 Final dividend	
Dividend amount	14.09 pence
Ex-dividend date	2 April 2014
Record date	4 April 2014
Final date for DRIP elections	24 April 2014
Dividend payment date	16 May 2014

Website: www.resolution.gg

*Password must be quoted to operator to gain access to the conference.

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Group Chief Executive's review

Introduction

We reached a significant turning point for the Group in 2013, and are entering a new and exciting chapter for Resolution. Our customers are at the heart of everything we do. As we help them prepare for the future, we will continue to deliver returns to our investors and focus on growing the business to support sustainable cash generation.

The strategic objectives of our business going forward are four-fold:

- focus on managing legacy life and pension products, and capturing value in the fast growing retirement provision market;
- make customers' money work harder to help them realise their financial goals;
- attract and retain best-in-class people, building distinctive capability and competitive advantage; and
- generate growth in both cash today and cash tomorrow while maintaining our strong capital base.

As our strong, financially disciplined team focus on these objectives we are confident in our ability to deliver returns to our investors. Over time we will continue to grow cash generation, underpinned by a strong capital base and rigorous capital allocation; this creates a platform to grow our dividend in due course.

During the second half of 2013, we saw signs of economic improvement and a more stable financial environment in the UK. Against this backdrop we are well positioned for key market trends. An ageing population and reduced state support, together with a shift from defined benefit to defined contribution schemes provide the foundation for growth in the pensions market. The UK Government's drive to help people achieve adequate retirement provision has resulted in the introduction of new regulations including the Retail Distribution Review ("RDR") and auto-enrolment which provide further impetus for growth. Auto-enrolment in particular will see many UK workers making private contributions towards a pension for the first time.

Our success is driven by a focus on profitable business lines where our scale and expertise can deliver high quality outcomes for customers and attractive returns for investors. We continuously strive to improve customer service and offer high quality propositions, ensuring that we demonstrate our brand values of ease, empathy and expertise in our customer interactions. A focus on the needs and objectives of our customers is central to our culture and ultimately we expect this will result in strong growth in profitable new business, driving cash generation in the future.

For over 200 years Friends Life has built up the expertise to help its customers prepare for the future with confidence, standing with them through life's ebbs and flows, protecting them against adversity and supporting them during and after full time employment. Our commitment to financial discipline and the careful management of our customers' money means they can trust us to commit to a life-long relationship.

This customer focus has never been compromised despite the restructuring and integration programme undertaken over the last three years. We have simplified management structures, upgraded systems, focused current and new business onto target platforms, removed duplication and outsourced non-core functions. We have simplified the structure of our senior executive team. Both our open market business and Heritage division have their own, dedicated Chief Executives. The senior management team has continued to deliver the strategy and this gives me real confidence for the prospects of the business.

Aligning strategic aims with social ones is part of our proud heritage. It runs through everything we do. It can be seen in the design of our insurance products which provide customers with comfort in the face of an uncertain future; in the partnerships we make in our long-term investments that support socially responsible infrastructure projects; most of all it can be seen in our people, who make a difference to both our customers and to the wider community.

Over the last few decades there has been a gradual shift in the corporate benefits market towards defined contribution schemes, shifting the investment risk from the corporate sector to individuals. This has been happening at the same time as state support has been reducing. We believe that we have an important role to play in plugging the savings gap: to help people as they accumulate wealth over their productive working years, as a partner as they make the transition to retirement, and by providing them with a secure income through their retirement. In addition to helping families through the accumulation and decumulation cycle we also provide protection products that provide a safety net for when our customers fall ill.

There are other ways in which we have a role to play in society. The long-term investment horizon for infrastructure projects is an obvious match with the long-term liabilities of insurance companies. In November, we awarded a £500 million mandate to MetLife Investment Management for infrastructure loans. The Group has also agreed a £75 million amortising loan facility with Drax Group plc. This loan will part-finance a £700 million project to convert three of the six plants at Britain's biggest coal-fired power station into the country's largest green energy generator. This is only the beginning. It makes good business sense to contribute to the UK recovery by investing in socially responsible long-term infrastructure projects of this kind.

As a company, we have a clear role to play in the community. This is strongly supported by our employees who engage in a variety of social and charitable initiatives. It is good for the community and good for our people, and is one of the reasons why Resolution is a great place to work. Every year we measure the level of staff engagement and we have seen a strong improvement this year. The Group's strong performance in 2013 was thanks to disciplined execution against a consistent strategy, a stable management, supportive customers and shareholders, and, above all, our great people.

Our journey so far...

Our actions over the last three years have transformed the Group. The completion of the capital optimisation programme, in which the business was re-organised into two UK life companies for closed and open business, drove efficiencies which have delivered a benefit of nearly £300 million to total free surplus over the last three years.

Our approach to managing the in-force book is unique in that we believe that a separate, dedicated management team ensures accountability, rigorous financial discipline and helps drive the focus on cash generation. In 2011 we formed Heritage, our closed book division. Heritage continues to generate cash and drive value through outsourcing of the cost base, capital and risk management initiatives, and the development of in-house investment management capabilities.

As part of our restructuring journey, we have rationalised our open business in the UK, reducing the number of open lines of business to three. The UK division today is focused on Retirement Income, Corporate Benefits and Protection, where we have scale and expertise to grow new business and where we have delivered a turnaround in value generation.

When we started the restructuring and transformation journey, the Group was generating less than £100 million of sustainable free surplus. In 2013, this has risen to £331 million. The value of UK new business was negative three years ago whereas in 2013 our businesses generated £184 million of VNB. This turnaround in profitability has been delivered by applying rigorous financial discipline and we have now reduced our UK and Heritage operating cost base by one-third since 2010.

£m	**2013**	2012	2011	2010
Sustainable free surplus ("SFS")	**331**	300	291	<100
UK division value of new business ("VNB")	**184**	142	63	(10)
Run-rate cost savings in UK and Heritage	**160**	140	105	
– Delivered	**129**	86	45	
– Secured	**31**	54	60	

In our International division, we are focused on cash generation and upstreaming dividend payments to the Group. We target low risk, high value new business and have exited those markets that do not fit these criteria. Following the closure or disposal of a number of non-core International businesses over the last 18 months, our core Friends Provident International ("FPI") business offers savings, investment and protection products for expatriates and affluent local nationals in Asia and the Middle East.

In 2014 we will transfer Overseas Life Assurance Business ("OLAB") to our Heritage division following the decision in early 2013 to stop writing new business in Germany. This will allow us to further leverage our expertise in managing closed books in our Heritage division.

The Group is now more efficient, more customer-focused and more profitable. Our cash position has strengthened, capital adequacy is robust and we have delivered strongly against our 2013 new business and cost saving targets.

In 2014 we intend to create a unified brand for the Group, subject to shareholder approval, renaming our parent company Friends Life Group Limited, reflecting the unified structure and governance of the business. This change demonstrates the transformation of the Group and is not only the right decision for shareholders, but will also provide significant benefits from a customer, distributor and colleague perspective.

Operational highlights

Heritage

In June, the Group completed the single largest remaining element of the separation programme, the Application Hosting Migration ("AHM") which moved legacy AXA business applications and IT infrastructure from AXA-Tech to Friends Life.

In the fourth quarter of 2013, the Group executed the first major migration from two legacy administration systems to the BaNCS IT platform operated by one of the Group's strategic partners, Diligenta. This represented a major operational milestone. In addition, as part of a multi-year programme to implement a uniform capital management framework for the with-profits business, circa £2 billion of annuity business has been re-allocated from the with-profits fund to the non-profit fund of Friends Life Limited ("FLL") and is expected to deliver circa £10 million per annum of sustainable free surplus from 2014. This is a significant achievement and a further tranche of with-profits fund reallocations with a value of circa £700 million is being considered in 2014.

This is underpinned by progress in our fixed income in-house asset management operation, Friends Life Investments ("FLI"), which was launched in July 2012. FLI now manages a total of £17.1 billion of Group assets, including £7.0 billion of assets recaptured in 2013. Setting up FLI, and restructuring approximately 20% of the Heritage assets, has saved the Group £5 million per annum, utilising its in-house investment capability and asset liability management skills to support the management of fixed income assets within the annuity, shareholder and with-profits portfolios. In 2014 we anticipate FLI will take responsibility for a further £2.3 billion of Resolution's sterling fixed income assets. The Group has also announced a new, scalable partnership with Schroders to manage £12.2 billion of equity and multi-asset funds from the fourth quarter of 2014.

UK division

We have also made great progress in the UK division. Our Retirement Income strategy is built on the strong foundations of the Heritage and Corporate Benefits pension books encompassing around 50,000 vesting pensioners per year and we made great progress in 2013 with an increase in the number of existing customers choosing to buy an annuity from Friends Life. The proportion of vestings increased to 34% from 25% in 2011. This proportion increases significantly where customers have engaged with our Lifestyle annuity proposition which is designed to deliver better value to customers by taking account of their lifestyle factors to offer a more tailored solution. Having seen this encouraging response from existing customers, we extended our Lifestyle annuity to the open market at the end of 2013 and we anticipate further growth in this area. We have also strengthened the support we offer our customers nearing retirement by launching a "shopping around" service in partnership with Key Retirement Solutions.

In Corporate Benefits we have continued to build scale with assets now at £20.1 billion, an increase of £2.3 billion over the year, whilst maintaining strict financial discipline on attracting new schemes. Over the course of the year 180,000 employees within 274 schemes of 203 employers have "staged" with the Group. We now have sufficient scale to be cash generative on an underlying free surplus basis and remain focused on writing profitable business. We have positioned ourselves strongly to take advantage of the opportunities presented by auto-enrolment, with our My Money platform providing a strong proposition in the market. In addition, we launched My Future, a new range of default funds that has had an encouraging early take up.

All Protection new business is now written on our specialist platforms, and this has transformed the profitability of this business which provides highly regarded customer propositions in both individual and group protection. In 2013 we have introduced new solutions that meet our customers' changing needs, such as our Cancer Work Support service to help members through treatment, recovery and returning to work.

International

Following the strategic review in 2012, we have applied a consistently rigorous approach in the International division, ceasing new business which was unprofitable, sub-scale or out of line with our risk and value criteria.

We completed the sale of our minority stake in AmLife at the beginning of 2013. In line with the 2012 strategic review, non-core operations in Germany and Japan have been closed to new business. FPI continues to make a positive contribution to the Group with a £6 million dividend paid in 2013 and a final dividend in respect of 2013 of £14 million paid in March 2014. Together with the dividends paid by Lombard, the 2013 dividend target for the International division of £33 million was met.

We also recognise the need for investment in this business to improve IT infrastructure and operational efficiency so that it maintains its competitive advantage in the fast moving markets of Asia and the Middle East. In 2013 we have commenced work on moving our core FPI business onto a standalone platform that works in Asian time zones, currencies and languages. This is both right to drive growth in the business and to give FPI much-needed operational independence from the UK mainframe platform.

We have achieved an enormous amount in 2013 as we completed the restructuring of our business and we are now strongly positioned to build on the growth opportunities.

Our strategy

Our stakeholders

Our strategy is based on meeting the needs of our three key stakeholder groups – our customers, our people and our shareholders. Our competitive advantage is driven by the areas in which we play, and the strength of our people who help us win in these markets. This drives the cash and returns we deliver to investors.

We aim to provide high quality propositions and services that protect our customers during their working lives should they fall ill or die, help them to prepare for a secure retirement and help them optimise returns on the money they save.

We do this by managing the business effectively, creating a working environment where our people are energised to deliver the best service by understanding our customers' needs. We have built a strong, financially disciplined team with distinctive capabilities that will enable us to deliver sustainable cash flows, new business growth and appropriate returns for our investors.

We also remain focused on generating value for our shareholders. We treat different parts of the Group very differently, based on what will secure maximum returns. We are unique in managing a separate Heritage division, and we invest in new business in a very disciplined manner.

Our markets

We only compete in attractive growth markets where we have scale and competitive advantage so that we are able to deliver good propositions for customers whilst generating sustainable cash and returns.

We expect to see growth in each of our chosen open markets. The UK life and pensions market, in particular, will benefit from two key drivers over the next decade:

- legacy life and pensions products, which are largely closed, and need skilled management; and
- a fast growing retirement market.

We are extremely well placed to participate profitably in both of these areas. In Heritage, Corporate Benefits and Retirement Income, where most of our new business comes from existing customers, management have control over many of the levers of value. There are significant revenue synergies across the different parts of the Group. These include the natural flow of business from Heritage and Corporate Benefits into Retirement Income, asset management synergies across Heritage and Corporate Benefits, and between Protection and Corporate Benefits in dealing with the needs of employers. In addition, there are significant cost and capital synergies.

As we deliver profitable new business, we strive to treat our customers fairly, and work together with the government and regulators to achieve this aim. Corporate Benefits and Retirement Income, in particular, are large and fast growing markets and it is right that they are being closely monitored by regulators. The impacts of RDR and recent scrutiny of annuity and pensions charges are still being addressed by the industry, but the overarching ambition of regulators and insurers alike is to give consumers confidence that the advice they are given, and products they buy, are appropriate to their needs.

Legacy life and pension products

Transition to retirement is one of the biggest movements of money UK financial services has ever experienced. The Group has a huge structural advantage in the market, with approximately one in nine of those retiring in the UK being customers of our Heritage or Corporate Benefits business. Historically not enough has been done to support our customers as they transition to retirement and there is a significant opportunity to enhance our capability and leverage the structural advantage and expertise we have.

Over £400 billion of assets across the UK life market are held in funds or product lines that are closed to new business. By their very nature these assets are expected to decline over time. A number of players in the UK today manage sizeable in-force books and have largely fixed cost bases to support these businesses. As their in-force assets decline, the cost of running these books will increasingly become a driver for consolidation in the market.

The skill set required to manage a closed business is distinct from that required for actively marketed businesses with growth strategies. Our Heritage division is a leading specialist in the UK closed book market and we expect to benefit, in due course, from our expertise in this area.

Retirement provision market

The retirement income market is projected to experience strong growth driven by demographic trends in the UK as well as asset accumulation in defined contribution pensions which will fuel annuity markets in the future. We are the second biggest participant in the corporate benefits market which currently has circa £350 billion of assets under administration and this is expected to more than triple by the end of the decade. We believe that most of the growth will be captured within the existing schemes. Given our scale we stand to benefit from substantial growth in assets under administration and hence revenue.

Our Corporate Benefits book, combined with the pensions in our Heritage division gives us access to approximately 50,000 vesting pensioners each year. This feeds our Retirement Income business where VNB increased by 84% between 2011 and 2012 and then grew again by 41% in 2013. This growth is consistent with our customer focus; we are committed to providing products that are appropriate to our customers' needs.

The process of accumulating pension funds and then decumulating them in retirement is complemented by our Protection propositions which offer support to our customers and their families during the key stages of their lives. In a stable marketplace we continue to successfully write profitable new business with innovative new life, critical illness and income protection solutions and services.

All of this is supported by our growing capability in investment management and strategic asset allocation.

International
The markets in which our International division operates are each expected to see future growth, although they are highly competitive and becoming increasingly regulated. Economic and regulatory uncertainty has led to challenging environments for the business, although we expect to grow our share of income among the upper middle and mass affluent markets.

The Group is currently in discussions regarding the potential sale of the Luxembourg based business, Lombard International Assurance. Notwithstanding this, Lombard's strategy remains unchanged with this business continuing to be a leading pan-European specialist in estate and succession planning solutions for high and ultra-high net worth individuals. FPI is well placed to enhance value creation through its portfolio of international licences in Singapore, Hong Kong, UAE and Isle of Man, focusing on profitable growth and cash generation.

Generation of cash and returns

Going forward the strategic focus of the Group will remain on cash and returns generation to investors and shareholders, underpinned by the strict financial discipline that we apply to every business in our portfolio.

We have already made great progress in our existing businesses on the path to this objective:

- our UK businesses have been turned around and are well placed for future growth;
- our Heritage division remains the key source of cash generation today as we continue to drive incremental opportunities for growth from the operation; and
- our International division has met its dividend target for 2013 of £33 million.

Focus on cash generation and financial discipline also sets a framework to consider the Group's participation in closed book acquisitions. We start with confidence that we have a strategy that is delivering growing cash on our current business, and hence are not compelled to do deals. We would only consider acquisitions if this would improve the Group's cash and dividend profile. If we do deploy more capital, we would expect to meet a returns threshold, designed to ensure we achieve appropriate risk-adjusted returns.

We continue to maintain a robust, low risk balance sheet and, while markets have improved over the last few years, we still believe this to be appropriate. As global investment markets improve it is possible to both maintain this low risk approach and invest a proportion of available shareholder assets in order to generate strong, risk-adjusted returns.

We remain committed to our ambitions for ordinary dividend growth. In the past we have based the move to a progressive dividend on the achievement of an absolute amount of distributable cash generation. Going forward there will be a more explicit link between ordinary dividend costs and SFS generation. Our dividend policy is to pay 21.14 pence per share per annum, with the expectation that a progressive dividend will be considered once the coverage ratio of SFS : Dividend costs exceeds 1.3 times. This is broadly consistent with our previous £400 million target but this target is now formally replaced by the coverage ratio. We are confident that we can achieve the 1.3 times coverage in due course through continued focus on capital efficiency, business growth and financial discipline.

To conclude, the last three years have been transformational in the history of the Group. We have combined three disparate businesses and generated capital synergies through that consolidation. We have focused our new business operations on areas where we have scale and competitive advantage, and have closed to new business areas in both the UK and overseas, that do not meet this strategic rationale. As a result, we are now a leaner and more focused business, excellently placed to benefit from strong macro drivers in the retirement market, and from further consolidation of closed books. While we have achieved a lot, my real excitement is the prospects for this business over the coming years as we reap the benefits of the changes we have made.

Key performance indicators

Set out below are the Group's key performance indicators ("KPIs"). These have been updated to reflect the Group's revised financial framework and have been set to align with the Group's ongoing strategy. Further details on the updated financial framework can be found in the Chief Financial Officer's review.

Cash today: Providing insight into the Group's ability to support dividends

£m	2013	2012
Sustainable free surplus ("SFS")	**331**	300

Performance

Positives

- Continued financial discipline reducing cost of investment in new business by 25%
- Expected return growth reflecting spike in with-profit maturities
- Managing non-core closure to new business reducing drag on surplus generation

Negatives

- Poor performance from Sesame Bankhall Group
- Higher finance costs following debt issue in 2012

Definition

SFS is the free surplus generated within FLG based on expected investment return less investment in new business and excludes operating assumption changes, amortisation and impairment of non-covered business intangible assets, economic variances, non-recurring items and non-operating items. It is presented net of tax.

£m	2013	2012
Free surplus generation ("FSG")	**377**	215

Performance

Positives

- Positive economic impacts as economy recovers

Negatives

- Increased non-recurring costs reflecting increase in Solvency II spend

Definition

FSG reflects the after tax free surplus generated in the period including both operating and non-operating items.

Cash tomorrow: Looking at the value of tomorrow's cash flows, today

£m	2013	2012
Value of new business ("VNB")	**204**	194

Performance

Positives

- Strong VNB growth in UK, up 30%, reflecting growth across all business units
- Exits from non-core International business significantly reducing loss on new business

Negatives

- Challenging market conditions for Lombard resulting in a 44% reduction in VNB

Definition

VNB is the present value of future post-tax cash flows on new business written, net of the frictional cost of required capital and the cost of non-hedgeable risk.

£m	**2013**	2012
Group embedded value MCEV basis	**6,065**	5,831

Performance

- Embedded value up 4% in 2013 reflecting the strong operating performance and non-operating economic variances as markets improve. These benefits are partially offset by non-operating expenses and dividend payments

Definition

Group embedded value comprises shareholder net assets on an MCEV basis and the net present value of future cash flows expected to be derived from the in-force business.

Capital strength: Demonstrating the Group's financial strength

%	**2013**	2012
IGCA surplus coverage	**238**	221

Performance

- IGCA coverage ratio improved over 2013 with surplus emerging and proceeds from AmLife sale more than offsetting financing and dividend costs

Definition

The IGCA is the calculation of the capital resources and capital requirement as defined by the PRA in the Insurance Groups Directive. The coverage ratio represents the proportion of capital resources to capital resource requirements (excluding WPICC). The position at 31 December 2013 of the Group and its subsidiaries is estimated.

%	**2013**	2012
Economic capital surplus coverage	**193**	185

Performance

- Economic capital surplus coverage ratio improved by 8% reflecting economic and experience variance benefits, offset by dividend payments

Definition

Economic capital represents management's internal risk-based estimate of the amount of capital needed to be held to mitigate the risk of insolvency to a minimum of a 99.5% confidence level over a one year period. The coverage ratio represents the proportion of capital resources to capital resource requirements. The position at 31 December 2013 of the Group and its subsidiaries is estimated and unaudited.

£m	**2013**	2012
Available shareholder assets ("ASA")	**917**	850

Performance

- ASA increased in 2013 principally reflecting the receipt of dividends from life companies which exceeded dividends paid to the company's shareholders

Definition

Group ASA consists of cash and financial assets held by the Friends Life and Resolution holding companies, together with any dividends declared and approved from life companies that are yet to be remitted.

Returns: Illustrating the returns achieved from operating activities

£m	**2013**	2012
IFRS based operating profit	**436**	274

Performance

Positives

- New business strain reduced by 32% reflecting strong financial discipline
- Improved economic conditions result in lower guarantee reserves in International division
- Benefits of with-profits annuity reallocation total £76 million

Negatives

- Surplus from Heritage in-force book reduced as business runs off
- Shareholder asset returns lower reflecting reduced long-term investment returns

Definition

IFRS is the primary accounting basis for all EU listed companies. IFRS based operating profit is a component of the IFRS result. It is based on longer term investment return, and excludes non-recurring items, and amortisation and impairment of acquired intangible assets. It is stated after policyholder tax and deducting interest payable on the Step-up Tier one Insurance Capital Securities.

£m	**2013**	2012
MCEV operating profit	**489**	382

Performance

Positives

- VNB growth underpinned by strong UK growth and exit from non-core International markets
- With-profits annuity reallocation benefits total £96 million
- Favourable impact from recognising value of tax losses

Negatives

- Lombard results significantly impacted by challenging market environment
- Lower expected returns from the in-force book reflecting significantly lower opening rates of return

Definition

MCEV operating profit is based on expected investment return and excludes economic variances, non-recurring items, amortisation and impairment of non-covered intangible assets and other non-operating variances.

Other performance indicators

%	2013	2012
Customer satisfaction[(i)]	**72**	73

(i) Between May 2012 and October 2013

Performance

Positives

- Consistent performance; over 70% of our customers consistently rate the overall quality of our products and services as good or very good
- For our Protection customers, this score is 86%
- Our scores have remained stable at a time of economic difficulty and financial uncertainty in the UK

Negatives

- We have an immediate ambition to increase the level of customer satisfaction with our products and services to nearer 80%
- Whilst only 6% of our customers rated us as poor or very poor. Over one in five customers did not express an opinion and we are working to reduce this number.

Definition

We conduct over 1,600 interviews each year with customers who have recently bought, continue to hold or have recently received the benefits from their Friends Life policy.

This provides us with an overall view of all aspects of our customers' experience with Friends Life from purchase to receiving the benefits of their policy.

%	2013	2012
Colleague engagement	**67**	56

Performance

Positives

- Colleague engagement levels have significantly improved over the last 12 months, increasing by 11 percentage points to 67% at Group level

Negatives

- Engagement levels are beneath the Financial Services industry benchmark of 73%. We aspire to be at least as good as the wider Financial Services industry and will continue to work towards achieving this.

Definition

Colleague engagement is measured across an index of 6 questions relating to advocacy, retention, and effort in relation to working at Friends Life. Colleagues are surveyed twice a year. Achieving the high level of commitment that comes from an engaged workforce is an enabler of our growth strategy.

%	2013	2012
Women in senior management	**26**	26

Performance

Positives

- Andy Briggs, Group Chief Executive personally sponsors the Group Diversity agenda and related programme of initiatives
- 26% of women in senior management can be considered a reasonable foundation
- We have plans in place to support women as they progress into senior leadership roles including networking sessions, mentoring programmes and enhanced diversity training for line managers

Negatives

- Friends Life aspires to a greater gender balance and proportion of women in senior leadership roles.

Definition

This measure refers to women in Senior Management roles (roughly equating to our top 150 leadership positions). We want to help female colleagues to realise their potential and remove any potential barriers to career progression, including into senior leadership roles

%	2013	2012
Equal opportunities	**73**	n/a

Performance

Positives

- 73% of colleagues surveyed feel they have equal opportunities, which can be considered a strong position to improve on
- Our current diversity initiatives have initiated a cultural shift in the organisation and in the longer term will lead to a higher number of colleagues feeling positive about developing and progressing their careers in Friends Life.

Negatives

- Of colleagues surveyed 16% are neutral and 11% are negative in their response.

Definition

Percentage of surveyed employees who feel they have equal opportunity for development and career progression. We want all our colleagues to feel they have the opportunity to develop, progress their careers within Friends Life and contribute fully to our business success.

£m	2013	2012
Community investment	**1.9**	1.2

Performance

Positives

- 81% of colleagues feel that Friends Life is socially responsible
- Annual community investment has increased by 58%
- £140,000 was raised by colleagues for Macmillan in 2013
- Over 700 days of colleague time was invested in local community volunteering projects

Negatives

- There is still work to do to achieve greater levels of colleague engagement in our volunteering activities and this is being embraced as part of our Community Investment Strategy

Definition

Community investment refers to the annual investment in community involvement and fundraising activities and is measured through colleague feedback, annual spend and number of colleague days invested. Community investment reflects our core business purpose and leads to higher levels of colleague engagement.

Chief Financial Officer's review

Introduction

Three years ago we set out on the journey to build the Friends Life group. Throughout this journey, 2013 has been a key milestone for us and I'm pleased to report that the restructuring phase is now complete. We have integrated the three acquired businesses, delivered targeted cost savings and are working with our outsourcers to finish the migration of legacy platforms to deliver the remaining secured cost savings. Financial targets were put in place at the outset, and whilst economic conditions have not made progress smooth, I am pleased to be reflecting on the delivery of some material achievements.

Over the years, the Group's transformation has been extraordinary. The activities to separate, integrate and transform the acquired businesses have been especially pleasing with our success demonstrated through improved profitability, greater capital efficiency and enhanced competitiveness of the business. The life operating businesses are now tangibly different from those acquired.

Delivering cash today and securing cash tomorrow, whilst maintaining a strong balance sheet, is reinforced by the Group's strong 2013 operating performance across all measures. Cash generation today remains strong, underpinned by a culture of innovation, whilst cash generation tomorrow is now well embedded in the Group's new business capabilities.

Financial performance

£m (unless otherwise stated)	**2013**	2012
Sustainable free surplus	**331**	300
Free surplus generation	**377**	215
Value of new business	**204**	194
Group embedded value on an MCEV basis	**6,065**	5,831
IGCA surplus coverage ratio(i)	**238%**	221%
Economic capital surplus coverage ratio(i)	**193%**	185%
Group available shareholder assets	**917**	850
IFRS based operating profit	**436**	274
MCEV operating profit	**489**	382

(i) 2012 IGCA and economic capital surplus has been revised to include Resolution entities. These measures were previously presented at the FLG level.

The results in the table above show an improving picture of cash generation, profitability and capital discipline and underpin our confidence that we have the right strategy.

The Group generated sustainable free surplus of £331 million in the year, up 10% on 2012. This is a strong performance and continues to highlight our focus on delivering cash to support our dividend. In 2013 we have maintained our financial discipline and reduced the cost of investing in new business by a further 25%. Importantly, this includes actions taken in the UK division where improvements in efficiency have reduced the free surplus cost of writing new business by 8%.

Benefits have also been realised in the Heritage division and non-core International business, where lower sales increments through either natural run-off or active market-exit decisions have resulted in reduced new business costs.

Development spend has been maintained at a relatively stable level in 2013. Notwithstanding this we do expect to invest additional funds in 2014, circa £15 million, focused on the development of the Retirement Income business.

The Group has delivered an increase in expected returns, outside those achieved on shareholder funds, across all divisions. As reported in our 2013 half year results, this improvement reflects the benefit of surplus emergence from new business written in 2012 as well as higher with-profits fund product maturities.

The generation of free surplus from our in-force books and subsequent investment in new business are core drivers of the sustainable free surplus result, and are key to our ongoing dividend policy. In line with this policy, a 2013 final dividend of 14.09 pence per share has been proposed subject to shareholder approval. This equates to a cash cost of £200 million, giving total expected dividend payments of £300 million in respect of 2013, and is covered 1.1 times by sustainable free surplus earnings.

Free surplus generation as a whole is up 75% to £377 million and largely reflects the benefit of positive economic variances in 2013 with narrowing credit spreads following increased confidence in the economy. It is widely acknowledged that, whilst confidence in the economy is not at the level it was before the financial crisis, it has improved markedly in 2013.

Group IFRS based operating profit of £436 million is up 59% on that delivered in 2012. Excluding the £(82) million impact of the International strategic review in 2012, the Group result is up 22% in 2013. One of the key drivers of this is the reduction in new business strain, similar to that seen within sustainable free surplus.

In-force surplus returns are up across the majority of divisions with economic improvements benefiting both the increase in annual charges as well as reducing the cost of guarantees, particularly in our non-core International business. Surplus generation has also benefited from continued maintenance cost control in the UK and Heritage divisions with the International division also benefiting from the absence of costs relating to the strategic review in 2012.

Heritage division initiatives have contributed favourably to the Group results with the reallocation of circa £2 billion of with-profits fund annuities to the non-profit funds contributing £76 million to the IFRS based operating result. This continues the Group's approach to strong and effective with-profits risk management.

The Group's MCEV operating result of £489 million is up on the £382 million reported in 2012 albeit the 2012 result included a £(94) million impact from the International strategic review. Excluding this impact, the 2013 result is up 3% and reflects a number of key factors.

New business VNB has increased 5% on 2012 with a strong UK division performance, up 30%, partially offset by reductions elsewhere. The operating performance also includes a £96 million benefit in the Heritage division from the annuity reallocation programme, with this slightly higher than the IFRS impact due to the recognition of additional VIF benefits.

As reported in the 2013 half year results, the impact of lower expected rates of return has materially reduced the returns generated from the in-force book. Expected existing business contribution in 2013 is therefore £77 million lower than in 2012. The rates applied to the opening balance sheet are shown below including the cash and gilt rate which halved to 0.67%. The table also shows the rates expected to be used in our 2014 results which, whilst higher in many cases, remain low for cash and government bonds.

	Rates used for expected return contribution		
%	2014	**2013**	2012
Reference rate:			
non-annuity business	0.71	**0.67**	1.35
annuity business	1.31	**1.42**	2.25
Best estimate returns:			
corporate bonds(i)	1.85	**2.25**	3.30
cash/Government bonds	0.71	**0.67**	1.35
equity	6.10	**4.90**	5.40
property	5.10	**3.90**	4.40

(i) Returns on corporate bonds vary by portfolio with the rates shown being a weighted average.

Group embedded value, on an MCEV basis, is a key measure of the Group's future cash generation ability and has increased to £6,065 million in 2013. The operating performance has been an important element of this growth, together with the benefit of narrowing credit spreads, as seen in free surplus generation, which have combined with equity market improvements to make a material contribution in 2013.

In November we notified the market that we were in discussions regarding the potential sale of Lombard and as at the time of writing these discussions are continuing. Disappointingly, 2013 has been a challenging year for Lombard with market conditions in Luxembourg and some core markets, notably Belgium, undergoing regulatory and legislative changes. These factors combined with the uncertainty about Lombard's ownership have to varying degrees impacted new business volumes, whilst the change to arrangements under which Belgian nationals could repatriate funds has materially impacted persistency levels in this market. As a result Lombard has contributed an operating loss of £(46) million to the 2013 Group MCEV results.

The capital position of the Group remains strong with the Group's estimated IGCA surplus at £2.2 billion representing a coverage ratio of 238% (31 December 2012: £2.2 billion, coverage ratio 221%). The Group's estimated economic capital surplus also remains strong at £3.9 billion with a coverage ratio of 193%.

Available shareholder assets ("ASA") of £917 million (31 December 2012: £850 million) reflect the continued strong cash generation within the life businesses. The life companies have paid £383 million of dividends in respect of 2013 to the Group holding companies. These dividends include £33 million from the International division.

Free surplus emergence

The estimated emergence of surplus from the UK and Heritage divisions' in-force book over the next 10 years is shown in the chart below. These estimates provided last year in respect of the five years through to 2017 are also shown, adjusted to include returns on shareholder assets. In comparison with the high-level estimates provided in 2012, free surplus generation in 2013 has been stronger at £541 million reflecting a spike in with-profits fund maturities.

The continued growth of free surplus generation from the in-force book is fundamental to the Group's ability to grow sustainable free surplus and as a result move on to a progressive dividend policy. The updated expectations for surplus generation shown below highlight a step up in ongoing surplus generation, with this growth expected to be split evenly between the UK and Heritage divisions and more than offsetting the run-off of the in-force book.

In the UK division the investment in profitable new business will be a key part of this growth, with the updated cash profile now including the benefit of new business written in 2013.

In the Heritage division, and as reported in our 2013 half year results, we have undertaken a number of initiatives, principally aimed at reducing the impact from the run-off of the Heritage book. These include the first tranche of with-profits annuity reallocations, which was completed at a free surplus cost of £(16) million in the second half of 2013, and the transfer of fixed income asset management in-house to the FLI team.

Supporting this performance, the cash run-off profile reflects year end economic benefits, with future returns now including the benefit of higher equity market levels at the end of 2013.

Going forwards, we expect to continue growing the contribution from new business and delivering on Heritage initiatives which gives us increased confidence in our ability to offset the future run-off.

UK and Heritage – Estimated expected return from in-force business (including returns on shareholder net assets)

£m	**2013**	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
2013 actual free surplus run-off	**541**										
Estimated free surplus run-off (2013) (i)		580	550	520	480	450	420	410	400	390	370
Estimated free surplus run-off (2012) (ii)	520	495	495	490	450						

(i) As at 31 December 2013

(ii) As at 31 December 2012 (annual disclosures were only provided up to 2017). Previous disclosure adjusted to include return on shareholder net assets

Target deliveries

£m (unless otherwise stated)		2013 Targets	**2013 Actual**	2010 Full year (baseline)
Corporate Benefits	VNB	25	**26**	(23)
	NBS	(75)	**(51)**	(80)
	IRR	10%+	**8.4%**	4.2%
Protection	VNB	80	**75**	(20)
	NBS	(30)	**(5)**	(193)
	IRR	20%	**13.8%**	3.3%
Retirement Income	VNB	50	**83**	33
	IRR	15%+	**25%+**	16.5%
FPI core business and Lombard IRR		20%	**12.0%**	n/a
Group IRR		15%+	**15.3%**(i)	8.6%
UK and Heritage new business cash strain reduction		£200m reduction	**£251m reduction**	n/a
UK and Heritage cost reductions		126	**129**(ii)	–
International division dividends		33	**33**	–

(i) 2013 Group IRR includes the benefit of discretionary investment of shareholder assets in the with-profits annuity reallocation. Excluding this, the Group IRR amounts to 11.2%.
(ii) With 2015 target of £160 million also secured.

We have made good progress in 2013 and I am pleased to be reporting on the successful delivery of our key 2013 financial targets. These have been achieved despite the relatively turbulent macroeconomic environment.

New business targets

New business profitability, a key growth measure for the Group, has been of particular importance. Historically, the legacy business did not deliver adequate returns. The UK businesses have undergone radical change, closing unprofitable lines and moving to more efficient platforms. New products have been designed to better meet our customers' changing needs and we have ensured that we are well placed to support customers by only competing in areas where we have scale and competitive advantage in attractive growth markets.

Financial discipline has been consistently applied, demonstrated in 2012 when the Group, a year earlier than targeted, achieved its goal of a £200 million reduction in UK and Heritage new business cash strain whilst at the same time delivering significant increases in VNB. I am delighted that progress on this front has continued in 2013 with new business cash strain now reduced by £251 million, which, along with the annuity reallocation programme, has supported the delivery of a Group IRR of 15.3%, above the 15% target.

As previously reported, much of the improvement in new business profitability has been driven by the 'migration' of new business to more efficient platforms and the delivery of targeted cost reductions. This is particularly evident in the Protection business which contributed £75 million VNB at an IRR of 13.8% in 2013 compared to a loss in 2010. Whilst the performance of this business is marginally below the targeted levels, I am delighted with the level of profitability this business has achieved.

The Corporate Benefits business is a key business for the Group and one which continues to be subject to numerous regulatory changes. The business has been well prepared for these trends, principally RDR and auto-enrolment, and whilst the IRR target has not been achieved, this business has successfully delivered £26 million of VNB in 2013, up 24% from 2012 and exceeding the target level of £25 million. Going forwards we expect to monitor the performance of the Corporate Benefits business unit through its ability to generate underlying free surplus. This is covered in more detail in the financial framework section that follows.

The Retirement Income business has had another strong year building on the 2013 targets achieved 12 months ahead of schedule. The business is a key growth area for the Group with a contribution from new business of £83 million in 2013 up 41% on 2012. We aim to develop the product propositions with the enhanced annuity product now well established and the business's recent entry into the open market has already seen a good flow of enquiries and quotations established. These channels will provide greater product coverage for our customers which we expect will support the higher proportion of customers choosing to stay with the Group in retirement.

Cost savings

The Group has made great progress over the last few years to deliver the targeted UK and Heritage divisions' cost savings and as at the 31 December 2013 has achieved run-rate savings of £129 million, marginally ahead of the £126 million target. In addition to the savings already achieved, the Group has secured the delivery of the remaining £31 million run-rate savings due to be delivered by the end of 2015. The Group's outsourcing arrangements are the main driver of these contractualised savings and will take total run-rate savings to £160 million. We will of course continue our focus on efficiency and effectiveness but we will not be setting new cost saving targets.

In line with our focus on financial discipline, we have continued to reduce the Group's operating expense base. Group operating expenses totalled £584 million in 2013, a 5% reduction on 2012. The UK and Heritage divisions have been principal drivers of this reduction.

As reported in our interim results, we completed the single largest remaining element of the Group's separation and integration programme in June. This completed the move from the Group's historic IT infrastructure with AXA-Tech to Friends Life. Alongside this, the continuing work with our outsource providers has resulted in a number of IT services moving to Diligenta in March 2013.

International targets

In November 2012, the Group set out a revised strategy for the International division. This included the exit from a number of markets and the sale of the Group's Malaysian joint venture, AmLife (AmLife Insurance Berhad and AmFamily Takaful Berhad). I'm delighted with the progress made on this front and the swift action taken to exit unprofitable areas of this division. However, notwithstanding the good operational performance, the International division has continued to experience challenging competitive conditions particularly in Lombard. As a result, new business profitability has fallen in 2013 and the International division core new business IRR, including Lombard, of 12.0% remains below the targeted level of 20%.

The Group also set dividend expectations for the FPI and Lombard business units, with these commitments in respect of 2013 amounting to £33 million (FPI £20 million; Lombard £13 million). Both businesses have met these commitments with FPI and Lombard paying £14 million in 2013 with a further total of £19 million paid in January and March 2014.

Medium-term targets

As previously reported, the macroeconomic environment is vastly different from that prevailing at the time the Group's targets were set. Although market conditions are currently improving, the returns achievable at present are significantly lower than in 2010. This has materially impacted the Group's ability to deliver the returns required to achieve both the £400 million cash generation from sustainable sources and 10% return on embedded value although neither of these targets were set for 2013.

Cash generation has been hindered by the reduced ability to generate surplus from shareholder net assets with cash and gilt returns significantly lower than in 2010. Similarly, reflecting the principles of MCEV reporting, the impact of a lower risk free rate has reduced the expected returns generated from the in-force book. At the end of 2012 we reported that opening 2013 returns would be lower than in 2012, including a 50bps reduction in equity returns. Whilst this is a material reduction in its own right, it also continues the trend seen since 2010. In 2013, expected returns, which are set using risk-free interest rates, are significantly lower than those applied in 2010 (equity returns down 240bps, corporate bond returns down 110bps and cash returns down 34bps). This is estimated to have had a circa 2% impact on 2013 MCEV operating returns. Adjusting for this reduction we estimate that, with all other things being equal, we would have expected to achieve an ROEV in the region of 9.2% in 2013.

%	**2013**	2012	2011	2010 baseline
ROEV annual progression	**7.2**	5.1	6.5	5.5

Financial framework

The transformation of the Group over recent years has been completed under the spotlight of a large number of financial targets, KPIs and additional metrics. The majority of these emerged over the acquisition phase of the UK Life Project with a number of the targets due for delivery at the end of 2013. As 2013 and associated targets are now behind us, the Group has revisited its financial framework. The revised framework ensures that the way we measure the performance of the business is aligned with our aim to generate suitable returns through the delivery of cash today and tomorrow whilst maintaining a strong capital base and allowing sufficient flexibility for financially disciplined investment.

We are transitioning to the Solvency II regime, building on our current, well-established economic capital models and processes. We are currently discussing our approach to implementation of Solvency II with the PRA (i.e. standard formula or internal model) and expect to enter the process for PRA approval of our internal model ("IMAP") such that approval is granted before the end of 2016. Although the final guidelines for calibration of the standard formula approach have not yet been released, our current expectation is that this would not give the most appropriate assessment of our solvency position. We do not currently expect to gain any capital benefit from IMAP, but continue to monitor this closely as further guidance emerges and our discussions with the PRA continue.

Strong capital base

As a long-term savings and insurance business, we maintain a strong balance sheet to assist us in meeting the needs of policyholders and generating returns for shareholders. This means that we not only hold assets to cover expected payments to customers but also include additional solvency requirements to allow for future uncertainty. We currently maintain and monitor our solvency capital position on two bases, being IGCA and economic capital. We will continue to report both these measures, with economic capital surplus now also included as a Group KPI.

We will also continue to report on our stock of available shareholder assets ("ASA"), previously known as available shareholder cash ("ASC"). In prior years, ASA has been invested entirely in cash or cash equivalent assets, with this mirroring the low risk appetite applied to shareholder funds. In line with previous communications and reflecting increased confidence in the macroeconomic environment, it is now appropriate to invest a proportion of these lower returning cash assets in higher risk-adjusted yielding asset classes. Following the streamlining of the Group's governance structure, we have also recalibrated the prudence buffer held within ASA. This has been changed to reflect one year's dividend and corporate holding company costs, equivalent to £325 million at the end of 2013 based on current ordinary dividend and expense levels.

Finally, we have removed shareholder asset quality from our KPIs. This measure was introduced at the height of the financial crisis and highlighted the strength of our balance sheet. We have consistently maintained a high level of asset quality since the inclusion of this measure as a KPI and now consider that the prominence of this measure can be reduced. Whilst this measure is no longer a KPI, we will continue to report shareholder asset quality within the financial performance section of the strategic report.

Delivery of cash today

The delivery of cash today and the continued focus on growing cash tomorrow are fundamental to the Group's ability to move to a progressive dividend policy. We continue to consider SFS the most appropriate metric for demonstrating the Group's cash generation abilities. However, there are areas where additional information will be provided to make it clearer how our business units contribute to this measure.

The Group currently writes both insurance and asset-based savings business. For insurance products such as those sold by our Protection and Retirement Income businesses, the current free surplus presentation, showing the investment in new business and expected return on in-force, works well. This is because the terms of customers' policies are largely established at the point of sale, allowing the related costs and benefits to be allocated between new business impact and in-force surplus benefit. This also applies to the VNB measure, where future expectations of cash generation are recognised when the product is sold.

For asset-based businesses, such as Corporate Benefits and Lombard, the growth in assets over the life of the policies is a key driver of cash generation but is not recognised in VNB or SFS investment in new business. For this reason we will no longer focus on the VNB of asset-based business, even though this business will continue to contribute to the Group metric. Instead we will extend the analysis of surplus generation for this business as follows:

£m	Corporate Benefits	Lombard	Total 2013
Income	**110**	**139**	**249**
Outgoings	**(94)**	**(110)**	**(204)**
Other	**(5)**	**(9)**	**(14)**
Asset-based underlying free surplus generation	**11**	**20**	**31**

Income represents the expected charges earned in the period across both new business and the in-force book. Similarly, outgoings include both costs incurred in writing new business (acquisition costs) and servicing the in-force book (maintenance costs, investment management fees and renewal commission). We believe that for asset-based businesses this presentation establishes a more holistic view of their cash generation ability and will help inform the choices available and decisions taken when writing new business.

In 2013, Corporate Benefits delivered a positive underlying free surplus with income (62bps) in relation to opening assets under administration exceeding outgoings (53bps) on this business for the first time. This is an inflection point for this business and highlights the benefit of scale and tight cost control with assets under administration now exceeding £20 billion.

So, in summary, 'cash today' metrics will be split between insurance and asset-based business and into primary and secondary metrics as set out below:

Metric	Insurance	Asset-based
VNB	✔	✓
IRR	✔	✓
INB	✔	✓
Payback	✓	n/a
Net fund flows	n/a	✔
Income bps	n/a	✔
Outgoings bps	n/a	✔
Regular premiums	n/a	✔

✔ Primary reporting metric

✓ Secondary reporting metric

Cash tomorrow

Notwithstanding the focus on cash, other measures, such as VNB, continue to be relevant in understanding the Group's cash generation potential. VNB as a measure of new business profitability is not new to the Group and has been a key target for elements of the business.

In recent years, we have delivered exceptional VNB growth rates, particularly in the UK division, with much of this improvement delivered through the integration of the acquired businesses, focus on target platforms and continuous financial discipline. Going forwards, whilst we do not expect this rate of growth to continue, it is our ambition to grow Group VNB at around 10% per annum. Although we expect the primary driver of Group VNB growth to be our Retirement Income business, it is not our intention to set specific business unit level ambitions and VNB will be a Group KPI managed at Group level. In addition, we will continue to focus on the intrinsic profitability of new business. To demonstrate this, we remain committed to the delivery of a new business IRR of 15% across our open insurance businesses.

Alongside new business growth we expect to deliver growing sustainable free surplus through ongoing scale efficiencies in the asset-based businesses and the completion of further Heritage initiatives. Reflecting our increased confidence in the macroeconomic environment and our desire to diversify our investment approach, thereby optimising returns for customers and shareholders, we intend to increase risk-adjusted returns in our shareholder-backed annuity portfolios.

Returns

The changes to our KPIs reflect the Group's focus on cash generation. This means that we are more focused on reporting earnings emerging from existing business with consideration for the key constraints such as the need to hold solvency capital.

Free surplus generation has therefore replaced IFRS and MCEV results after tax as a KPI, strengthening the link between the ongoing performance of the Group, described by SFS, and the total returns generated including economic movements and non-operating expenses. Similarly, we will no longer report FLG operating ROEV as a KPI. Whilst we continue to believe a 10% ROEV is achievable in a better economic climate, we are focused on the Group's cash generation performance and do not believe that ROEV is the best measure of this. Consequently, we will increase our focus on a returns measure that compares sustainable free surplus to shareholder net worth (that is, total free surplus and required capital). In normal circumstances we would expect our ambition for this 'cash return' to be above 25%.

We will continue to report IFRS and MCEV profit after tax as well as ROEV within the detail of the business review.

Dividend progression

Aligning the KPIs with the measures through which we intend to manage the Group is an important step in delivering our dividend growth ambitions. We are also updating our ordinary dividend policy. The previous commitment of considering a move to a progressive dividend when distributable cash generation reached £400 million is being replaced by a policy that relates ordinary dividend cost coverage to SFS generation. Our ordinary dividend policy is to pay 21.14 pence per share per annum, with the expectation that a progressive dividend would be considered once the coverage ratio of SFS:Dividend cost exceeds 1.3 times. This is broadly consistent with our previous £400 million commitment based on a current dividend cost of £300 million. Our SFS of £331 million currently remains outside this range at 1.1 times, however, we are confident that we can achieve the 1.3 times coverage in due course (and thus trigger a review of the move to a progressive dividend) through continued focus on capital efficiency, business growth and financial discipline.

Outlook

I am delighted with the progress the Group has made over the last few years and am confident that the Group will continue to progress against its key strategic objectives. We have now established a new financial framework and as we transition over the next few years to an economic capital based Solvency II regime, this will ensure that the Group's performance is appropriately measured and supports decision-making in line with the Group's strategy and focus.

Looking forward, we will continue to develop the Group's key strengths particularly in the management of closed books and in the retirement income market, supporting the delivery of positive outcomes for both customers and investors alike.

Business review

Group results

Group operating results

Shown below are the Group operating IFRS, free surplus and MCEV results. Further detail on business unit performances can be found in the sections that follow.

£m

Group IFRS operating results	UK	Heritage	Int'l	Corporate	2013	2012
New business strain	(1)	(25)	(71)	–	(97)	(142)
In-force surplus	69	264	208	–	541	550
Long-term investment return	13	(84)	(1)	3	(69)	(23)
Principal reserving changes and one-off items	8	141	15	–	164	(23)
Development costs	(30)	(7)	(13)	–	(50)	(50)
Other income and charges	(19)	2	(2)	(34)	(53)	(38)
IFRS based operating profit/(loss) before tax	40	291	136	(31)	436	274

Group operating free surplus generation	UK	Heritage	Int'l	Corporate	2013	2012
Expected return from in-force business	99	442	141	–	682	668
Investment in new business	(98)	(30)	(85)	–	(213)	(285)
Underlying free surplus generation	1	412	56	–	469	383
Development costs	(23)	(7)	(11)	–	(41)	(38)
Coupon on external debt	–	–	–	(92)	(92)	(73)
Coupon on internal debt	–	–	–	–	–	(12)
	(22)	405	45	(92)	336	260
Operating experience variances	(11)	27	9	–	25	(31)
Other operating variances	15	(1)	(12)	–	2	86
Other income and charges	(22)	–	(2)	(8)	(32)	(15)
Sustainable free surplus generation	(40)	431	40	(100)	331	300
Operating assumption changes	17	48	(13)	–	52	(68)
Operating FLG free surplus generation	(23)	479	27	(100)	383	232

Group MCEV operating results	UK	Heritage	Int'l	Corporate	2013	2012
Value of new business	184	(19)	39	–	204	194
Expected existing business contribution	60	211	52	(75)	248	325
Operating experience variances	(33)	(12)	(12)	–	(57)	(56)
Operating assumption changes	(6)	93	(68)	–	19	(9)
Other operating variances	36	127	15	–	178	27
Development costs	(30)	(7)	(13)	–	(50)	(50)
Other income and charges	(19)	–	(2)	(32)	(53)	(49)
MCEV operating profit/(loss) before tax	192	393	11	(107)	489	382

Non-operating results

£m **Group IFRS results**	**2013**	2012
IFRS based operating profit before tax	**436**	274
Short-term fluctuations in investment return	**182**	275
Gain on sale of associates (AmLife)	**20**	–
Other non-recurring items	**(151)**	(258)
STICS[(i)] interest adjustment to reflect IFRS accounting for STICS as equity	**31**	31
IFRS profit before acquisition accounting adjustments and shareholder tax	**518**	322
Amortisation and impairment of acquired in-force business	**(392)**	(417)
Amortisation and impairment of other intangible assets	**(91)**	(97)
IFRS profit/(loss) before shareholder tax	**35**	(192)
Shareholder tax	**200**	151
IFRS profit/(loss) after tax	**235**	(41)

Group free surplus generation		
Operating FLG free surplus generation	**383**	232
Economic variances	**264**	120
Capital optimisation programme	**–**	101
Other non-operating items	**(249)**	(208)
FLG free surplus generated	**398**	245
RSL income and charges	**(21)**	(30)
Total free surplus generated	**377**	215

Group MCEV results		
MCEV operating profit before tax	**489**	382
Economic variances	**412**	154
Amortisation and impairment of non-covered business intangible assets	**–**	(15)
Non-recurring costs	**(181)**	(255)
Other non-recurring items and non-operating variances	**38**	128
MCEV profit before tax	**758**	394
Tax	**(179)**	(126)
MCEV profit after tax	**579**	268

(i) Step-up Tier one Insurance Capital Securities

Group IFRS: non-operating results

Short-term fluctuations in investment returns on assets backing the shareholder and non-profit funds amounted to a favourable £182 million. This principally reflects the release of credit default reserves and annuity portfolio mismatch variances, where the liabilities are matched on a realistic basis as opposed to the reported regulatory basis.

Gain on sale of associates of £20 million reflects the profit on the sale of the Group's 30% stake in AmLife (AmLife Insurance Berhad and AmFamily Takaful Berhad), which was completed on 4 January 2013.

Other non-recurring items of £(151) million include:

- separation and integration programme costs, net of provision releases, of £(24) million;
- outsourcing implementation costs of £(65) million;

- finance transformation costs of £(49) million largely relating to Solvency II; and
- other non-recurring costs of £(13) million include costs of the 2013 capital optimisation programme amounting to £(9) million and strategic review fees of £(4) million.

A shareholder tax credit of £200 million is recognised for the year. This tax credit is different from the expected shareholder tax on a profit before shareholder tax of £35 million. The difference includes £70 million in respect of the reduction in the rate of UK corporation tax, and a further £70 million in relation to tax reliefs, charges and expenses predominantly in relation to the life insurance companies in the Group, which are taxed on the "I minus E" basis. The difference also includes £25 million in respect of the use of previously unvalued shareholder tax losses, £21 million from adjustments relating to prior periods and a net £22 million from various adjustments such as the impact of lower tax rates on overseas business and the non-taxable gain on the disposal of the Group's holding in AmLife.

The tax credit in relation to the amortisation and impairment of AVIF and other intangibles in the year, including the associated impact of the reduction in the corporation tax rate, is £185 million.

Group free surplus generation: non-operating results

Economic variances combine the impact of changes to economic assumptions with the investment return variances over the year. Total economic variances in 2013 had a £264 million positive impact on free surplus. A £156 million positive impact resulted from annuity business, primarily as a result of the unwind of credit default allowances, in addition to an assumption change to reduce future credit default allowances due to the narrowing of corporate bond spreads in 2013. A further £108 million positive impact resulted on other lines of business, primarily due to movements in interest rates and equity markets during the year.

Other non-operating items of £(249) million include £(151) million of non-recurring items, consistent with those reported within the IFRS result. In addition, there is a net impact of £(98) million from items specific to free surplus, including £(89) million in respect of a provision made to contribute towards the deficit reduction plan for the Group's defined benefit pension scheme.

RSL income and charges of £(21) million relate to corporate costs incurred within the Resolution Limited holding company.

Group MCEV: non-operating results

Economic variances combine the impact of changes to economic assumptions with the investment return variances over the year. Total economic variances in 2013 had a £412 million positive impact on MCEV profit before tax. Corporate bond spreads narrowed by around 50bps over the period which resulted in an increase in MCEV profit of £318 million, primarily in respect of annuity business in the UK and Heritage divisions. The equity market movements increased the value of future annual management charges on unit-linked business, resulting in an increase of £354 million. These positive movements were partially offset by a £(210) million charge from an increase in long-term interest rates from low opening levels, and a further £(50) million charge principally from an increase in assumed expense inflation.

Non-recurring costs in 2013 total £181 million and include costs of £151 million, consistent with those reported within the IFRS result, in addition to net costs of £30 million specific to MCEV. The £30 million specific to MCEV includes a £7 million difference between the actual tax relief expected and the notional tax gross up applied to all non-recurring costs under MCEV. The application of these different tax rates results in a higher cost, gross of notional tax, under MCEV than under IFRS. In addition, a further provision of £20 million for Solvency II costs is partially offset by the release of £(6) million of provisions for the Diligenta outsourcing under MCEV. The balance of non-recurring and non-operating variances represents the impact of the additional 1% reduction in the rate of Corporation Tax from 1 April 2015 announced on 20 March 2013.

Group net assets and shares in issue

£m (unless otherwise stated)	2013	2012
Total IFRS net assets	**5,549**	5,698
Net Group MCEV	**6,065**	5,831
Shares in issue[(i)]	**1,417,508,151**	1,418,109,028

(i) Adjusted to exclude 600,877 Resolution Limited shares held by subsidiaries at 31 December 2013 (31 December 2012: nil)

At 31 December 2013, IFRS total equity was £5,549 million (31 December 2012: £5,698 million), with equity attributable to equity holders of the parent of £5,229 million (31 December 2012: £5,377 million). IFRS net assets per share attributable to shareholders were £3.69 (31 December 2012: £3.79) based on shares in issue at the balance sheet date.

Net Group MCEV was £6,065 million (31 December 2012: £5,831 million) giving MCEV per share of £4.28 (31 December 2012: £4.11).

Heritage division

2013 highlights

- Reallocation of with-profits annuities (phase 1) completed, circa £2 billion of annuities transferred from with-profits fund to FLL non-profit fund as part of the with-profits annuity reallocation programme. This transfer is expected to provide future free surplus benefits of circa £10 million per annum.
- Service improvement programme achieved a key milestone, with the transfer of policies from two legacy administration systems to the Diligenta BaNCS IT platform in December.
- Internal company restructuring completed, delivering material operational simplification and leaving only two UK based life companies, broadly aligned with the UK and Heritage divisions.
- Heritage IFRS based operating result of £291 million (2012: £332 million) with a reduction from the run-off of the business and lower interest rates, partially offset by increased one-off benefits driven by the with-profits annuity reallocation activity.
- SFS generation of £431 million (2012: £489 million) reflecting strong in-force surplus emergence but with the material prior year one-off benefits not fully repeated in 2013.
- MCEV operating profit of £393 million (2012: £359 million) reflecting the impact of the with-profits annuity reallocation activity with the benefits of the transaction more than offsetting the material reduction in expected return on all asset classes, as anticipated at the end of 2012.
- Deal announced to transfer £12.2 billion of equity and multi-asset funds of Friends Life from F&C to Schroders and £2.3 billion of fixed income assets from F&C to FLI.

Strategy

The Heritage division has £68 billion of assets under administration and serves circa 4 million customers across a range of products. These products are no longer actively marketed and are largely administered on legacy systems.

A dedicated management team is in place with a focus on looking after customers' needs and enabling the Heritage division to become the UK's leading legacy business manager.

The value drivers for the Heritage division, in the context of the overall Group's strategy are:

- operational excellence: dedicated customer service within an efficient cost base in line with business scale;
- capital efficiency: optimisation of capital required for the business;
- cash generation: safe generation with focused opportunities for enhancing future cash generation;
- strong risk focus: robust financial risk and balance sheet volatility management; and
- focus on asset management: utilising the recently created internal asset management capability to maximise returns and lower costs.

The Heritage division is making good progress towards achieving its strategic outcomes.

The Group continues to provide good customer service supported by its outsourced suppliers. The first major migration from two legacy administration systems onto the Diligenta BaNCS IT platform was completed in December, with the resulting cost synergies being part of the contractualised savings already reported. The migration of data and processes was successful, however, it has led to a temporary increase in waiting times for some customers. These issues are being addressed, with actions in place to ensure there are no similar impacts for the migrations planned in 2014.

The Group has completed the planned Part VII transfers of all life company business and as a result there are now only two active life companies: Friends Life Limited ("FLL") which mainly contains the Heritage division's business (including all six with-profits funds) and Friends Life and Pensions Limited ("FLPL") which mainly contains the UK division's business. As part of this programme, Friends Life Company Limited ("FLC") and Friends Life WL Limited ("FLWL") have ceased to underwrite long-term insurance business and are in the process of being de-authorised. The capital efficiency gains delivered broadly cover the programme's costs, with the principal benefits achieved through material operational simplification of the Group.

A multi-year programme to implement a uniform capital management framework for the six with-profits funds is ongoing. As part of that initiative and the ongoing objective to ensure that with-profits funds remain appropriately invested for customers and shareholders, the with-profits annuity reallocation programme involved a reallocation of circa £2 billion of annuities from a with-profits fund to FLL non-profit fund. A free surplus investment of £(16) million in 2013 is expected to generate circa £10 million per annum of SFS, whilst also significantly de-risking future returns for policyholders. Other tranches of with-profits fund annuities are being investigated with a further reallocation of circa £700 million being considered in 2014. If suitable financial terms can be agreed for this and further reallocations, then future tranches would be expected to require at least the same level of investment, but with significantly smaller benefits.

Friends Life Investments Limited ("FLI") now manages £17.1 billion of fixed interest assets, including £7.0 billion from recaptures in 2013. This has delivered more internal control over the investment performance, together with a material reduction in investment costs, benefitting MCEV operating profit in 2013 by £31 million. The recaptures to date have enabled £5 million per annum ongoing benefits. Work continues to assess further potential recaptures.

Investments have also been made in a number of different asset classes in order to support increased yield for the assets within the annuity portfolios in both UK and Heritage divisions. This includes investments in the first government guaranteed infrastructure loan of £75 million in April 2013 and the Group's first export credit agency arrangement of £74 million in September 2013. In addition, a commercial real estate loan mandate and an infrastructure loan mandate, each of £500 million, have been put in place.

Financial performance

IFRS based operating profit

£m	2013	2012
New business strain	**(25)**	(23)
In-force surplus	**264**	334
Long-term investment return(i)	**(84)**	(41)
Principal reserving changes and one-off items	**141**	68
Development costs	**(7)**	(6)
Other income	**2**	–
IFRS based operating profit before tax	**291**	332

(i) Long-term investment returns are now reported separately for the UK and Heritage divisions, with them previously having been consolidated at UK territory level and reported in Heritage division only in 2012.

The 2013 Heritage IFRS based operating profit of £291 million is £(41) million lower than in 2012, with reduced in-force surplus and lower long-term investment return being partially offset by increased benefit from principal reserving changes and one-off items.

In-force surplus has reduced due to the run-off of the closed book of business and as a result of £(36) million of provision movements in respect of a number of operational items, arising from the review of the legacy business. This review is designed to reduce the risk of future negative variances and safeguard future cash emergence. In-force surplus has been further reduced by the non-recurrence of some positive experience variances noted in 2012.

The reduction in long-term investment return is due to lower interest rates and increased internal debt costs paid to the Corporate segment following the US$575 million UT2 debt issued in November 2012. The Heritage division meets all of these internal debt costs. In addition, there has been a transfer of assets to the UK division reducing the Heritage division return and increasing the UK division return by £12 million.

Principal reserving changes and one-off items are significantly higher than in 2012 largely due to the with-profits reallocation programme generating a £76 million benefit. Other favourable operating assumption changes have been included principally resulting from improved mortality and morbidity experience on term assurance (£17 million) and income protection business (£31 million).

Operating expenses

£m	2013	2012
Acquisition	**30**	40
Maintenance	**246**	244
	276	284
Development	**7**	6
Total	**283**	290

2013 acquisition costs are lower than 2012, mainly driven by the strategic decision to stop actively selling new business. Contractual savings in customer service and IT achieved through the Diligenta partnership along with the successful completion of the AHM programme to move all IT infrastructure and business applications hosted by AXA to Friends Life have further reduced the acquisition costs of the division.

Maintenance costs of £246 million include a £9 million impact of expense provision movements following a review of the legacy business. While temporarily increasing the division's costs, the review was designed to provide future stability in the ongoing management of the business and safeguard future cash emergence. Excluding the provision increases, the Diligenta and IT contractual savings also reduced the underlying maintenance cost base for Heritage.

Development spend of £7 million is broadly in line with 2012 full year costs and reflects the ongoing cost of implementing regulatory change, such as auto-enrolment, as well as improvements to existing products and systems to support the in-force business.

Sustainable free surplus generation

£m	**2013**	2012
Expected return from in-force business:		
Free surplus emergence	**428**	420
Return on shareholder assets	**14**	33
Investment in new business	**(30)**	(55)
Underlying free surplus generation	**412**	398
Development costs	**(7)**	(5)
Operating experience variances	**27**	8
Other operating variances	**(1)**	88
Sustainable free surplus generation	**431**	489

The Heritage SFS generation of £431 million is down £(58) million on 2012, with the strongly favourable other operating variances in 2012 not repeating in 2013.

Expected return from in-force business at £442 million is broadly consistent with that in 2012, with the general run-off of in-force being offset by a spike in with-profits surplus emergence as policies mature. This is not expected to recur in 2014.

Operating experience variances include £31 million from the release of tax provisions.

Other operating variances include the impact of the with-profits annuity reallocation which has resulted in a strain of £(16) million in 2013. The impact of this has been offset by £16 million revised transfers on guaranteed annuity options triggered by the vesting of previous pensions business within the with-profits funds.

MCEV operating profit

£m	**2013**	2012
Value of new business	**(19)**	2
Expected existing business contribution	**211**	281
Operating experience variances	**(12)**	9
Operating assumption changes	**93**	65
Other operating variances	**127**	8
Development costs	**(7)**	(6)
MCEV operating profit before tax	**393**	359

The Heritage MCEV operating profit of £393 million is £34 million higher than the £359 million reported in 2012, with an increase in other operating variances from the benefit of the with-profits annuity reallocation offsetting a reduction in the expected existing business contribution, due to lower rates of return.

MCEV operating profit includes an expected existing business contribution which is calculated with reference to risk-free interest rates. As communicated previously, expected existing business contribution has reduced significantly compared to 2012, due to material reductions in the level of expected rates of return on all asset classes in line with rates reported at the end of 2012.

The £93 million operating assumption changes include a £31 million benefit reflecting revised assumptions in respect of future investment expenses. This has been enabled by the recapture of certain asset portfolios by FLI. Operating assumption changes also includes an increased recognition of deferred tax assets of £46 million.

Other operating variances of £127 million include a £96 million benefit from the with-profits annuity reallocation and benefits from modelling changes.

Value of in-force business

The Heritage business represents a significant proportion of the Group's in-force value. The breakdown by product is shown below.

£bn	2013	2012
Pensions	**0.6**	0.5
Investments	**0.7**	0.6
Annuities	**0.2**	0.2
Protection	**0.4**	0.5
With-profits	**0.4**	0.5
Total	**2.3**	2.3

Total Heritage value of in-force business remains unchanged from 2012. This reflects the positive economic conditions in 2013 which have offset the run-off of the closed book.

Heritage assets under administration

£bn	2013	2012
Unit-linked pensions	**19.3**	18.3
Unit-linked investment	**15.5**	15.4
Annuities and protection	**9.5**	7.7
With-profits	**23.7**	27.3
Total	**68.0**	68.7

The increase in annuities and protection assets under administration and corresponding decrease in with-profits funds principally reflects the transfer of circa £2 billion annuities from the with-profits funds under the with-profits annuity reallocation. For unit-linked business the favourable investment returns over 2013 have offset the run-off of the business.

New business

£m (unless otherwise stated)	2013	2012
VNB	**(19)**	2
Investment in new business	**(30)**	(55)
IRR	**(1.9)%**	4.6%
APE	**54**	102

The Heritage division specifically focuses on those products no longer actively marketed. Despite not actively seeking new business, the Heritage book delivers ongoing incremental business written across all product types. This incremental new business is largely accepted as part of the contracts on existing business.

The contribution from Heritage new business in 2013 was a loss of £(19) million compared to a profit of £2 million in 2012. This reduction reflects 2012 being the final year of Department of Work and Pensions ("DWP") rebate new business, following regulatory changes alongside a general run-off of volumes in Heritage with new business now focused in other divisions. The 2012 full year VNB for DWP business was £13 million.

The improvement in investment in new business reflects the lower sales volumes and corresponding reduction in capital requirements.

Outlook

During 2014, further migrations are planned from legacy administration systems to the Diligenta BaNCS IT platform. A migration programme has also been agreed with the existing outsource supplier (Capita) to transfer the business that they administer from the legacy systems. Although these projects are not expected to deliver further synergies beyond those already contractualised, they will support the drive for operational efficiency and simplification, and improve customer service.

A robust Enterprise Risk Management framework for financial risk and balance sheet management is being embedded, which will include further progress in delivering a controlled framework for taking investment and risk decisions within all Friends Life with-profits funds. As part of this the reallocation of additional with-profits fund annuity books is being considered. Future tranches are expected to require similar investment, but with smaller benefits, with a further reallocation of circa £700 million being considered in 2014.

Following the cessation of sales of new business in September 2013, the Overseas Life Assurance Business ("OLAB"), previously reported in the International division, will be transferred to Heritage in 2014. This will take advantage of Heritage's expertise in managing closed books of business.

We will continue to review options for ensuring that asset management is both cost efficient and generating good returns for policyholders and shareholders. The deal entered into with Schroders, with the transfer of assets expected to be complete in the fourth quarter of 2014, is an example of this activity.

UK division

2013 highlights

- VNB up 30% on 2012 to £184 million on an 8% increase in sales, with £8 million lower investment in new business.
- IRR has increased from 13.3% to 15.3% reflecting the financial discipline behind the growth in new business.
- IFRS based operating profit of £40 million significantly improved from a loss of £(32) million in 2012 as a result of reduced new business strain and increased in-force surplus.
- SFS improved from £(66) million to £(40) million demonstrating increased returns from in-force business and lower development costs.
- These results have been achieved despite a disappointing loss from Sesame Bankhall Group amounting to £(22) million SFS and £(19) million in IFRS and MCEV.
- MCEV operating profit of £192 million is up from £143 million in 2012 reflecting a £42 million increase in VNB.
- The division has demonstrated strong operational progress in 2013 through investment in target platforms, rigorous cost control and propositional developments.

Strategy

Friends Life presented the UK division's strategic agenda in November 2011 and excellent progress has been made in the past two years. Business integration and transformation activities have largely been completed and the focus of the UK division is on driving profitable growth in its chosen markets whilst maintaining financial discipline. Good progress has been made on developing key proposition initiatives across the division's markets.

The Retirement Income business has delivered a number of key customer propositions that will support sustainable growth in the 'at retirement' market. It has upgraded the proposition for existing customers approaching retirement, including the promotion of a comprehensive enhanced annuity option and launched the Friends Lifestyle Annuity into the open market in the final quarter of 2013. It has also piloted a 'shopping around' service in partnership with Key Retirement Solutions which supports customers at, or close to, retirement with options around provider and product type.

In the Corporate Benefits market, the Group has developed auto-enrolment technology which provides simple solutions to the regulatory and technical burden on employers. In addition, a new range of default funds, My Future, launched in the first quarter, has had encouraging early take up.

Further enhancements were made to the already highly regarded Protection proposition in 2013. These were very well received and retained the focus on continued innovation and ensuring products meet customer needs and expectations.

Financial performance

New business profitability

UK division 2013 VNB up 30% on prior year, from £142 million to £184 million

£m (unless otherwise stated)	2013	2012
VNB		
Corporate Benefits	**26**	21
Protection	**75**	62
Retirement Income	**83**	59
Total VNB	**184**	142
Investment in new business		
Corporate Benefits	**(48)**	n/a
Protection	**(44)**	n/a
Retirement Income	**(6)**	n/a
Total investment in new business	**(98)**	(106)
IRR		
Corporate Benefits	**8.4%**	7.2%
Protection	**13.8%**	13.8%
Retirement Income	**25%+**	25%+
Total IRR	**15.3%**	13.3%
APE		
Corporate Benefits	**574**	535
Protection	**84**	90
Retirement Income	**66**	44
Total APE	**724**	669

UK division VNB is up 30% on 2012 at £184 million with growth in each business, particularly in Retirement Income which grew by 41% on 2012. The growth was achieved whilst reducing the level of investment in new business for the division from £(106) million in 2012 to £(98) million in 2013. The focus on operational efficiency as well as an improved mix, higher investment returns and a change to the reinsurance programme for Protection were the main drivers of the additional value and lower strain.

Corporate Benefits: £26 million VNB, 24% increase on prior year

Corporate Benefits VNB was up 24% with a growth in APE of 7%. This growth is increasingly supported by the success of the My Money platform where there is continued focus on proposition development to enhance the customer experience and innovative new product design.

The Workplace Solutions team continues to drive new business opportunities from the existing book and has seen material growth as a result of auto-enrolment. Auto-enrolment has significantly increased the number of members in existing schemes on target platforms. This has driven up the value of new business through the recognition of increased economies of scale including the benefit to the Group of focusing on auto-enrolment mandates from existing customers where set up and other initial costs have largely been incurred already. There has been good progress on the Embassy Transition programme, such that new members joining certain schemes on the Embassy platform are assumed to transition on to target platforms by 2015.

Sales of new schemes have shown steady growth and the pipeline of confirmed scheme wins is comparable with that taken into the start of 2013. There is an expectation that the flow of new scheme volumes will increase following the enhancements to the division’s proposition and distribution reach. Furthermore, increments and new entrants to existing schemes are also showing strong growth with sales in the second half of the year up 16% on the first half.

Over the course of the year 274 schemes of 203 employers have staged with the Group. The trend of employers enrolling on minimum contributions and with qualifying earnings has continued into the last quarter of the year, exerting pressure on new business margins. This trend is expected to continue for new business resulting from auto-enrolment and has also impacted the IRR of 8.4% (2012: 7.2%).

Whilst it has been disappointing to see employees' retirement savings limited by the significant numbers of schemes paying only minimum contributions, the division expects to see these contributions, and the value to the Group from these schemes, increase as statutory minimum levels move from 2% to 8% in aggregate by 2018. The Group expects an increased number of smaller schemes to auto-enrol during 2014 and is introducing a fee paying arrangement for the employer services offered to ensure these remain commercially attractive.

Corporate Benefits assets under administration

£bn	
1 January 2013	**17.8**
Inflows	2.0
Outflows	(1.1)
Net funds flow before exceptional losses	0.9
Exceptional losses	(1.1)
Net investment return	2.5
31 December 2013	**20.1**

Total assets under administration are £20.1 billion, an increase of £2.3 billion over the period driven by positive market movements.

Retention of the in-force book remains a key priority and increasing focus on this has driven improved net fund flows in the final quarter of the year with notifications of schemes expected to disinvest in the coming year well down on the level 12 months ago.

Outflows for the period are heavily impacted by the run-off of two, now closed, non-strategic products. Additionally, there have been heavy outflows from schemes secured by commission paying competitors in the run up to RDR. After adjusting for these exceptional items, there were net inflows. Whilst this has created short term pressure through reduced incremental business on existing schemes, the Group has applied financial discipline and avoided a significant cash strain that would have been payable as a result of employees auto-enrolling into schemes paying initial commission.

Protection: £75 million VNB, 21% increase on prior year

The Protection business has delivered VNB of £75 million up 21% on prior year on 7% lower volumes. The increase in value has been driven by the use of more cost efficient target platforms, and the successful restructuring of reinsurance contracts.

Sales of individual protection are down 15% on prior year, largely driven by an acceleration of business into the fourth quarter of 2012 ahead of the implementation of gender neutral pricing on 21 December 2012. This acceleration had a knock-on impact on the first quarter of 2013, however the subsequent quarter on quarter trajectory shows strong growth with fourth quarter volumes being some 191% of the first quarter volumes.

Group protection sales have delivered a 70% increase in value on a 9% increase in APE. As well as volume growth, margins have improved from the restructure of reinsurance arrangements and a shift in mix towards the more profitable critical illness and income protection products.

Retirement Income: VNB of £83 million up 41% on prior year

Retirement Income VNB of £83 million is 41% ahead of 2012. This growth is driven by increased volumes from better customer engagement and product innovation, improved investment returns and the benefit of lower investment costs from FLI. Results for the fourth quarter of the year have been impacted by competitive pressure and the business expects this to continue into 2014.

The new annuity platform has been delivered to facilitate more sophisticated pricing and the underwriting necessary to support enhanced annuity products. Through the course of 2013, the business migrated increasing numbers of its retiring customers onto this new platform to ensure they benefit from this new proposition and the improved support the business is now able to offer for their retirement decision making. These migrations will continue through 2014 and it is expected that it will support the Group's retention rate through a period of market uncertainty. The number of existing customers choosing to buy an annuity from Friends Life rose in the period with the proportion of vestings increasing to 34% up from 25% in 2011.

The new Flexible Lifestyle Annuity ("FLA") was launched in December following a period of pilot activity. A successful launch has been executed via the main intermediary portals and a small initial pipeline of business established providing a foundation for growing volumes through the first quarter of 2014.

IFRS based operating profit

£m	2013	2012
New business strain	**(1)**	(36)
In-force surplus	**69**	61
Long-term investment return(i)	**13**	1
Principal reserving changes and one-off items	**8**	(21)
Development costs	**(30)**	(36)
Other income and charges	**(19)**	(1)
IFRS based operating profit before tax	**40**	(32)

(i) Long-term investment returns are now reported separately for the UK and Heritage divisions, with them previously having been consolidated at UK territory level.

The UK division IFRS based operating profit before tax of £40 million increased by £72 million in the year to 31 December 2013. New business strain improved by £35 million, a fall of 97% despite a 8% increase in new business volumes. Protection delivered £22 million of this saving, predominantly driven by synergies achieved from writing Protection business on more efficient target platforms and restructuring reinsurance arrangements in the year.

In-force surplus has increased by £8 million compared to prior year, in line with higher Corporate Benefits AMC income from a growing in-force book.

Principal reserving changes and one-off items of £8 million reflect a number of small model refinements in each of the businesses.

Whilst development costs have reduced by £6 million compared with 2012, there has been considerable investment in enhancing the Protection proposition and the launch of the open market annuity product within Retirement Income.

The movement in other income and charges of £(18) million reflects the results of the Sesame Bankhall Group (full year loss of £(19) million) where a provision has been set up following a review of past business including pensions transfers. The strategic review of Sesame Bankhall Group is ongoing.

Operating expenses

£m	2013	2012
Acquisition	**99**	110
Maintenance	**48**	49
	147	159
Development	**30**	36
Total	**177**	195

Tight expense management and the efficiency savings from moving onto target platforms in Protection resulted in a reduction in operating expenses which are 9% lower than 2012.

Development costs have reduced by £6 million compared to the prior year despite the high level of regulatory change impacting the division, considerable investment in enhancing the Protection proposition and the launch of the open market annuity product within Retirement Income.

Sustainable free surplus generation

£m	2013	2012
Expected return from in-force business:		
Free surplus emergence	**93**	85
Return on shareholder assets	**6**	1
Investment in new business	**(98)**	(106)
Underlying free surplus generation	**1**	(20)
Development costs	**(23)**	(27)
Operating experience variances	**(11)**	(14)
Other operating variances	**15**	–
Sustainable free surplus before Sesame	**(18)**	(61)
Sesame	**(22)**	(5)
Sustainable free surplus generation	**(40)**	(66)

Expected return on in-force business has increased in the year reflecting the additional contribution from new business written in 2012 as well as the growth in assets under administration in Corporate Benefits. This has been partially offset by the lower returns on reserves, as a result of lower expected short-term interest rates in 2013. Investment in new business has reduced by £8 million compared with 2012, despite new business volumes increasing by 8%. This is as a result of significantly improved new business strain for Protection due to operating efficiencies from being on the target platforms for the whole year and successfully restructuring reinsurance contracts, offset by an increase in capital requirements from higher volumes of more competitively priced annuities.

Operating experience variances of £(11) million are £3 million favourable compared to 2012. In 2013, the variance is driven by adverse claims experience of individual protection products, and temporary maintenance expenses associated with My Money, the newly established Corporate Benefits platform.

Other operating variances of £15 million are largely driven by a release of reserves following completion of the Part VII transfers.

MCEV operating profit

£m	2013	2012
VNB	**184**	142
Expected existing business contribution	**60**	61
Operating experience variances	**(33)**	(30)
Operating assumption changes	**(6)**	(3)
Other operating variances	**36**	11
Development costs	**(30)**	(36)
Life and pensions covered business operating profit before tax	**211**	145
Other income and charges	**(19)**	(2)
MCEV operating profit before tax	**192**	143

MCEV operating profit before tax of £192 million is up £49 million on prior year.

VNB has improved significantly across the division with all businesses demonstrating good growth on 2012, particularly from Retirement Income.

Expected existing business contribution is in-line with that of 2012 with growth on the existing book being offset by a lower expectation of yields on assets, in particular on fixed income assets.

Operating experience variances are £(33) million for the year, heavily impacted by short-term adverse persistency from Corporate Benefits as a result of exercising financial discipline and allowing certain commission paying schemes to transfer away. A provision of £33 million in respect of these RDR related losses has been released.

Operating assumption changes include £46 million in respect of increased recognition of deferred tax assets and favourable expense basis adjustments of £7 million. Offsetting this is a £(50) million impact from a provision for re-writing some group pensions business on more competitive terms combined with a revised view of expected lapse rates, and a £(9) million impact in respect of a change in mortality assumptions within the Protection business.

Other operating variances of £36 million include £15 million in respect of the migration to target platform of a book of group protection business and £8 million from restructuring reinsurance contracts.

Outlook

Despite the continued regulatory and political scrutiny surrounding the charges associated with corporate pension schemes and the annuity market generally, the UK division is well placed to benefit from the expected economic recovery. Higher employment levels and salary inflation will drive the new business contribution for workplace schemes in Corporate Benefits and the expected growth in markets will drive increased revenue flows. Economic improvement is also expected to drive recovery in the housing market.

The Corporate Benefits business will continue to drive assets under administration through its focus on auto-enrolling clients (the Group expects to stage several hundred schemes in 2014), through the right level of attention from relationship managers, further enhancement of auto-enrolment services, and appropriate focus on those clients transitioning from the Embassy platform to ensure high levels of retention. Growth opportunities are expected from the development of the Master Trust proposition, recently launched on NGP, and the development of a proposition suitable for small to medium sized employers, which will be particularly important as the business expands distribution into the corporate IFA sector.

Increased assets under administration in turn drive larger retirement savings which will increase the number and size of annuities being written. The Retirement Income business is expected to grow, though at a more modest rate than in 2013, driven by continued improvement in customer retention as a result of engagement initiatives and steady growth of open market opportunities. The Group believes that the margin pressure seen in the latter part of 2013 will continue and anticipates addressing this through further evolution of the investment strategy.

Continued recovery of the housing market is expected to present an opportunity for increased levels of Protection business, in particular through estate agencies. The Protection proposition suite remains highly regarded and the Group is well placed to benefit from strong relationships from the division’s partnerships with estate agencies and intermediaries operating through panels. The Protection business continues to develop new channels through existing partners and through the growth of new partners.

In addition, greater focus is being placed on strengthening and expanding relationships with key partners, customers and extending distribution reach through corporate IFAs.

International division

2013 highlights

- The International division has met its dividend target for 2013 of £33 million with the final dividend payment of £23 million (£14 million from FPI and £9 million from Lombard). An interim dividend of £10 million was paid in July 2013.
- The exit from FPI non-core markets has been completed. The sale of the Group's 30% stake in AmLife in January 2013 has been followed by the cessation of new business in Germany in September 2013.
- International VNB is £39 million (31 December 2012: £50 million). FPI VNB has improved by 180% reflecting good performance in challenging market conditions. However, Lombard VNB has disappointed and is down 44% having been adversely impacted by challenging conditions in its markets, especially Belgium.
- The International businesses generated sustainable free surplus of £40 million in 2013 (31 December 2012: £(28) million) supporting dividend commitments.
- International IFRS based operating profit of £136 million (31 December 2012: £(9) million) reflects increased income from the larger in-force book, favourable economic experience on the return of premium guarantee on German business and the non-recurrence of adverse assumption changes and one-off costs which impacted 2012.
- International MCEV operating profit of £11 million (31 December 2012: £1 million) reflects the improvement in the profitability of the FPI business driven by the strategic changes implemented in 2013, which is mostly offset by the impact of macroeconomic uncertainty in Europe and more particularly legal and tax changes in Belgium, on Lombard's persistency.
- International assets under administration continue to grow supported by market returns. Assets under administration now total £20.2 billion (31 December 2012: £18.9 billion) for Lombard and £7.2 billion (31 December 2012: £6.7 billion) for FPI.
- In FPI, the combination of decreasing operating expenses and growing assets under administration is expected to support cash generation in future years.

Strategy

The Group is committed to realising value for shareholders and, as confirmed in November 2013, has held discussions regarding the potential sale of the Luxembourg based business, Lombard International Assurance. Notwithstanding this, Lombard's strategy remains unchanged with this business continuing to be a leading pan-European specialist in estate and succession planning solutions for high and ultra-high net worth individuals.

The strategy for FPI also remains unchanged. FPI will enhance value creation through its sustainable portfolio of international licenses in Singapore, Hong Kong, UAE and Isle of Man, focusing on profitable growth and cash generation.

The priorities of the division are to:

- selectively grow the business and generate sales of profitable products;
- improve the efficiency of the back-office and deploy more resources to Asia;
- increase the dividends to Group to £50 million per annum for 2015 onwards (target of £33 million for 2013 has been met); and
- target growth in assets under administration to support future cash generation.

Financial performance

The consolidated results of the International division are set out below. The results of the Lombard and FPI businesses are set out in the following sections, including a split of the core and non-core elements in FPI.

£m	**2013**	2012
IFRS		
Lombard	**34**	28
FPI – core	**63**	58
FPI – non-core	**39**	(95)
Total International IFRS based operating result before tax	**136**	(9)
SFS		
Lombard	**6**	(4)
FPI – core	**20**	30
FPI – non-core	**14**	(54)
Total International sustainable free surplus generation	**40**	(28)
MCEV		
Lombard	**(46)**	104
FPI – core	**40**	(2)
FPI – non-core	**17**	(101)
Total International MCEV operating result before tax	**11**	1

The International division results include good progress on IFRS based operating profit and cash generation, although MCEV operating profit was impacted by the loss in Lombard due to lower new business levels and adverse persistency, particularly in Belgium.

The International division's IFRS based operating profit was £136 million, up £145 million on 2012. This largely reflects the non-recurrence of adverse assumption changes and one-off costs that impacted 2012, favourable economic experience on the return of premium guarantee on German business and income from the larger in-force book in FPI.

Sustainable free surplus of £40 million for the International division increased by £68 million above 2012 and largely reflects lower investment in new business partially offset by higher development spend as the Group continues to invest in its open businesses.

International MCEV operating profit of £11 million is £10 million higher than 2012. This result reflects good progress in FPI which is £160 million higher than 2012 at £57 million. However this has been mostly offset by the adverse tax and regulatory changes in Lombard's markets.

Outlook

The Group remains confident that the International division will make an increasing contribution towards generating shareholder cash, as evidenced by the £33 million of dividends paid in respect of 2013 and the core business will continue to generate value for the future.

However, £33 million of dividends paid to the Group for 2013 exceeds total free surplus generated in the year. As a result 2014 dividends are increasingly dependent on in year performance and surplus generation.

Notwithstanding the current challenging conditions in Lombard's markets, the longer term drivers of the demand for individually structured wealth solutions using life assurance remain compelling.

Following the cessation of sales of new business in September 2013, the non-core business ("OLAB") will be transferred to the Heritage division in 2014 to take advantage of Heritage's expertise in managing closed books of business.

Increased focus on retention of the in-force book will drive improved assets under management for FPI which will in turn drive future cash generation.

Lombard operating review

£m (unless otherwise stated)	2013	2012
IFRS based operating profit	**34**	28
MCEV operating result	**(46)**	104
Sustainable free surplus	**6**	(4)
Assets under administration (£bn)	**20.2**	18.9
Dividends paid to Group relating to each year	**13**	4

The Lombard MCEV result is very disappointing compared to 2012 and reflects the persisting significant macroeconomic uncertainty, combined with important changes in the tax and legal framework of several of Lombard's key markets during 2013, especially Belgium. In addition, the uncertainty from the potential sale of the business has adversely impacted the sales volumes and lapse experience and hence MCEV operating results. Notwithstanding this, assets under administration continue to grow supported by market returns and total £20.2 billion (€24.3 billion) at 31 December 2013. This increase, coupled with the non-recurrence of significant one-offs incurred in 2012 in respect of the strategic development plan launched in 2012 resulted in a significantly higher IFRS based operating profit and sustainable free surplus. Lombard paid a £13 million (€16 million) dividend meeting its 2013 dividend commitments.

New business profitability

£m (unless otherwise stated)	2013	2012
VNB	**25**	45
Investment in new business	**(24)**	(23)
IRR(i)	**13.3%**	22.5%
APE	**198**	238
APE in constant currency	**190**	n/a

(i) Lombard IRR takes into account the Luxembourg regulatory regime in which DAC is an allowable asset.

Lombard's value of new business amounted to £25 million, 44% below 2012. The impact of lower volumes (20% down on the same period last year in constant currency) and the negative impact of persistency basis changes are partly offset by lower acquisition expenses. IRR is similarly impacted.

APE performance by region is as follows:

APE (actual exchange rates, £m)	2013	2012
UK and Nordic	**68**	54
Northern Europe	**12**	35
Southern Europe	**110**	123
Rest of world	**8**	26
Total including large cases	**198**	238
Of which: large cases (greater than €10 million)	**87**	102
Total excluding large cases	**111**	136

Some regions have performed well compared to 2012, notably France, Germany, UK and the Nordic region. However, Northern Europe saw a significant reduction in sales driven by Belgium underperformance. Rest of world decreased significantly on 2012 due to a reduced level of large cases written in 2013.

IFRS based operating profit

£m	**2013**	2012
New business strain	**(31)**	(30)
In-force surplus	**68**	60
Development costs	**(3)**	(2)
IFRS based operating profit before tax	**34**	28

Lombard generated an IFRS based operating profit before tax of £34 million in 2013, £6 million up on 2012. The year on year increase principally reflects the non-recurrence of one-off expenses incurred in 2012 in respect of the strategic review.

IFRS new business strain is 3% higher than 2012 (1% in constant currency) due to lower AMCs on new business, resulting from lower sales volumes.

Assets under administration

Despite difficult trading conditions assets under administration continued to increase in 2013. Positive net trading volumes combined with positive investment return and the strengthening of the Euro against Sterling drove assets under administration from £18.9 billion (€23.3 billion) at the end of 2012 to £20.2 billion (€24.3 billion) at 31 December 2013. Over the 12-month period from 31 December 2012, assets under administration have grown 4% in Euro terms.

	€bn	**£bn**
1 January 2013	**23.3**	**18.9**
Inflows	**2.3**	**2.0**
Outflows	**(2.3)**	**(2.0)**
Net investment return	**1.0**	**0.8**
Foreign exchange	**–**	**0.5**
31 December 2013	**24.3**	**20.2**

Operating expenses

£m	**2013**	2012
Acquisition	**39**	41
Maintenance	**29**	34
	68	75
Development	**3**	2
Total	**71**	77

Operating expenses, which exclude commission payments, were 8% below 2012 reflecting the lower amount of one-off expenses in respect of the strategic review that were mainly recognised in 2012. As projected in the original strategic review plan, maintenance costs are expected to further reduce in 2014.

Sustainable free surplus generation

£m	**2013**	2012
Expected return from in-force business	**44**	36
Investment in new business	**(24)**	(23)
Underlying free surplus generation	**20**	13
Development costs	**(2)**	(1)
Operating experience variance	**(9)**	(16)
Other operating variances	**(3)**	–
Sustainable free surplus generation	**6**	(4)

Sustainable free surplus of £6 million is up £10 million on 2012 and supports the 2013 dividend payment. The result is driven by both the higher opening assets under administration as well as the non-recurrence of one-off expenses incurred in 2012.

MCEV operating result

£m	**2013**	2012
VNB	**25**	45
Expected existing business contribution	**33**	35
Operating experience variances	**(25)**	(23)
Operating assumption changes	**(82)**	36
Other operating variances	**6**	13
Development costs	**(3)**	(2)
Life and pensions covered business operating result before tax	**(46)**	104

As a result of the unprecedented difficult trading environment in Lombard's core markets, due largely to the regulatory and legal framework changes, the MCEV operating result for 2013 is materially down on 2012, resulting in a loss of £(46) million. The result reflects a lower contribution from new business and materially adverse lapse experience particularly in Belgium as a result of tax and legal changes. Furthermore, the lapse assumptions for the future have been revised upwards as a result of the adverse experience. The combined effects of both 2013 lapse experience and revised future lapse assumptions for the Belgian book account for two thirds of the operating loss. The 2012 results benefited from one-off positive changes resulting from the Lombard restructuring project totalling £46 million not repeated in 2013.

Expected existing business contribution has decreased from £35 million in 2012 to £33 million as a result of the impact of lower economic assumptions partly offset by the higher opening value of the in-force book.

Rates used for expected return contribution

%	**2013**	2012
Reference rate	**2.13**	1.61
Best estimate returns:		
Corporate bonds	**3.13**	3.55
Equity	**5.13**	5.55

Adverse operating experience variances of £(25) million primarily consist of persistency experience relating to surrenders, particularly in Belgium, where new tax reforms including the launch of new rules around asset repatriation have been implemented in 2013. This new landscape has materially affected the wider Luxembourg life assurance market and is not specific to Lombard.

Operating assumption changes of £(82) million mainly consist of the adverse impact of lapse assumptions. Lapse expectations in the Belgian market have been revised upwards reflecting ongoing outflows and represent circa 90% of the lapse assumption impact. Although overall expenses remain well controlled and within prior projections, lower new business volumes coupled with higher lapses result in an increased per policy modelled expenses.

FPI operating review

£m (unless otherwise stated)	**2013**	2012
IFRS based operating result	**102**	(37)
Sustainable free surplus	**34**	(24)
MCEV operating result	**57**	(103)
Dividends paid to Group	**20**	–
Assets under administration (£bn)	**7.2**	6.7

The results of the FPI business in 2013 are encouraging with strong IFRS and MCEV operating profits as well as robust sustainable free surplus, supporting the dividend payment. The return to profitability reflects the strategic actions taken and the results are significantly better than the results for 2012, which were dominated by the impact of one-off charges relating to market exits and assumption changes principally in the non-core businesses.

The FPI results are shown in the sections below analysed between the core and non-core business. Additional detail is shown at the end of this section including the Lombard business. The core business excludes AmLife, OLAB (mainly Germany) and new business to Japanese nationals, which ceased in 2012.

New business profitability

£m (unless otherwise stated)	2013	2012
VNB		
Core	**21**	17
Non-core	**(7)**	(12)
Total VNB	**14**	5
Investment in new business		
Core	**(39)**	(39)
Non-core	**(22)**	(62)
Total Investment in new business	**(61)**	(101)
IRR		
Core	**11.0%**	11.0%
Non-core	**0.0%**	2.0%
Total IRR	**6.4%**	5.4%
APE		
Core	**127**	146
Non-core	**14**	56
Total APE	**141**	202

Total FPI sales volumes were 30% lower than in 2012, reflecting the exit from all non-core markets, in particular new business with Japanese nationals, the sale of AmLife and a controlled exit from writing new business in Germany.

VNB of the core business has increased 24% to £21 million, despite a 13% fall in core APE, reflecting the strategic focus towards value over volume and the benefit from the impact of favourable expense and mortality assumption changes. Moreover, the Group is leveraging its longstanding IFA relationships and continuing to diversify its distribution mix, including bancassurance opportunities with potential new partners and remains well positioned to take advantage when markets improve.

In North Asia, APE was in line with 2012 at £30 million despite regulatory and media pressures on the overall region's unit-linked market which experienced a fall of 18% for the first three quarters of 2013 compared to the same period in 2012. Market fundamentals continue to be strong, led by the trend of Chinese mainlanders looking to invest and diversify offshore.

Volumes in South East Asia and the Middle East have both decreased by circa 20% due to increasing competition from existing and new competitors which are all aggressively investing in new business. Despite these factors, volumes of bancassurance in South East Asia continue to improve with a 4% increase compared to the same period in 2012.

Non-core sales volumes of £14 million are significantly lower than 31 December 2012 reflecting the planned reduction in volumes following the closure to new business with Japanese nationals in 2012, the sale of the Group's 30% stake in AmLife on 4 January 2013, and the closure to new pensions business from Germany on 30 September 2013.

IFRS based operating result

£m	Core	Non-core	2013	2012
New business strain	(24)	(16)	**(40)**	(53)
In-force surplus	100	40	**140**	95
Long-term investment return	(1)	–	**(1)**	–
Principal reserving changes and one-off items	(3)	18	**15**	(70)
Development costs	(7)	(3)	**(10)**	(6)
Other income and charges	(2)	–	**(2)**	(3)
IFRS based operating profit/(loss) before tax	63	39	**102**	(37)

FPI IFRS based operating result increased to £102 million from £(37) million in the same period of 2012. This reflects an increase in IFRS in-force surplus of £45 million due to a larger book together with improved economics largely relating to the return of premium guarantee business in Germany. Additionally, the results have benefited from a £13 million reduction in IFRS new business strain, driven by lower acquisition expenses combined with lower German volumes and the non-recurrence of the large adverse 2012 principal reserving changes and one-offs.

Principal reserving changes of £15 million in 2013 mainly relate to favourable operating assumption changes on the non-core business.

Assets under administration

£bn	FPIL	OLAB	AmLife	FPI Total
1 January 2013	**6.1**	**0.5**	**0.1**	**6.7**
Inflows	1.1	0.1	–	1.2
Outflows	(0.7)	–	–	(0.7)
Market and other movements	0.1	–	–	0.1
Sale of AmLife	–	–	(0.1)	(0.1)
31 December 2013	**6.6**	**0.6**	**–**	**7.2**

Assets under administration as at 31 December 2013 increased to £7.2 billion. Despite challenging market conditions the business generated net inflows of £0.5 billion supported by stable regular premiums year-on-year, market growth accounted for a £0.1 billion increase.

Operating expenses

£m	2013	2012
Acquisition	**28**	33
Maintenance	**31**	34
	59	67
Development	**10**	6
Total	**69**	73

Operating expenses, which exclude commission payments and non-recurring costs, decreased to £69 million from £73 million in 2012. Acquisition costs decreased largely as a result of the lower new business volumes following the strategic market exits. Maintenance expenses have decreased as a result of tight cost management. Development expenses amounting to £10 million principally reflect the International Transformation programme focusing on system and process improvements. Work on core Personal Portfolio Bond systems and the development of the Digital Portal strategy will drive future efficiencies including the online submission of new business and dealing. In addition, a service improvement programme will deliver staffing efficiencies in the back office by June 2014.

Sustainable free surplus generation

£m	Core	Non-core	2013	2012
Expected return from in-force business	**77**	**20**	**97**	93
Investment in new business	**(39)**	**(22)**	**(61)**	(101)
Underlying free surplus generation	**38**	**(2)**	**36**	(8)
Development costs	**(7)**	**(2)**	**(9)**	(5)
Operating experience variances	**–**	**18**	**18**	(9)
Other operating variances	**(9)**	**–**	**(9)**	(2)
Other income and charges	**(2)**	**–**	**(2)**	–
Sustainable free surplus generation	**20**	**14**	**34**	(24)

FPI sustainable free surplus increased by £58 million to £34 million arising from lower investment in new business and better experience variances.

The core business sustainable free surplus of £20 million (31 December 2012: £30 million) has decreased driven by lower in-force surplus from lower volumes of regular premium savings business written in 2012 compared with 2011. The surplus emergence on the regular premium savings business is weighted towards the early years of the contract, hence the recent volumes of new business and the phasing over the year will impact expected returns in subsequent reporting periods.

The non-core sustainable free surplus of £14 million (31 December 2012: £(54) million) has improved as the volume of regular premium German pensions business, and hence the investment in new business, is reduced. Apart from receiving regular premiums and increments in line with standard policy terms, there will be no further investment in non-core new business and the Group will be focused on generating surplus from the existing book. Overall we do not expect to see a material change in non-core sustainable free surplus in 2014.

MCEV operating result

£m	Core	Non-core	**2013**	2012
VNB	21	(7)	**14**	5
Expected existing business contribution	16	3	**19**	23
Operating experience variances	3	10	**13**	(12)
Operating assumption changes	11	3	**14**	(107)
Other operating variances	(2)	11	**9**	(5)
Development costs	(7)	(3)	**(10)**	(6)
Life and pensions covered business operating profit/(loss) before tax	42	17	**59**	(102)
Other income and charges	(2)	–	**(2)**	(1)
MCEV operating profit/(loss) before tax	40	17	**57**	(103)

FPI MCEV operating profit of £57 million has improved £160 million and reflects a £9 million improvement in VNB as well as the non-recurrence of the 2012 adverse assumption changes and other operating variances. MCEV operating profits on core business at £40 million have improved by £42 million (31 December 2012: £(2) million). Non-core MCEV operating profit of £17 million has improved £118 million (31 December 2012: £(101) million) primarily due to £(86) million assumption changes impacting 2012 principally arising from the strategic review.

The expected existing business contribution has reduced from £23 million to £19 million, reflecting the lower opening in-force book resulting from the assumption changes arising from the strategic review, combined with lower rates of expected return on all assets.

Rates used for expected return contribution

%	**2013**	2012
Reference rate	**0.67**	1.35
Best estimate returns:		
Corporate bonds	**2.40**	2.98
Equity	**4.90**	5.40
Property	**3.90**	4.40

Operating experience variances totalling £13 million are driven by improved persistency and a reduction in reserves held to back the German return of premium guarantee due to high surrender rates.

Operating assumption changes of £14 million relate to improved unit-linked mortality assumptions, improved maintenance expenses on Personal Portfolio Bonds, and improved fund management rebate assumptions. These are partially offset by adverse changes to the persistency assumptions.

Other operating variances of £9 million include a favourable improvement to the modelling of the German return of premium guarantee liability.

International division additional information

IFRS based operating profit

£m	2013 Lombard	2013 FPI Core	2013 FPI Non-core	**2013 Total International**	2012 Lombard	2012 FPI Core	2012 FPI Non-core	2012 Total International
New business strain	(31)	(24)	(16)	**(71)**	(30)	(23)	(30)	**(83)**
In-force surplus	68	100	40	**208**	60	82	13	**155**
Long-term investment return	–	(1)	–	**(1)**	–	–	–	**–**
Principal reserving changes and one-off items	–	(3)	18	**15**	–	4	(74)	**(70)**
Development costs	(3)	(7)	(3)	**(13)**	(2)	(5)	(1)	**(8)**
Other income and charges	–	(2)	–	**(2)**	–	–	(3)	**(3)**
IFRS based operating profit before tax	34	63	39	**136**	28	58	(95)	**(9)**

Sustainable free surplus

£m	2013 Lombard	2013 FPI Core	2013 FPI Non-core	**2013 Total International**	2012 Lombard	2012 FPI Core	2012 FPI Non-core	2012 Total International
Expected return from in-force business	44	77	20	**141**	36	78	15	**129**
Investment in new business	(24)	(39)	(22)	**(85)**	(23)	(39)	(62)	**(124)**
Development costs	(2)	(7)	(2)	**(11)**	(1)	(4)	(1)	**(6)**
Operating experience	(9)	–	18	**9**	(16)	(5)	(4)	**(25)**
Other operating variances	(3)	(9)	–	**(12)**	–	–	(2)	**(2)**
Other income and charges	–	(2)	–	**(2)**	–	–	–	**–**
Sustainable free surplus	**6**	**20**	**14**	**40**	(4)	30	(54)	**(28)**

MCEV operating result

£m	2013 Lombard	2013 FPI Core	2013 FPI Non-core	**2013 Total International**	2012 Lombard	2012 FPI Core	2012 FPI Non-core	2012 Total International
VNB	25	21	(7)	**39**	45	17	(12)	**50**
Expected existing business contribution	33	16	3	**52**	35	18	5	**58**
Operating experience variance	(25)	3	10	**(12)**	(23)	(5)	(7)	**(35)**
Other assumption changes	(82)	11	3	**(68)**	36	(21)	(86)	**(71)**
Other operating variances	6	(2)	11	**15**	13	(5)	–	**8**
Development costs	(3)	(7)	(3)	**(13)**	(2)	(5)	(1)	**(8)**
Other income and charges	–	(2)	–	**(2)**	–	(1)	–	**(1)**
MCEV operating result before tax	**(46)**	**40**	**17**	**11**	104	(2)	(101)	**1**

Corporate

The Corporate segment includes the corporate holding and service companies of the Group, and holds all the external debt of the Group.

IFRS based operating result

£m	2013	2012
Investment return and other items	**123**	118
External finance costs	**(120)**	(108)
Other corporate net costs	**(34)**	(27)
IFRS based operating loss before tax	**(31)**	(17)

The Corporate IFRS based operating result is principally driven by external finance costs and corporate costs, offset by interest on internal debt. The increase in 2013 external finance costs reflects the issue of UT2 perpetual subordinated debt and repayment of the remaining deferred consideration notes from AXA Group in November 2012, together with a refinement to the finance cost methodology.

Other corporate net costs of £(34) million relate to overhead costs associated with management of the Resolution holding companies principally in respect of investor related activities. The change since 2012 reflects the increased focus of Friends Life staff on investor related activities and changes to the costs allocated from the life businesses.

Sustainable free surplus generation

£m	2013	2012
Coupon on external debt	**(92)**	(73)
Coupon on internal debt	**–**	(12)
Other income and charges	**(8)**	(10)
Sustainable free surplus generation	**(100)**	(95)

The sustainable free surplus contribution from Corporate principally reflects the debt costs (net of tax) incurred by the Group. Following the Corporate debt restructuring in November 2012, all of the Group's finance costs are now reflected within sustainable free surplus.

Sustainable free surplus continues to exclude corporate costs relating to the Resolution holding companies.

MCEV operating results

The Corporate segment consists of both non-covered and covered business. The non-covered element relates to the net assets of the corporate holding and service companies whilst the covered element principally represents the net debt liabilities held at the Group level.

£m	2013	2012
Expected existing business contribution on debt	**(75)**	(75)
Other income and charges	**(32)**	(46)
Operating loss before tax	**(107)**	(121)

The expected existing business contribution on debt has remained unchanged from the previous year. The benefit of the reduction in the year in the expected rates of return applied in the calculation of the debt contribution, was offset by the higher market value of debt and the impact of debt restructuring in November 2012.

Other income and charges in 2012 included £(23) million coupon on the Resolution Limited deferred consideration notes.

Financing and interest costs

The Group has a number of debt instruments and the operating costs of financing these for the year ended 31 December 2013 are presented below.

£m (unless otherwise stated)	Coupon	Principal	Clean market value of debt[i]	Finance costs[iii] IFRS	MCEV
LT2 subordinated debt 2021	12.00%	162	210	(20)	(10)
LT2 subordinated debt 2022	8.25%	500	550	(41)	(26)
UT2 reset perpetual subordinated debt[ii]	7.875%	356	378	(28)	(18)
STICS 2003	6.875%	210	210	(14)	(9)
STICS 2005	6.292%	268	268	(17)	(12)
Total 31 December 2013		**1,496**	**1,616**	**(120)**	**(75)**
Total 31 December 2012		1,494	1,590	(108)	(75)

(i) Market value is based on listed ask price, at 31 December 2013, excluding accrued interest.
(ii) The UT2 reset perpetual subordinated debt is a $575 million US Dollar denominated instrument. The principal and clean market values represent Sterling equivalent values as at 31 December 2013. The finance cost of £28 million is based on the Sterling equivalent principal on the day of issue of £356 million.
(iii) Finance costs within sustainable free surplus amount to £(92) million, being the IFRS amount of £(120) million net of tax.

The finance cost included within IFRS based operating profit reflects the actual coupon paid. This represents a refinement in estimation to reflect a more accurate view of the longer term cost of the Group's external debt. In previous years, operating finance costs were based on the market value of the debt instruments. The change has not had a material impact on the results of the Group. Finance costs within the MCEV result continue to reflect the expected rate of return.

Gearing and liquidity

IFRS gearing (£m)	2013	2012
Equity attributable to equity holders of the parent	**5,229**	5,377
Loans and borrowings[i]	**1,050**	1,099
	16.7%	17.0%

(i) IFRS debt gearing excludes the 2003 and 2005 STICS, as these securities are classified as equity in IFRS.

MCEV gearing (£m)	2013	2012
Group MCEV, gross of debt	**7,688**	7,427
Debt	**1,623**	1,596
	21.1%	21.5%

At 31 December 2013, the ratio of debt to IFRS equity attributable to equity holders of the parent, gross of debt, was 16.7% (31 December 2012: 17.0%), with the change in equity principally reflecting the payment of dividends in the period.

The MCEV gearing of 21.1% (31 December 2012: 21.5%) is marginally down over the period reflecting the increase in gross Group MCEV.

The liquidity of the Group remains strong and is complemented with an undrawn £250 million funding facility with a consortium of banks. This facility was renegotiated in May 2013 with a five year term and replaces the previous £500 million facility which had never been drawn.

Cash and capital

Introduction

The Group remains committed to the optimisation of capital within the business. 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 31 December 2013 remains strong with ASA of £917 million and an estimated IGCA surplus of £2.2 billion resulting in a coverage ratio, excluding WPICC of 238%. At 31 December 2013 the estimated economic capital surplus at Group level was £3.9 billion corresponding to a coverage ratio of 193%.

Cash and capital definitions

(i) WPICC represents the difference between the surplus capital calculated on a regulatory basis and that on a realistic basis, in accordance with regulations, and is excluded from both IGCA capital resources and capital resources requirements under the CMP.
(ii) Economic capital represents management's internal risk-based estimate of the amount of capital needed to be held to mitigate the risk of insolvency to a minimum of a 99.5% confidence level over a one year period. The coverage ratio represents the proportion of capital resources to capital resource requirements.
(iii) The IGCA and unaudited economic capital position at 31 December 2013 of the Group and its subsidiaries are estimated.

Capital management policies and monitoring buffers

The Group's capital management policies ("CMPs") that apply at a life company level and at the Group level were set out in the 2012 full year results. These policies remain unchanged and are summarised 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 WPICC, FPIL and Lombard; and
- 125% of Pillar 2 requirements, including any ICG and specifically excluding FPIL and Lombard.

In addition to the above, capital within FLL is held to cover at least one year of the FLL debt servicing costs (currently £115 million per annum) and any debt repayment requirements in the following year.

Group CMP

The CMP at Group 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 an additional requirement in respect of debt servicing costs. This requirement is to hold excess capital, over 150%, in the form of cash or cash equivalents at holding company level sufficient to pay at least the next year's gross annual interest cost (currently £120 million per annum) and any mandatory repayments of principal that fall due on debt in the next year.

Capital monitoring buffers

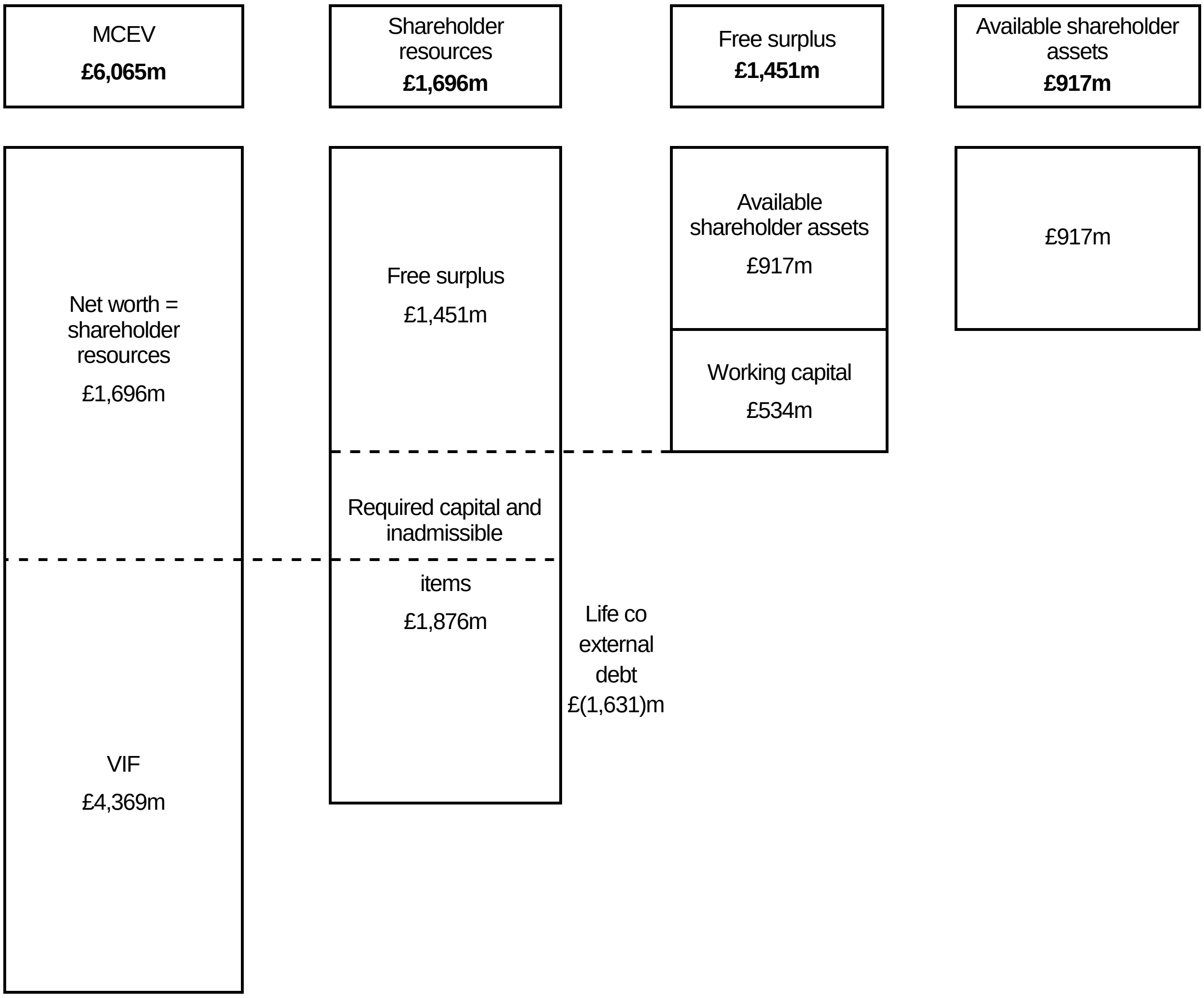
The Group has a robust monitoring system and in addition to the amounts held to meet its CMPs, it holds a prudence buffer together with a monitoring buffer held within working capital.

The prudence buffer is designed to cover an additional year of the Company's current dividend and the holding companies' corporate costs. In prior years this prudence buffer also included an allowance for the interest costs associated with the DCNs, which were repaid in November 2012. At 31 December 2013 the prudence buffer was therefore reduced to £325 million (2012: £400 million), reflecting the current level of dividends and corporate costs.

The monitoring buffers for the Group and life companies are reviewed regularly alongside the Group and life company solvency risk appetites. At 31 December 2013 the biting constraint is the Group IGCA position, and a monitoring buffer of 10% of the IGCA requirements, excluding WPICC, is held within the working capital.

Cash and capital management framework

The Group's cash and capital management framework is based on MCEV as this comprises the discounted value of expected future cash flows on a market consistent basis. The chart below shows how the core components of MCEV reconcile to ASA as at 31 December 2013.



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 the 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.

Working capital represents assets set aside to cover known future requirements and amounts necessary to maintain sufficient flexibility to facilitate compliance with the Group CMP and additional regulatory requirements. In addition, any assets subject to restriction in their availability to shareholders will be designated as working capital and this includes any free surplus held in the life companies in excess of the life companies CMP.

ASA consists of cash and other liquid assets 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, ASA is stated after the deduction of working capital from free surplus. ASA represents cash available to cover Resolution's corporate costs, to service debt issued by holding companies and, subject to shareholder approval, to pay dividends or return to shareholders. The generation of ASA therefore represents a key performance metric of the Group.

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

		Shareholder resources		
£m (net of tax)	Value in-force	Required capital[(i)]	Free surplus	Total MCEV
Opening MCEV at 1 January 2013	4,242	269	1,320	5,831
Sale of AmLife	(15)	(25)	47	7
Free surplus generated in the year	127	75	377	579
Dividend payment	–	–	(300)	(300)
Other reserve movements	15	(74)	7	(52)
Closing MCEV at 31 December 2013[(i)]	**4,369**	**245**	**1,451**	**6,065**

(i) Required capital is calculated based on the requirements under the Group CMP, and includes required capital of £224 million (2012: £229 million) in respect of non-covered business and £21 million (2012: £40 million) in respect of covered business.

The free surplus generated in the year of £377 million is explained in the financial performance section of the Chief Financial Officer's review.

Other reserve movements include the impact of foreign exchange movements and actuarial losses on the Group's defined benefit pension scheme.

Working capital and other assets and liabilities

The working capital at 31 December 2013 of £534 million has increased from £470 million at 31 December 2012 and is held in both the life companies and the holding companies.

The working capital comprises:

- amounts required to meet current estimates of future non-recurring costs and discretionary working capital allowances offset by related benefits that are expected in the short term;
- an appropriate monitoring buffer to facilitate ongoing compliance with the Group's CMPs;
- amounts to cover the necessary funding to protect against any temporary shortfall in delivery of cash generation relative to Group targets; and
- restricted assets included within free surplus e.g. illiquid or intangible assets and any assets in excess of the CMP held within the life companies after declaration of dividends.

The largest components of working capital are the monitoring buffer (£162 million), the amounts retained within the life companies in excess of the CMP (£133 million), and amounts set aside to meet non-recurring costs (£92 million).

Available shareholder assets

The ASA of £917 million comprises £758 million of shareholder cash at Friends Life holding company level (including the £273 million interim dividend proposed by FLL), together with £159 million held by Resolution holding companies.

£m	**2013**	2012
Friends Life holding companies cash	**485**	464
Proposed dividend from FLL	**273**	250
Friends Life available shareholder cash	**758**	714
Resolution holding companies cash	**159**	136
Available shareholder assets	**917**	850

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

£m	**2013**	2012
Settlement of final dividend	**200**	200
Prudence buffer in accordance with Group policy	**325**	400
Non-specified ASA holdings	**392**	250
Available shareholder assets	**917**	850

The ASA balance as at 31 December 2013 is held to cover the costs of the proposed final dividend and to maintain a prudence buffer of £325 million which is designed to cover an additional year of the Company's current dividend cost, and the holding companies corporate costs. The Group CMP requirement to hold cash at FLG sufficient to meet one year of FLG's debt servicing costs 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, however is covered by the additional ASA holdings at Group level.

Economic capital position

The UK life operations 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 an 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.

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

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

The estimated Group economic capital surplus above capital requirements as at 31 December 2013 is strong at £3.9 billion (a coverage ratio of 193%). The increase since 31 December 2012 (surplus of £3.5 billion) primarily reflects market movements.

The sensitivities to market shocks show that economic capital surplus at a Group level would have reduced by:

- an estimated £0.8 billion in the event of a combined 40% fall in equity markets and a 30% fall in property markets;
- an estimated £0.1 billion in the event of a 200bps fall in interest rates; and
- an estimated £0.8 billion in the event of a widening of corporate bond spreads of 200bps (of which one-third is assumed to relate to defaults).

The sensitivities reflect investment activities, the with-profits annuity reallocation and model changes implemented since 31 December 2012.

Insurance Groups Capital Adequacy

In addition to individual company requirements, the Group is required to meet the IGCA requirements of the Insurance Groups Directive. Following the governance changes made in the first half of 2013 Resolution Limited is now deemed to be the ultimate EEA parent undertaking of the Group and as such the IGCA requirements are now reported at the Resolution Limited level. The Group's capital policy is to maintain sufficient Group capital resources to cover 150% of Group CRR (excluding WPICC).

The balance sheet remains strong with an estimated IGCA surplus of £2.2 billion at 31 December 2013, with Group capital resources being 238% of Group CRR (excluding WPICC of £4.2 billion).

The movement in IGCA surplus over the period largely reflects the generation of surplus and the proceeds from the sale of the 30% stake in AmLife, offset by external dividend paid.

Movement in IGCA surplus	**£m**
1 January 2013	**2,154**
Surplus emerging	**420**
Proceeds from sale of AmLife	**50**
Dividend paid	**(300)**
Finance costs and other movements	**(88)**
31 December 2013	**2,236**

At 31 December 2013 the capital held to meet CMPs was £812 million (1 January 2013: £889 million) and the excess over the CMPs was £1,424 million (1 January 2013: £1,265 million).

The sensitivities to market shocks show that IGCA surplus would have reduced by:

- an estimated £0.2 billion in the event of a combined 40% fall in equity markets and a 30% fall in property markets;
- an estimated £0.2 billion in the event of a 200bps fall in interest rates; and

- an estimated £0.6 billion in the event of a widening of corporate bond spreads of 200bps (of which one-third is assumed to relate to defaults).

Management of the with-profits funds

Friends Life manages six with-profits 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 fund hedging ratio	Target EBR level	**2013 Full year**	2012 Full year
Friends Life FP With Profits Fund (pre-demutualisation business)	100%	45	**47**	47
Friends Life FP With Profits Fund (post-demutualisation business)	100%	55	**57**	57
Friends Life FLC old With Profits Fund	100%	60	**61**	60
Friends Life FLC new With Profits Fund	100%	60	**61**	60
Friends Life FLAS With Profits Fund	95%	50	**52**	51
Friends Life WL With Profits Fund	90%	50	**51**	51

The target fund hedging ratio shown is the proportion of the guarantees in the fund which are hedged against falls in listed equity values.

The EBRs apply to the funds backing the majority of asset shares, although sub-funds within these may have different allocations. For example, for Friends Life WL With Profits Fund, the benchmark applies to products with equity participation; there are some products invested wholly or partly in a purely fixed interest asset mix and these are not allowed for in the figures quoted above.

The allocation for assets backing guarantees and options within the with-profits funds comprises a range of assets including gilts, bonds and hedging derivatives (equity put and call options, equity futures, interest rate swaps and swaptions).

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). During 2013, around £2 billion of immediate annuity liabilities were moved out of the FLAS With Profits Fund to the FLL Non Profit Fund. However, around £0.9 billion of immediate annuity liabilities still remain in the FLAS With Profits Fund, as well as some immediate annuity liabilities in other with-profits funds.

Asset quality and exposure

The Group's financial assets as at 31 December 2013, excluding cash, are summarised as follows:

£bn	Unit-linked	With-profits	Non-profit	Shareholder	**2013 Total**	2012 Total
Shares, unit trusts and OEICs	63.1	6.8	0.1	–	**70.0**	63.9
Government securities	7.2	7.1	1.8	0.1	**16.2**	18.7
Corporate bonds and asset-backed securities	5.5	7.4	9.4	0.1	**22.4**	22.4
Derivatives	0.1	0.2	–	–	**0.3**	0.8
Deposits	0.2	–	–	–	**0.2**	0.2
Total 31 December 2013	**76.1**	**21.5**	**11.3**	**0.2**	**109.1**	**–**
Total 31 December 2012	70.7	24.9	10.2	0.2	–	106.0

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

£bn	Unit-linked	With-profits	Non-profit	Shareholder	**2013 Total**	2012 Total
Corporate bonds and asset-backed securities	5.5	7.4	9.4	0.1	**22.4**	22.4
less: policyholder exposure	5.5	6.4	–	–	**11.9**	13.2
Shareholder exposure	–	1.0	9.4	0.1	**10.5**	9.2
AAA		0.1	1.0	–	**1.1**	1.3
AA		0.1	3.3	–	**3.4**	3.0
A		0.4	3.3	0.1	**3.8**	3.4
BBB		0.3	1.7	–	**2.0**	1.2
Sub-BBB or rating not available		0.1	0.1	–	**0.2**	0.3
% Investment grade					**98.1%**	96.7%

98.1% 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 31 December 2013. The Group holds default reserves to cover the risk of defaults and credit rating downgrades on corporate bonds that back all annuity business within the Friends Life group. The reserves reflect assumed defaults over the outstanding terms to maturity of the bonds. The shareholder share of default reserves at 31 December 2013 was £0.45 billion (31 December 2012: £0.5 billion). This represents a haircut of 48% of the overall corporate bond spreads over gilts of equivalent term (31 December 2012: 43%).

The vast majority of the Group's exposure to sovereign debt holdings is to UK gilts. The Group has £13 million direct shareholder exposure (including shareholder fund exposure to non-profit and with-profits funds) to the higher risk government debts of Spain, Portugal, Italy, Ireland and Greece (31 December 2012: £7 million).

Financial strength ratings

The Group targets financial strength ratings in the single "A" range for its principal life business and expects them to remain there for the foreseeable future. Current financial strength ratings are set out below.

	Friends Life Limited
Fitch	A+ (strong)
Moody's	A3 (strong)
Standard & Poor's	A – (strong)

Principal risks and uncertainties

The Group actively identifies, assesses and monitors current and emerging principal risks. These are regularly reviewed by the Executive and Risk and Compliance Committee. The following risks present the principal risks deemed to be facing the Group at the current time:

Risk	Description and impact	How we manage
Regulatory change, including tax and Solvency II	The Group operates in a highly regulated financial services market both in the UK and internationally. This has a significant impact and influence on both strategic decisions and day-to-day management of the Group. It is impossible to fully predict the nature of the regulatory changes which may occur in the future or the impact that such changes may have on the Group and its strategic objectives. Some changes in legal requirements (including taxation) and regulatory regimes, or the differing interpretation and application of regulation over time, may have detrimental effects on the Group. The risk of the regulatory environment having a detrimental impact on the Group is believed to be increasing. Specific items of current note are:	The Group has processes in place to identify emerging risks from regulatory and legislative change and to monitor the timely implementation of new requirements. There is often only limited opportunity to influence regulatory change outcomes and therefore the Group's response is to base its business strategy on prevailing regulation as well as both known and planned change. The business plans are stressed against extreme events, including regulatory change, to give confidence as to the strength of the capital position and our ability to deliver on our strategic objective, now and over the planning horizon.
	Solvency II Solvency II will have implications for the whole industry as to the way in which companies calculate capital. Solvency II continues to be viewed as potentially having a significant impact on the Group. A trilogue meeting in November 2013 finally resulted in an agreement on Omnibus II (Solvency II). The outcome confirmed the goal of the long awaited start date for Solvency II as being 1 January 2016 and produced a position on long standing areas of debate. We are awaiting the final text of outcomes but these details already provide greater certainty over the content and timeframe of Solvency II.	There remains considerable further work to transition the Group across to a Solvency II basis. With greater certainty around the implementation dates, detailed planning work has been completed to ensure readiness. In the absence of final regulation, we will continue to adapt our plans as specific requirements are confirmed. Nonetheless, as we transition, there will be an impact in terms of the way in which the Group needs to hold capital against a Solvency II balance sheet and we will consider how best to do this in the manner that best serves our customers and shareholders.
	Annuity market developments There is a risk that politically motivated changes will impact on the annuity market in the run up to the next General Election which will be called on or before 7 May 2015. The direction has been made clear by the Financial Services Consumer Panel ("FSCP") recommending regulatory and government-led structural reform of the annuities market. Views have been expressed by Government on the desirability of a "portable" annuity, Coupled with the FSCP views, the Financial Conduct Authority has suggested that some parts of the annuity market are not working well for consumers and identified a number of concerns; a competition market study has also been launched as a continuation of this work.	These developments potentially pose a challenge to the current structure of the annuity market. We will consider how the Group can develop our annuity proposition in the market in line with a changing environment.
	Retail Distribution Review The Retail Distribution Review ("RDR") came into effect in January 2014 and will have a wide reaching impact on the way in which financial advice is provided across the industry and the way in which consumers pay for that advice. Now that the measures are in effect, the real implications of RDR on the financial services advisory market and consumer purchasing patterns are expected to emerge. This will be an area that all those providers offering advice will inevitably watch closely for emerging trends over the coming year.	In the lead up to RDR becoming effective, the Group has taken a rigorous approach to ensuring compliance with RDR measures and the potential effect of RDR on our products and services. We will continue to track emerging trends to ensure that our business model continues to be relevant and appropriate for customers. This is particularly relevant within Sesame, where, given the distribution via Authorised Representatives, it is expected that trends towards restricted advice may emerge quicker than in other advisory areas.

	OFT/DWP workplace pensions consultation Following a review by the Office of Fair Trading, the Department of Work and Pensions have stated that they are considering proposing a pension scheme charge cap.	The outcome and implementation of the OFT and DWP reviews of workplace pension arrangements remains uncertain. The extent of any changes, including the potential impact from charge caps (and any consequent increased requirement to hold capital) on providers of workplace pensions together with any requirement to remove commission payments and the industry response to these measures could have a range of possible impacts on the Group's trading and financial performance in 2014 and beyond.
Economic conditions	Changes in economic conditions give rise to changes in the values of the assets and liabilities of the Group's insurance businesses. The Group is impacted by conditions in the UK and other European countries as a result of its operations and investment assets being predominantly focused in these countries. Global economic output strengthened in the second half of 2013 and it is anticipated that this trend will continue in the short-medium term. Forward-looking projections point to: a turning point from recession to recovery within the Euro area; continued growth in emerging market and developing economies; revised downward growth in the Middle East. This mixed economic picture paints continued challenges but also potential opportunities for the Group's international subsidiaries. Sustained low interest rate was noted as a principal risk in 2012. This risk typically reduces with economic growth, however, should it materialise sustained low interest rates could have a material impact on the business. This is due to insurance businesses and shareholder funds being invested in corporate bonds, cash instruments and government debt which typically see yields reduce in a low interest environment.	The Group actively monitors changes in the economic environment to enable proactive management of impacts to relevant markets We mitigate the impact of economic conditions through measures such as the matching of long-term assets and liabilities, the use of financial instruments to reduce the volatility of returns on assets, diversification in the product portfolio, and by ensuring that the Group is robustly capitalised. Specifically, our exposure to sovereign debt from all but the strongest countries in the Eurozone is modest. Stress and scenario testing is used to form a view on the implications of extreme events, such as long-term low interest rates so as to understand how best to manage that scenario. Approaches, such as further diversification into additional asset classes in which the Group invests, are being considered as part of investigating the opportunities to increase the rate of return achieved without significantly increasing the investment risks taken.
Credit	The Group faces significant credit risk exposure (both from credit default and credit spread widening) as a result of its use of corporate bonds to back non-profit business and for the investment of shareholder funds. In 2013, UK Government debt was downgraded. Given the nature of the Group's liabilities, this did not have a material effect on the asset strategy. The shareholder funds have also taken on additional credit risk following the transfer of annuities from the with-profits funds. The additional risk is commensurate with the return and appetite within the shareholder funds.	We mitigate our exposure to credit risks by adopting a conservative investment policy with investment skewed towards bonds with high credit ratings. Credit risk is regularly monitored within the Group and the Group has improved its credit modelling with the implementation of a market leading credit risk model.
Variation in principal valuation assumptions	Writing life assurance and pension business requires the setting of assumptions about future experience. The factors considered in these assumptions include mortality and longevity, lapse and persistency rates, valuation interest rates, credit defaults and expense levels. Events causing a substantial change to these assumptions could require them to be recalibrated and impact the profitability, earnings and capital position of the Group.	Assumptions that are made are subject to rigorous and ongoing review and we take a prudent approach to evaluating the appropriate level of provisions and capital for each of the Group's risks. Stress and scenario testing is used to validate the appropriateness of key assumptions against single events and combinations of extreme events including economic conditions, investment performance, lapse and mortality/morbidity events.

Outsourcing	As part of the Group’s strategy for increasing operational efficiency it utilises various outsourcing capabilities, including long-term strategic partnerships with Diligenta and Capita who provide specialist IT and business processing. The Group also has key relationships with HSBC and State Street who, between them, provide Investment middle office, fund accounting and unit pricing operations. Fund management services are provided by AXA Investment Managers and F&C Asset Management plc. There are risks associated with outsourcing, for example, if the outsourcer is or becomes unable to provide the expected services or does not provide them to the standards and quality expected.	The Group’s outsource suppliers continue to provide good service. During 2013, the Group executed the first major migration from two legacy systems to a system operated by Diligenta. This was a significant operational milestone. Further migrations are planned for 2014 and 2015. The Group has service level agreements in place with its outsource partners and actively monitors the standards of delivery against these agreements in order to mitigate the risks associated with outsourcing. The Group is part way through a programme which will improve the risk framework in place to manage and monitor operational risk, including that which falls within our outsource suppliers. The improvements will ensure that the framework is appropriate to the Group’s evolving needs and operations. The financial strength and strategic position of the Group’s major outsource partners are actively monitored in order to manage potential counterparty credit and continuity of service risks.

As stated in note 1 to the IFRS consolidated financial statements, the directors have considered the Group’s risks and uncertainties and are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

Directors' statement of responsibilities

The financial information set out in this report does not constitute the Company's statutory accounts for the years ended 31 December 2013 or 2012, but is derived from those accounts. Statutory accounts for 2012 have been delivered to the Guernsey Registry and those for 2013 will be delivered following the Company's Annual General Meeting. The Auditor has reported on those accounts; its Reports were unqualified and did not draw attention to any matters by way of emphasis without qualifying its Report.

The directors are responsible for preparing the Annual Report and the consolidated financial statements in accordance with applicable Guernsey law and International Financial Reporting Standards ("IFRS") adopted for use in the European Union and have disclosed their responsibilities in this regard in the 2013 Annual Report and Accounts.

Pursuant to the Disclosure and Transparency Rules (DTR 4), the directors confirm that, to the best of each director's knowledge:

- the financial statements of the Company, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit and loss of the Company and the Group as a whole; and
- the Business Review includes a fair review of the development and performance of the business, and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board

Tim Tookey

Chief Financial Officer

17 March 2014

IFRS FINANCIAL INFORMATION

Consolidated income statement

For the year ended 31 December 2013	Notes	2013 £m	Restated 2012 £m
Revenue			
Gross earned premiums	2	**1,971**	1,906
Premiums ceded to reinsurers	2	**(595)**	(602)
Net earned premiums	2	**1,376**	1,304
Fee and commission income and income from service activities		**827**	749
Investment return[(i)]		**8,786**	9,045
Total revenue		**10,989**	11,098
Other income	2	**20**	–
Claims, benefits and expenses			
Gross claims and benefits paid		**(4,494)**	(4,175)
Amounts receivable from reinsurers		**688**	680
Net claims and benefits paid		**(3,806)**	(3,495)
Change in insurance contract liabilities		**2,331**	8
Change in investment contract liabilities		**(6,900)**	(5,052)
Transfer from/(to) unallocated surplus		**29**	(4)
Movement in net asset value attributable to unit-holders	2	**(89)**	(118)
Movement in policyholder liabilities		**(4,629)**	(5,166)
Acquisition expenses	2	**(603)**	(614)
Administrative and other expenses [(i)]	2	**(1,460)**	(1,597)
Finance costs	2	**(142)**	(157)
Total claims, benefits and expenses		**(10,640)**	(11,029)
Share of loss of associates		**–**	(3)
Profit before tax from continuing operations		**369**	66
Policyholder tax	5	**(334)**	(258)
Profit/(loss) before shareholder tax from continuing operations		**35**	(192)
Total tax charge	5	**(134)**	(107)
Policyholder tax	5	**334**	258
Shareholder tax	5	**200**	151
Profit/(loss) for the year		**235**	(41)
Attributable to:			
Equity holders of the parent[(ii)]		**204**	(72)
Non-controlling interests		**31**	31
Profit/(loss) for the year		**235**	(41)

Earnings per share from continuing operations		2013 pence	2012 pence
Basic earnings per share	4	**14.39**	(5.17)
Diluted earnings per share	4	**14.38**	(5.17)

(i) As a result of the revision to IAS 19: *Employee benefits*, curtailment gains of £32 million for the year ended 31 December 2012 have been presented within administrative expenses, rather than within investment return. Refer to note 6 for further details.
(ii) All profit attributable to equity holders of the parent is from continuing operations.

The notes 1 to 12 form an integral part of these financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2013

	Equity holders of the parent £m	Non-controlling interests £m	Total £m
Profit for the year	**204**	**31**	**235**
Other comprehensive income:			
Items that will not be reclassified to profit and loss:			
Remeasurement losses on the defined benefit scheme	**(113)**	**–**	**(113)**
Income tax relating to items that will not be reclassified	**36**	**–**	**36**
Total items that will not be reclassified to profit and loss	**(77)**	**–**	**(77)**
Items that may be reclassified subsequently to profit and loss:			
Foreign exchange adjustments(i)	**5**	**-**	**5**
Shadow accounting(ii)	**4**	**-**	**4**
Total items that may be reclassified subsequently to profit and loss	**9**	**-**	**9**
Other comprehensive loss, net of tax	**(68)**	**-**	**(68)**
Total comprehensive income, net of tax	**136**	**31**	**167**

For the year ended 31 December 2012	Equity holders of the parent £m	Non-controlling interests £m	Total £m
(Loss)/profit for the year	(72)	31	(41)
Other comprehensive income:			
Items that will not be reclassified to profit and loss:			
Remeasurement losses on the defined benefit scheme	(42)	–	(42)
Revaluation of owner occupied properties	(2)	–	(2)
Shadow accounting(iii)	2	–	2
Income tax relating to items that will not be reclassified	7	–	7
Total items that will not be reclassified to profit and loss	(35)	–	(35)
Items that may be reclassified subsequently to profit and loss:			
Foreign exchange adjustments(i)	(17)	–	(17)
Shadow accounting(ii)	5	–	5
Total items that may be reclassified subsequently to profit and loss	(12)	–	(12)
Other comprehensive loss, net of tax	(47)	–	(47)
Total comprehensive (loss)/income, net of tax	(119)	31	(88)

(i) Foreign exchange adjustments relate to the translation of overseas subsidiaries.
(ii) Shadow accounting that may be reclassified subsequently to profit and loss is as a result of a loss of £(4) million (31 December 2012: loss of £(5) million) included within foreign exchange adjustments on translation of overseas subsidiaries held by a with-profits fund of Friends Life Limited ("FLL").
(iii) Shadow accounting that will not be reclassified to profit and loss is in respect of a loss of £(2) million relating to the revaluation of owner occupied properties, held by a with-profits fund of FLL.

Consolidated statement of IFRS based operating profit

For the year ended 31 December 2013

	Notes	**2013 £m**	2012 £m
Profit before tax from continuing operations	2	**369**	66
Policyholder tax	5	**(334)**	(258)
Profit/(loss) before shareholder tax excluding returns generated within policyholder funds		**35**	(192)
Non-recurring items	2	**131**	258
Amortisation and impairment of acquired present value of in-force business	7	**392**	417
Amortisation and impairment of other intangible assets	7	**91**	97
Interest payable on STICS	2	**(31)**	(31)
Short-term fluctuations in investment return	2	**(182)**	(275)
IFRS based operating profit before tax	2	**436**	274
Tax on operating profit		**4**	2
IFRS based operating profit after tax attributable to equity holders of the parent(i)		**440**	276

Earnings per share		**2013 Pence**	2012 Pence
Operating earnings per share	4	**31.03**	19.84
Diluted operating earnings per share	4	**31.01**	19.84

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

Consolidated statement of financial position

At 31 December 2013

	Notes	**2013 £m**	2012 £m
Assets			
Pension scheme surplus	6	**–**	33
Intangible assets	7	**3,855**	4,321
Property and equipment		**50**	53
Investment properties		**2,561**	2,735
Investment in associate		**4**	4
Financial assets	8,9	**109,064**	105,990
Deferred acquisition costs		**897**	838
Reinsurance assets		**2,837**	3,153
Current tax assets		**33**	8
Insurance and other receivables		**1,100**	1,125
Cash and cash equivalents		**9,690**	9,449
Net assets of operations classified as held for sale		**–**	30
Total assets		**130,091**	127,739
Liabilities			
Insurance contracts		**34,590**	37,232
Unallocated surplus		**627**	656
Financial liabilities:			
– Investment contracts		**83,502**	78,184
– Loans and borrowings	10	**1,050**	1,099
– Amounts due to reinsurers		**1,580**	1,767
Net asset value attributable to unit-holders		**621**	754
Provisions		**227**	278
Pension scheme deficit	6	**52**	–
Deferred tax liabilities		**980**	893
Current tax liabilities		**1**	21
Insurance payables, other payables and deferred income		**1,312**	1,157
Total liabilities		**124,542**	122,041
Equity attributable to equity holders of the parent			
– Share capital		**4,223**	4,225
– Other reserves		**1,006**	1,152
		5,229	5,377
Attributable to non-controlling interests		**320**	321
Total equity		**5,549**	5,698
Total equity and liabilities		**130,091**	127,739

The financial statements were approved by the Board of Directors on 17 March 2014.

Consolidated statement of changes in equity

For the year ended 31 December 2013

	Attributable to equity holders of the parent			Non-controlling interests £m	Total £m
	Share capital £m	Other reserves £m	Total £m		
At 1 January 2013	**4,225**	**1,152**	**5,377**	**321**	**5,698**
Profit for the year	**–**	**204**	**204**	**31**	**235**
Other comprehensive loss	**–**	**(68)**	**(68)**	**–**	**(68)**
Total comprehensive income	**–**	**136**	**136**	**31**	**167**
Dividends paid	**–**	**(300)**	**(300)**	**–**	**(300)**
Interest paid on STICS	**–**	**–**	**–**	**(31)**	**(31)**
Appropriations of profit	**–**	**(300)**	**(300)**	**(31)**	**(331)**
Tax relief on STICS interest	**–**	**7**	**7**	**–**	**7**
Increase in own shares held by the Group	**(2)**	**–**	**(2)**	**–**	**(2)**
Share-based payments, net of settlements(i)	**–**	**7**	**7**	**(1)**	**6**
Other movements(ii)	**–**	**4**	**4**	**–**	**4**
At 31 December 2013	**4,223**	**1,006**	**5,229**	**320**	**5,549**

For the year ended 31 December 2012

	Attributable to equity holders of the parent			Non-controlling interests £m	Total £m
	Share capital £m	Other reserves £m	Total £m		
At 1 January 2012	4,128	1,544	5,672	323	5,995
(Loss)/profit for the year	–	(72)	(72)	31	(41)
Other comprehensive loss	–	(47)	(47)	–	(47)
Total comprehensive (loss)/income	–	(119)	(119)	31	(88)
Dividends paid	–	(283)	(283)	–	(283)
Interest paid on STICS	–	–	–	(31)	(31)
Appropriations of profit	–	(283)	(283)	(31)	(314)
Tax relief on STICS interest	–	7	7	–	7
Shares issued in lieu of dividend	90	–	90	–	90
Reduction in own shares held by the Group	7	–	7	–	7
Share-based payments, net of settlements(i)	–	3	3	(2)	1
At 31 December 2012	4,225	1,152	5,377	321	5,698

(i) The other reserves movement for equity-settled schemes is £7 million for the year (31 December 2012: £3 million) and relates to the expense, net of partial settlement, of the Lombard long-term incentive plan ("LTIP") along with the expense for the deferred share award plans ("DSAP") and the Friends Life group LTIP.

(ii) Other movements comprise the release of a share entitlement provision (£2 million) and consolidation of the Group's Employee Benefit Trust (£2 million). Following demutualisation of Friends Provident in 2001, share and cash entitlements that were not claimed were placed into two trusts. The trusts were wound up in 2004 and the liability for any future claims in respect of demutualisation was transferred to the Group. This provision was released following expiry of the Group's obligation on 9 July 2013.

Consolidated statement of cash flows

For the year ended 31 December 2013

	2013 £m	2012 £m
Operating activities		
Profit/(loss) for the year	**235**	(41)
Adjusted for:		
– profit on disposal of investment in associate	**(20)**	–
– net realised and unrealised gains on assets at fair value	**(5,507)**	(5,630)
– finance costs	**142**	157
– amortisation and impairment of intangible assets	**483**	514
– depreciation of property and equipment	**5**	5
– movement in deferred acquisition costs	**(59)**	(195)
– total tax charge	**134**	107
– purchase of shares and other variable yield securities	**(23,948)**	(22,536)
– proceeds from sale of shares and other variable yield securities	**25,363**	23,045
– purchase of loans, debt securities and other fixed income securities	**(26,911)**	(23,841)
– proceeds from sale of loans, debt securities and other fixed income securities	**28,257**	26,166
– purchase of investment properties	**(45)**	(51)
– proceeds from sale of investment properties	**265**	228
– decrease in insurance contract liabilities	**(2,642)**	(32)
– increase in investment contract liabilities	**4,840**	3,532
– (decrease)/increase in unallocated surplus	**(29)**	4
– (decrease)/increase in provisions	**(51)**	50
– net movement in receivables and payables	**216**	(214)
Pre-tax cash inflow from operating activities	**728**	1,268
Tax paid	**(48)**	(70)
Net cash inflow from operating activities	**680**	1,198
Investing activities		
Disposal of held for sale assets, net of cash transferred	**50**	–
Additions to internally generated intangible assets	**(4)**	(4)
Net additions of property and equipment	**(2)**	(2)
Net cash inflow/(outflow) from investing activities	**44**	(6)
Financing activities		
Shares purchased in settlement of incentive schemes	**(1)**	(4)
Proceeds from increase in long-term debt	**–**	349
Repayment of long-term debt	**–**	(423)
Finance costs	**(143)**	(170)
STICS interest	**(31)**	(31)
Net movement in other borrowings, net of expenses	**(40)**	(20)
Dividends paid to equity holders of the parent	**(300)**	(193)
Net cash outflow from financing activities	**(515)**	(492)
Increase in cash and cash equivalents	**209**	700
Balance at beginning of year	**9,449**	8,791
Exchange adjustments on the translation of foreign operations	**32**	(42)
Balance at end of year	**9,690**	9,449

Notes to the consolidated accounts

For the year ended 31 December 2013

1. Accounting policies

1.1 Basis of preparation

The financial statements of the Company as at and for the year ended 31 December 2013 comprise the consolidated financial statements of the Company and its subsidiaries (together referred to as "the Group") and the Group's interests in its associate.

For the year ended 31 December 2013 the consolidated income statement includes the results of AmLife Insurance Berhad and AmFamily Takaful Berhad (collectively "AmLife") up until the date of their disposal on 4 January 2013. The consolidated income statement for the year ended 31 December 2012 includes the results of AmLife for the full year.

The consolidated financial statements as at and for the year ended 31 December 2013 have been prepared in accordance with IFRS as adopted by the European Union ("IFRS").

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

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

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

The directors have, at the time of approving the financial statements, a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements.

The International Accounting Standards Board ("IASB") issued the following new standards and changes to existing standards which are relevant to the Group and effective for the Group financial statements from 1 January 2013.

- IFRS 13: Fair value measurement establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The standard is applied prospectively. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Group.

  IFRS 13 also requires specific disclosures on fair values; the Group provides these disclosures in note 9.

- IAS 19: Employee benefits (Revised 2011): IAS 19R includes a number of amendments to the accounting for defined benefit plans, including elimination of the corridor approach and recognition of all actuarial gains and losses in other comprehensive income ("OCI") under the heading of "Remeasurements on the defined benefit scheme" as they occur; to immediately recognise all past service costs; and to replace interest cost and expected returns on plan assets with a net interest amount, calculated by applying the discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. These are applied retrospectively. The amendments also include enhancements to disclosure requirements; the Group is already largely compliant and no material updates have been required.

  Elimination of the corridor approach has no impact on the results of the Group, as the existing policy is to recognise all actuarial losses in OCI as they occur. The change in accounting for net interest income/expense, which represents a change in accounting policy, has not impacted profit before tax or the statement of comprehensive income in prior years or the year ended 31 December 2013.

  The income statement has been restated for the requirement to present curtailment gains within administrative and other expenses; previously, curtailment gains of £32 million at 31 December 2012 were included within investment return.

- Amendments to IAS 1: Presentation of financial statements: The amendments introduce a grouping of items presented in OCI. The items that could be reclassified to profit and loss at a future point in time, e.g. foreign exchange adjustments, are required to be presented separately from items that will never be reclassified.

Below is a list of new standards and changes to existing standards, relevant to the Group, that have been issued by the IASB with effective dates for annual accounting periods beginning on or after 1 January 2014, unless otherwise stated, but where earlier adoption is permitted. They have been endorsed by the European Union ("EU") unless otherwise stated. They have not been considered for early adoption by the Group. These changes will not materially impact the Group unless otherwise stated.

New standards:

- IFRS 9: Financial instruments. This standard reflects the first phase of the IASB's work on the replacement of IAS 39: Financial instruments: recognition and measurement, and relates to the classification and measurement of financial assets and liabilities as defined in IAS 39, with classification dependent upon the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instruments. The adoption of IFRS 9 will have a material impact on the classification and measurement of the Group's financial assets and liabilities. It is not anticipated that this standard will become effective before 1 January 2017; it is yet to be endorsed by the EU. The impact of these new requirements is currently being assessed by the Group.
- IFRS 10: Consolidated financial statements. This standard provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. It replaces the requirements in IAS 27: Consolidated and separate financial statements and SIC 12: Consolidation – special purpose entities;
- IFRS 11: Joint arrangements. This IFRS establishes principles for the financial reporting by parties to a joint arrangement. It supersedes the requirements in IAS 31: Interests in Joint Ventures and SIC 13: Jointly controlled entities-non-monetary contributions by venturers;and
- IFRS 12: Disclosure of interests in other entities. This IFRS combines, enhances and replaces disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities.

Amendments to existing standards:

- improvements to IFRSs 2010 to 2012: These annual improvements address eight standards in the 2010-2012 reporting cycle. They include changes to IFRS 2: Share-based payments, IFRS 3: Business combinations, IFRS 8: Operating segments, IFRS 13: Fair value measurement, IAS 7: Cash flow statements, IAS 16: Property, plant and equipment, IAS 24: Related party disclosures and IAS 38: Intangible assets. The amendments are effective for annual periods beginning on or after 1 July 2014 but have not yet been endorsed by the EU; and
- improvements to IFRSs 2011 to 2013: These annual improvements address four issues to four standards in the 2011-2013 reporting cycle. They include changes to IFRS 1: First time adoption of IFRS, IFRS 3: Business combinations, IFRS 13: Fair value measurement, and IAS 40: Investment property. The amendments are effective for annual periods beginning on or after 1 July 2014 but have not yet been endorsed by the EU.

The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

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

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

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

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.

An operating segment is a component of the Group that engages in business activities from which it earns revenues and incurs expenses.

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

- UK comprising Corporate Benefits, Protection and Retirement Income market-facing businesses and Sesame Bankhall Group ("SBG");
- Heritage, comprising the bulk of the UK business that is no longer actively marketed and Friends Life Investments ("FLI");
- FPI comprising Friends Provident International Limited ("FPIL"), the Overseas Life Assurance Business ("OLAB") within the UK life and pensions subsidiaries and the Group's share of AmLife (prior to its disposal on 4 January 2013); 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.

In previous reporting periods, UK and Heritage were reported as a single segment. The comparatives have been restated to provide separate disclosure of UK and Heritage for the full year to 31 December 2012.

b) Operating segment information

(i) IFRS based operating profit

Year ended 31 December 2013	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Total £m**
Life and pensions operating profit	**76**	**380**	**115**	**37**	**–**	**608**
Longer term shareholder investment return	**13**	**(84)**	**(1)**	**–**	**3**	**(69)**
Other (expense)/income	**(19)**	**2**	**(2)**	**–**	**(34)**	**(53)**
Development costs	**(30)**	**(7)**	**(10)**	**(3)**	**–**	**(50)**
IFRS based operating profit/(loss) before tax	**40**	**291**	**102**	**34**	**(31)**	**436**
Tax on operating profit						**4**
IFRS based operating profit after tax attributable to equity holders of the parent						**440**
Operating earnings per share (pence)						**31.03**

Year ended 31 December 2012	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Total £m
Life and pensions operating profit/(loss)	4	379	(28)	30	–	385
Longer term shareholder investment return	1	(41)	–	–	17	(23)
Other expense	(1)	–	(3)	–	(34)	(38)
Development costs	(36)	(6)	(6)	(2)	–	(50)
IFRS based operating (loss)/profit before tax	(32)	332	(37)	28	(17)	274
Tax on operating profit						2
IFRS based operating profit after tax attributable to equity holders of the parent						276
Operating earnings per share (pence)						19.84

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

Year ended 31 December 2013	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Total £m**
IFRS based operating profit/(loss) before tax	**40**	**291**	**102**	**34**	**(31)**	**436**
Non-recurring items[(i)(ii)(iii)]	**(35)**	**(226)**	**18**	**–**	**112**	**(131)**
Amortisation and impairment of acquired value of in-force business	**(47)**	**(203)**	**(92)**	**(50)**	**–**	**(392)**
Amortisation and impairment of other intangible assets	**(42)**	**(14)**	**(7)**	**(28)**	**–**	**(91)**
Interest payable on STICS	**–**	**31**	**–**	**–**	**–**	**31**
Short-term fluctuations in investment return[(iv)]	**19**	**158**	**5**	**(2)**	**2**	**182**
(Loss)/profit before policyholder and shareholder tax	**(65)**	**37**	**26**	**(46)**	**83**	**35**
Policyholder tax	**9**	**325**	**–**	**–**	**–**	**334**
(Loss)/profit before tax from continuing operations	**(56)**	**362**	**26**	**(46)**	**83**	**369**

Year ended 31 December 2012	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Total £m
IFRS based operating (loss)/profit before tax	(32)	332	(37)	28	(17)	274
Non-recurring items[(v)(vi)(vii)(viii)]	(9)	(264)	–	(1)	16	(258)
Amortisation and impairment of acquired value of in-force business	(52)	(216)	(94)	(55)	–	(417)
Amortisation and impairment of other intangible assets	(42)	(4)	(22)	(28)	(1)	(97)
Interest payable on STICS	–	31	–	–	–	31
Short-term fluctuations in investment return[(iv)]	52	246	(4)	(1)	(18)	275
(Loss)/profit before policyholder and shareholder tax	(83)	125	(157)	(57)	(20)	(192)
Policyholder tax	2	256	–	–	–	258
(Loss)/profit before tax from continuing operations	(81)	381	(157)	(57)	(20)	66

(i) UK non-recurring items of £(35) million for the year ended 31 December 2013 include separation and integration costs of £(14) million, costs of £(12) million relating to service improvement elements of the outsourcing arrangement with Diligenta, £(5) million in respect of Solvency II costs of which £(3) million relates to a provision for future costs, costs in respect of capital optimisation programme of £(3) million and finance transformation costs of £(1) million.

(ii) Heritage non-recurring items of £(226) million for the year ended 31 December 2013 include costs of £(116) million in respect of a charge for deficit funding relating to the Group's defined benefit pension scheme (the income for which is reported within the Corporate segment results), £(63) million separation and integration costs offset by a £53 million provision release in respect of AHM, £(75) million of costs in respect of the Diligenta outsourcing agreement offset by a £22 million provision release, £(34) million of Solvency II costs which include a provision of £(26) million for future costs, finance transformation costs of £(7) million and £(6) million of costs relating to the 2013 capital optimisation programme. Corporate non-recurring items also include costs of £(4) million relating to strategic review fees.

(iii) FPI non-recurring items of £18 million for the year ended 31 December 2013 include profit on disposal of the Group's entire 30% holding in AmLife of £20 million and finance transformation costs of £(2) million.

(iv) Includes shareholder investment return short-term fluctuations and investment variances arising from the mismatch 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. In the year ended 31 December 2012, this includes a £99 million benefit within Heritage that relates to the release of unit-linked tax loss provisions as a result of updated fund growth estimates.

(v) UK non-recurring items of £(9) million for the year ended 31 December 2012 relate to costs in respect of the transition and service improvement elements of the outsourcing arrangement with Diligenta.

(vi) Heritage non-recurring items of £(264) million for the year ended 31 December 2012 include £(124) million of costs in respect of the separation and integration program, £(75) million in respect of Solvency II and finance system developments, £(73) million of costs in respect of the transition and service improvement elements of the outsourcing arrangement with Diligenta offset partially by £31 million release of reserves, non-recurring costs of £(17) million related to the 2012 capital optimisation programme and other non-recurring costs of £(6) million.

(vii) Corporate non-recurring items of £16 million for the year ended 31 December 2012 include a curtailment gain of £32 million arising on the defined benefit pension scheme, of which £22 million relates to the closure of the scheme to future service accrual and £10 million to reduced future anticipated costs due to the Diligenta outsourcing arrangement. This is partially offset by £(16) million of costs in relation to the transition of Resolution Operations LLP ("ROL"). The transition costs include £(10) million mainly in relation to the costs of transferring an operating agreement, under which the Company outsourced most of its operations, from ROL to the Group, and the recognition of an onerous lease provision in respect of the ROL offices to be taken on by the Group; a further £(6) million relates to restructuring activities.

(viii) Lombard non-recurring items of £(1) million for the year ended 31 December 2012 relate to Solvency II costs.

(iii) Revenue and expenses

For the year ended 31 December 2013	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Elimination of inter-segment amounts[ii] £m	Total £m
Gross earned premiums on insurance and investment contracts	2,887	1,818	1,239	1,983	–	–	7,927
Investment contract premiums[i]	(2,235)	(629)	(1,109)	(1,983)	–	–	(5,956)
Gross earned premiums	652	1,189	130	–	–	–	1,971
Premiums ceded to reinsurers	(96)	(495)	(4)	–	–	–	(595)
Net earned premiums	556	694	126	–	–	–	1,376
Fee and commission income	299	299	117	112	–	–	827
Investment return	1,800	5,857	292	827	94	(84)	8,786
Total revenue	2,655	6,850	535	939	94	(84)	10,989
Intersegment revenue	–	–	–	–	84	(84)	–
Total external revenue	2,655	6,850	535	939	10	–	10,989
Other income[iii]	–	–	20	–	116	(116)	20
Net claims and benefits paid	(141)	(3,643)	(22)	–	–	–	(3,806)
Change in insurance and investment contract liabilities	(1,851)	(1,758)	(230)	(730)	–	–	(4,569)
Transfer from unallocated surplus	–	26	3	–	–	–	29
Movement in net assets attributable to unit-holders	(35)	(54)	–	–	–	–	(89)
Acquisition expenses	(400)	(56)	(98)	(49)	–	–	(603)
Administrative and other expenses	(284)	(873)	(175)	(205)	(39)	116	(1,460)
Finance costs	–	(130)	(7)	(1)	(88)	84	(142)
Total claims, benefits and expenses	(2,711)	(6,488)	(529)	(985)	(127)	200	(10,640)
Intersegment expenses	–	(200)	–	–	–	200	–
Total external claims, benefits and expenses	(2,711)	(6,288)	(529)	(985)	(127)	–	(10,640)
(Loss)/profit before tax from continuing operations	(56)	362	26	(46)	83	–	369
Policyholder tax	(9)	(325)	–	–	–	–	(334)
Shareholder tax	27	164	11	22	(24)	–	200
Segmental result after tax	(38)	201	37	(24)	59	–	235

(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 internal recharges on pension deficit reduction contributions of £116 million and profit from the disposal of AmLife of £20 million, refer to note 2 section d) for further details.

For the year ended 31 December 2012	Restated UK £m	Restated Heritage £m	FPI £m	Lombard £m	Restated Corporate £m	Elimination of inter-segment amounts(ii) £m	Restated total £m
Gross earned premiums on insurance and investment contracts	3,389	2,596	1,268	2,377	–	–	9,630
Investment contract premiums(i)	(2,814)	(1,383)	(1,150)	(2,377)	–	–	(7,724)
Gross earned premiums	575	1,213	118	–	–	–	1,906
Premiums ceded to reinsurers	(85)	(512)	(5)	–	–	–	(602)
Net earned premiums	490	701	113	–	–	–	1,304
Fee and commission income	310	259	75	105	–	–	749
Investment return(iii)	1,476	6,108	305	1,154	96	(94)	9,045
Total revenue	2,276	7,068	493	1,259	96	(94)	11,098
Intersegment revenue	–	1	–	–	93	(94)	–
Total external revenue	2,276	7,067	493	1,259	3	–	11,098
Other income	–	–	–	–	–	–	–
Net claims and benefits paid(iv)	(101)	(3,376)	(18)	–	–	–	(3,495)
Change in insurance and investment contract liabilities (iv)	(1,481)	(2,150)	(347)	(1,066)	–	–	(5,044)
Transfer to unallocated surplus	–	(1)	(3)	–	–	–	(4)
Movement in net assets attributable to unit-holders	(50)	(68)	–	–	–	–	(118)
Acquisition expenses	(372)	(111)	(89)	(42)	–	–	(614)
Administrative and other expenses(iii)	(353)	(842)	(183)	(207)	(12)	–	(1,597)
Finance costs	–	(138)	(8)	(1)	(104)	94	(157)
Total claims, benefits and expenses	(2,357)	(6,686)	(648)	(1,316)	(116)	94	(11,029)
Intersegment expenses	–	(77)	(1)	–	(16)	94	–
Total external claims, benefits and expenses	(2,357)	(6,609)	(647)	(1,316)	(100)	–	(11,029)
Share of loss of associates	–	(1)	(2)	–	–	–	(3)
(Loss)/profit before tax from continuing operations	(81)	381	(157)	(57)	(20)	–	66
Policyholder tax	(1)	(257)	–	–	–	–	(258)
Shareholder tax	21	100	26	22	(18)	–	151
Segmental result after tax	(61)	224	(131)	(35)	(38)	–	(41)

(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) As a result of the revision to IAS 19: *Employee benefits*, curtailment gains of £32 million have been presented within administrative expenses, rather than within investment return. Refer to note 6 for further details.
(iv) As a result of a review of investment contract disclosure during the year a restatement has been made between UK and Heritage for the allocation of claims offset by a change in investment contract liabilities.

(iv) Products and services

For the year ended 31 December 2013	**Gross earned premiums £m**	**Net earned premiums £m**	**Fee and commission income £m**	**Total external revenue[i] £m**
UK				
– Corporate benefits	**28**	**28**	**88**	**116**
– Protection	**271**	**175**	**–**	**175**
– Retirement income	**353**	**353**	**–**	**353**
– Other	**–**	**–**	**211**	**211**
Heritage				
– With-profits	**369**	**271**	**–**	**271**
– Pensions	**28**	**26**	**221**	**247**
– Investments	**104**	**96**	**67**	**163**
– Protection	**373**	**233**	**–**	**233**
– Annuities	**315**	**68**	**–**	**68**
– Other	**–**	**–**	**11**	**11**
FPI				
– Investments	**100**	**100**	**117**	**217**
– Protection	**30**	**26**	**–**	**26**
Lombard				
– Investments	**–**	**–**	**112**	**112**
Total	**1,971**	**1,376**	**827**	**2,203**

(i) Total external revenue does not include investment return of £8,786 million.

For the year ended 31 December 2012	Gross earned premiums £m	Net earned premiums £m	Fee and commission income £m	Total external revenue[i] £m
UK				
– Corporate benefits	30	24	98	122
– Protection	224	144	–	144
– Retirement income	321	321	–	321
– Other	–	–	210	210
Heritage				
– With-profits	397	344	3	347
– Pensions	71	(15)	178	163
– Investments	139	132	79	211
– Protection	426	278	(5)	273
– Annuities	180	(37)	6	(31)
FPI				
– Investments	92	90	68	158
– Protection	26	23	–	23
– Other	–	–	7	7
Lombard				
– Investments	–	–	105	105
Total	1,906	1,304	749	2,053

(i) Total external revenue does not include investment return of £9,045 million.

Products and services are presented consistently with the disclosure of business segments, with each segment being broken down into the business units and products of which they comprise.

(v) Assets and liabilities

As at 31 December 2013	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Elimination of inter-segment amounts[i] £m**	**Total £m**
Segment assets	**23,883**	**75,809**	**8,830**	**20,796**	**2,264**	**(1,495)**	**130,087**
Investment in associate	**–**	**4**	**–**	**–**	**–**	**–**	**4**
Total assets	**23,883**	**75,813**	**8,830**	**20,796**	**2,264**	**(1,495)**	**130,091**
Total liabilities	**22,793**	**73,000**	**8,562**	**20,448**	**1,234**	**(1,495)**	**124,542**
Other segment information:							
– Capital expenditure	**–**	**–**	**1**	**4**	**1**	**–**	**6**
– Depreciation	**1**	**1**	**–**	**1**	**2**	**–**	**5**
– Amortisation of intangibles	**89**	**217**	**88**	**78**	**–**	**–**	**472**
– Impairment	**–**	**–**	**11**	**–**	**–**	**–**	**11**

As at 31 December 2012	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Elimination of inter-segment amounts[i] £m	Total £m
Segment assets	21,725	77,530	8,306	19,485	2,102	(1,443)	127,705
Investments in associates (including held for sale)	–	4	30	–	–	–	34
Total assets	21,725	77,534	8,336	19,485	2,102	(1,443)	127,739
Total liabilities	20,609	74,560	8,014	19,116	1,185	(1,443)	122,041
Other segment information:							
– Capital expenditure	1	–	–	4	2	–	7
– Depreciation	–	1	–	2	2	–	5
– Amortisation of intangibles	94	220	97	83	1	–	495
– Impairment	–	–	19	–	–	–	19

(i) Eliminations mainly comprise intercompany loans.

c) Geographical segmental information

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

For the year ended 31 December 2013	UK £m	Rest of the world £m	Total £m
Gross earned premiums	**1,836**	**135**	**1,971**
Fee and commission income	**615**	**212**	**827**
Revenue from external customers	**2,451**	**347**	**2,798**
Investment return			**8,786**
Premiums ceded to reinsurers			**(595)**
Total revenue			**10,989**

For the year ended 31 December 2012	UK £m	Rest of the world £m	Restated Total £m(i)
Gross earned premiums	1,785	121	1,906
Fee and commission income	587	162	749
Revenue from external customers	2,372	283	2,655
Investment return(i)			9,045
Premiums ceded to reinsurers			(602)
Total revenue			11,098

(i) As a result of the revision to IAS 19: *Employee benefits*, curtailment gains of £32 million have been presented within administrative expenses rather than within investment return. Refer to note 6 for further details.

d) Disposal of investment in associate undertakings

On 4 January 2013 the Group disposed of its entire holding of 30% of the ordinary share capital of both AmLife Insurance Berhad and AmFamily Takaful Berhad (collectively “AmLife”) to AmBank Group of Malaysia for RM 245 million (£50 million) resulting in a profit on disposal of £20 million.

The Group’s share of the carrying value of AmLife at the date of sale on 4 January 2013 is shown below:

	2013 £m
Carrying value	**30**
Proceeds from disposal	**50**
Profit on disposal recognised through other income	**20**

3. Appropriations of profit

a) Dividends paid on ordinary shares

A final dividend in respect of 2012 of 14.09 pence per share was paid on 20 May 2013 totalling £200 million. An interim dividend of 7.05 pence per ordinary share was paid on 4 October 2013 amounting to £100 million.

Subject to the approval of shareholders at the annual general meeting on 8 May 2014, a final dividend of 14.09 pence per share will be paid on 16 May 2014 amounting to £200 million. This amount is not reflected in these financial statements. Shareholders have been offered a dividend reinvestment plan (“DRIP”), which allows them to purchase additional shares on the dividend payment date from the proceeds of their cash dividend.

b) Step-up tier one Insurance Capital Securities interest

Interest on the 2003 STICS is paid in equal instalments in May and November each year at a rate of 6.875%. During the year ended 31 December 2013, interest of £14 million (2012: £14 million) was paid to the 2003 STICS holders.

Interest on the 2005 STICS is paid annually in June at a rate of 6.292%. During the year ended 31 December 2013, interest of £17 million (2012: £17 million) was paid to the 2005 STICS holders.

4. Earnings per share

a) Basic and operating earnings per share from continuing operations

Earnings per share have been calculated based on the profit or loss after tax and on the operating profit after tax attributable to equity holders of the parent and the weighted number of shares in issue adjusted for own shares held. The directors consider that operating earnings per share provides a better indication of the performance of the Group.

For the year ended 31 December	**2013 Earnings £m**	**2013 Pence per share**	2012 Earnings £m	2012 Pence per share
Profit/(loss) after tax attributable to equity holders of the parent	**204**	**14.39**	(72)	(5.17)
Add back:				
– short-term fluctuations in investment return	**(182)**	**(12.85)**	(275)	(19.76)
– non-recurring items	**131**	**9.24**	258	18.54
– amortisation and impairment of acquired intangible assets	**483**	**34.07**	514	36.94
– tax credit on items excluded from operating profit	**(196)**	**(13.82)**	(149)	(10.71)
Operating profit after tax attributable to equity holders of the parent	**440**	**31.03**	276	19.84

b) Diluted basic earnings per share from continuing operations

i) Based on profit after tax attributable to equity holders of the parent

For the year ended 31 December	2013 Earnings £m	2013 Weighted average number of shares	2013 Pence per share
Profit after tax attributable to equity holders of the parent	**204**	**1,417,808,590**	**14.39**
Dilutive effect of share awards	**–**	**904,272**	**(0.01)**
Diluted basic earnings per share on profit after tax attributable to equity holders of the parent	**204**	**1,418,712,862**	**14.38**

ii) Based on operating profit after tax attributable to equity holders of the parent

For the year ended 31 December	2013 Earnings £m	2013 Weighted average number of shares	2013 Pence per share
Operating profit after tax attributable to equity holders of the parent	**440**	**1,417,808,590**	**31.03**
Dilutive effect of share awards	**–**	**904,272**	**(0.02)**
Diluted basic earnings per share on operating profit after tax attributable to equity holders of the parent	**440**	**1,418,712,862**	**31.01**

There were no dilutive factors for the year ended 31 December 2012.

c) Weighted average number of ordinary shares

For the year ended 31 December 2013	Actual	Weighted
Issued ordinary shares at beginning of period	**1,418,109,028**	**1,418,109,028**
Effect of:		
– purchase of own shares held	**(600,877)**	**(300,438)**
Number of ordinary shares at end of period	**1,417,508,151**	**1,417,808,590**

For the year ended 31 December 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	9,477,125
– scrip dividend (interim 2012)	26,435,094	6,283,752
– reduction in own shares held	2,661,384	1,999,674
Number of ordinary shares at end of period	1,418,109,028	1,391,288,156

5. Taxation

a) Tax recognised in the consolidated income statement

For the year ended 31 December	2013 £m	2012 £m
Current tax		
UK corporation tax at 23.25% (2012: 24.5%)	**1**	68
Adjustments in respect of prior periods	**(6)**	(4)
Overseas tax	**19**	11
Total current tax charge	**14**	75
Deferred tax		
Origination and reversal of temporary differences	**240**	92
Change in tax rates	**(70)**	(61)
Recognition of deferred tax assets previously unrecognised	**(50)**	–
Adjustments in respect of prior periods	**–**	1
Total deferred tax charge	**120**	32
Total tax charge	**134**	107
Analysis:		
– policyholder tax	**334**	258
– shareholder tax	**(200)**	(151)
Total tax charge	**134**	107

Legislation was enacted in 2012 to bring a decrease in the rate of corporation tax from 24% on 1 April 2012 to 23% on 1 April 2013. During the year legislation was enacted to reduce the rate to 21% from 1 April 2014 and 20% from 1 April 2015. Under IFRS, deferred tax is calculated using rates substantively enacted by the reporting date and as such the reduction to a 20% rate has been taken into account in deferred tax balances. The average rate of corporation tax for the full calendar year is 23.25%.

b) Factors affecting tax charge for year

For the year ended 31 December	2013 £m	2012 £m
Profit before tax from continuing operations	**369**	66
Profit before tax from continuing operations determined with reference to the average rate of corporation tax in the UK of 23.25% (2012: 24.5%)	**86**	16
Effects of:		
– non-taxable income	**(106)**	(120)
– deductions not allowable for tax purposes	**(9)**	26
– tax on reserving adjustments and other IFRS adjustments	**–**	24
– overseas tax	**(5)**	(10)
– valuation of tax assets and liabilities	**(49)**	(75)
– valuation of unrealised capital losses	**–**	43
– adjustments in respect of prior periods	**(21)**	(2)
– impact of reduction in corporation tax rate to 20% (2012: 23%) on deferred tax asset/liability	**(70)**	(61)
– non-taxable result of Resolution holding companies	**–**	8
– policyholder tax	**334**	258
– other	**(26)**	–
Total tax charge	**134**	107

6. Staff pension schemes

a) Introduction

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

The Group has one closed defined benefit scheme: the Friends Provident Pension Scheme ("FPPS"), which closed to active membership at 31 December 2012.

FPIL and SBG operate defined contribution arrangements. Lombard does not operate a pension scheme.

b) Closed FPPS defined benefit scheme overview

On an IAS 19: Employee benefits (Revised 2011) basis, a gross deficit of £(4) million has been recognised in respect of the FPPS at 31 December 2013 (2012: surplus of £62 million). A deficit reduction plan was entered into during January 2013 based on the triennial valuation as at 30 September 2011, which showed a deficit on a funding basis of £185 million. That plan set out a new schedule of deficit reduction contributions of £175 million, in addition to a £20 million payment which was made in July 2012 and £20 million in July 2013 under the previous deficit reduction plan. The new recovery plan commenced in January 2013 with a payment of £1.5 million, and a further £1.5 million has been paid in July 2013 in addition to the £20 million previously agreed. Further deficit reduction contributions totalling £172 million will be paid into the scheme, with payments of £21.5 million to be made by 31 July each year for the next eight years from 2014 to 2021.

Under IFRIC 14, deficit reduction contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available after they are paid into the scheme, a liability is recognised when the obligation arises. In accordance with s207(4) Finance Act 2004, an additional liability of £48 million has been recognised at 31 December 2013 (2012: £29 million), reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £132 million (£172 million of deficit reduction contributions at a present value of £136 million, partially offset by the current deficit of £(4) million). A deferred tax asset of £34 million (2012: £5 million) has also been recognised to reflect tax relief at a rate of 20% (2012: 23%) that is expected to be available on the deficit reduction contributions, in future periods.

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

Amounts recognised in the consolidated statement of financial position

As at 31 December	**2013 £m**	2012 £m
IAS 19 (deficit)/surplus (excluding deficit reduction contribution)	**(4)**	62
Authorised payments surplus charge (penal tax) at 35% of available surplus following deficit reduction contribution, discounted to present value[(i)]	**(48)**	(29)
Net pension (deficit)/surplus (excluding deficit reduction contribution)	**(52)**	33

(i) Included in the charge for the year ended 31 December 2013 is a finance charge of £(2) million (2012: £nil) relating to penal tax on the present value of pension deficit funding, which is recognised in the consolidated income statement

Movement in IAS 19 pension surplus

For the year ended 31 December	2013 £m	Restated(iv) 2012 £m
Pension surplus at 1 January	**62**	52
Current service cost(i)	**–**	(7)
Past service credit(i)(ii)	**–**	32
Net interest on net defined benefit liability (asset)(i)(iii)	**3**	3
Employer contributions	**28**	27
Remeasurement losses	**(96)**	(45)
Administration costs(i)	**(1)**	–
Pension (deficit)/surplus	**(4)**	62
Present value of deficit reduction contributions	**136**	20
Available surplus subject to authorised payments surplus charge	**132**	82

(i) Recognised in the consolidated income statement.
(ii) The restated past service credit for 2012 includes two credits resulting from curtailment gains arising within the FPPS, £10 million on the Diligenta outsourcing agreement entered into by the Group in January 2012 and £22 million as a result of the closure of the FPPS to future accrual in the second half of 2012.
(iii) The actual return on plan assets for the year ended 31 December 2013 is £81 million (31 December 2012: £64 million).
(iv) As a result of the revision to IAS 19: *Employee benefits*, comparatives have been restated as follows:
- Service cost is now split into current service cost and past service credit.
- Curtailment gains of £32 million for the year ended 31 December 2012 are now presented as a past service credit. These were previously included within investment return.
- Remeasurement gains and losses are now presented as remeasurements of the net defined benefit liability (asset).
- Interest cost and expected return on plan assets have been replaced with net interest on net defined benefit liability (asset) calculated by applying the discount rate used to measure the defined benefit obligation to the net defined benefit liability (asset).

The total gain recognised in the income statement for the year ended 31 December 2013 was £nil (2012: gain of £28 million). In addition to the amounts shown in the table above, a finance charge of £(2) million (2012: £nil) relating to penal tax on the present value of pension deficit funding has also been recognised in the income statement.

Analysis of net pension surplus and related deferred tax asset

As at 31 December 2013	Pension deficit £m	Deferred tax £m
Gross IAS 19 pension deficit and related deferred tax asset	**(4)**	**1**
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)(i)	**(48)**	**–**
Restriction of asset due to authorised payments surplus charge	**–**	**(1)**
Tax relief available on deficit reduction contributions	**–**	**34**
Net pension deficit and related deferred tax asset	**(52)**	**34**

(i) Includes a finance charge of £(2) million (2012: £nil) relating to penal tax recognised on the present value of pension deficit funding.

As at 31 December 2012	Pension surplus £m	Deferred tax £m
Gross IAS 19 pension surplus and related deferred tax liability	62	(14)
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)	(29)	–
Restriction of liability due to authorised payments surplus charge	–	14
Tax relief available on deficit reduction contributions	–	5
Net pension surplus and related deferred tax asset	33	5

Remeasurement losses recognised in the consolidated statement of comprehensive income

For the year ended 31 December	2013 £m	Restated 2012 £m
Remeasurement losses:		
– actuarial losses of the defined benefit scheme	**(117)**	(46)
– return on pension asset (excluding amounts included in net interest on net defined benefit liability (asset))	**21**	1
– irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)[(i)]	**(17)**	3
Remeasurement losses of the defined benefit scheme	**(113)**	(42)
Taxation	**36**	7
Remeasurement losses of the net defined benefit scheme after tax	**(77)**	(35)

(i) An additional finance charge of £(2) million (2012: £nil) is also recognised in the consolidated income statement relating to penal tax on the present value of pension deficit funding.

A tax credit of £34 million (2012: charge of £(5) million) in respect of deficit reduction contributions and a further credit of £2 million (2012: credit of £12 million) in respect of other movements in the pension scheme are included in the aggregate tax line for items that will not be reclassified to profit and loss in the consolidated statement of comprehensive income.

7. Intangible assets

Movements in intangible assets are as follows:

For the year ended 31 December 2013	**AVIF £m**	**Other £m**	**Total £m**
Cost			
At 1 January 2013	**5,505**	**560**	**6,065**
Additions	**–**	**4**	**4**
Disposals(iii)	**–**	**(8)**	**(8)**
Foreign exchange adjustments	**15**	**4**	**19**
At 31 December 2013	**5,520**	**560**	**6,080**
Amortisation and impairment			
At 1 January 2013	**1,497**	**247**	**1,744**
Amortisation charge for the year(i)	**381**	**91**	**472**
Impairment charge for the year(i)(ii)	**11**	**–**	**11**
Disposals (iii)	**–**	**(8)**	**(8)**
Foreign exchange adjustments	**4**	**2**	**6**
At 31 December 2013	**1,893**	**332**	**2,225**
Carrying amounts at 31 December 2013	**3,627**	**228**	**3,855**

For the year ended 31 December 2012	AVIF £m	Other £m	Total £m
Cost			
At 1 January 2012	5,521	560	6,081
Additions	–	4	4
Foreign exchange adjustments	(16)	(4)	(20)
At 31 December 2012	5,505	560	6,065
Amortisation and impairment			
At 1 January 2012	1,084	150	1,234
Amortisation charge for the year(i)	412	83	495
Impairment charge for the year(i) (ii)	5	14	19
Foreign exchange adjustments	(4)	–	(4)
At 31 December 2012	1,497	247	1,744
Carrying amounts at 31 December 2012	4,008	313	4,321

(i) Amortisation and impairment charges are included within administrative and other expenses in the consolidated income statement.
(ii) AVIF impairment of £(11) million (2012: £(5) million) has been recognised within OLAB in the FPI segment, as a result of worsening persistency. 2012 also includes a £(12) million impairment of goodwill and £(2) million impairment of distributor relationships in respect of Financial Business Partners AG ("fpb AG") part of the FPI segment.
(iii) Disposals relate to the sale of fully amortised software of £(8) million.

AVIF is shown gross of policyholder and shareholder tax of £693 million (2012: £849 million), with the offsetting balance included in deferred taxation.

i) AVIF

An analysis of AVIF by operating segments used for segmental reporting (see note 2) is set out below:

As at 31 December 2013	**Cost £m**	**Amortisation and impairment £m**	**Net book value £m**
UK	**896**	**(291)**	**605**
Heritage	**3,011**	**(906)**	**2,105**
FPI	**1,014**	**(436)**	**578**
Lombard	**599**	**(260)**	**339**
Total	**5,520**	**(1,893)**	**3,627**

As at 31 December 2012	Cost £m	Amortisation and impairment £m	Net book value £m
UK	896	(245)	651
Heritage	3,011	(702)	2,309
FPI	1,014	(344)	670
Lombard	584	(206)	378
Total	5,505	(1,497)	4,008

ii) Other intangibles

Other intangibles are made up of the following:

As at 31 December 2013	**Cost £m**	**Amortisation and impairment £m**	**Net book value £m**
Distribution channels and customer relationships	**444**	**(237)**	**207**
Brand	**49**	**(37)**	**12**
Software	**55**	**(46)**	**9**
Goodwill	**12**	**(12)**	**–**
Total	**560**	**(332)**	**228**

As at 31 December 2012	Cost £m	Amortisation and impairment £m	Net book value £m
Distribution channels and customer relationships	441	(174)	267
Brand	49	(28)	21
Software	58	(33)	25
Goodwill	12	(12)	–
Total	560	(247)	313

iii) Impairment

As at 31 December 2013, based on an impairment review of each of the CGUs, an impairment charge of £(11) million has been recognised in FPI AVIF in respect of its OLAB operation. Following an impairment review at 31 December 2012, FPI AVIF in respect of its OLAB operation and other intangible assets in respect of fpb AG, the Group's distributor of German business, were impaired by £(5) million and £(14) million respectively.

8. Financial assets

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

As at 31 December	2013 £m	2012 £m
Fair value through profit or loss (note 8(a))		
Designated on initial recognition	**108,791**	105,172
Held for trading	**265**	812
Loans at amortised cost (note 8(b))	**8**	6
Total financial assets	**109,064**	105,990

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

As at 31 December 2013	With-profits £m	Unit-linked £m	Non-linked annuities £m	Non-linked other £m	Shareholder £m	Total £m
Shares and other variable yield securities	**6,803**	**63,145**	**–**	**122**	**15**	**70,085**
Debt securities and other fixed income securities:						
– Government securities	**7,084**	**7,181**	**1,044**	**724**	**78**	**16,111**
– Corporate bonds and loans at fair value	**7,388**	**5,466**	**8,115**	**1,297**	**112**	**22,378**
Derivative financial instruments	**170**	**66**	**22**	**5**	**2**	**265**
Deposits with credit institutions	**–**	**217**	**–**	**–**	**–**	**217**
Total financial assets held at fair value	**21,445**	**76,075**	**9,181**	**2,148**	**207**	**109,056**

As at 31 December 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	6,801	56,940	–	125	13	63,879
Debt securities and other fixed income securities:						
– Government securities	8,903	7,617	1,018	1,074	79	18,691
– Corporate bonds and loans at fair value	8,533	5,891	6,546	1,302	124	22,396
Derivative financial instruments	675	22	107	8	–	812
Deposits with credit institutions	–	206	–	–	–	206
Total financial assets held at fair value	24,912	70,676	7,671	2,509	216	105,984

The unit-linked column and with-profits column in the tables above include £614 million (2012: £744 million) of financial assets relating to the non-controlling interests in the OEICs that have been consolidated as the Group holding is 50% or more. These comprise £523 million of shares and other variable yield securities, £69 million of government securities and £22 million of corporate bonds (2012: £535 million of shares and other variable yield securities, £87 million of government securities and £122 million of corporate bonds).

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

The majority of financial assets held are readily realisable, however amounts of £98,798 million (2012: £96,900 million) are not expected to be realised for more than 12 months after the reporting date in line with the expected maturity of insurance and investment contract liabilities.

Asset-backed securities (excluding those held by the linked funds) amount to £4,124 million (2012: £3,940 million) and 98% (2012: 96%) of these are at investment grade as set out in note 9(e).

b) Loans at amortised cost

As at 31 December	2013 £m	2012 £m
Mortgage loans	**4**	2
Other loans	**4**	4
Total loans	**8**	6

The fair value of loans is considered to be the same as their carrying value.

c) Assets backing unit-linked liabilities

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

As at 31 December	2013 £m	2012 £m
Shares and other variable yield securities	**63,145**	56,940
Debt securities and other fixed income securities	**12,647**	13,508
Derivative financial instruments	**66**	22
Deposits with credit institutions	**217**	206
Total financial assets held at fair value	**76,075**	70,676
Investment properties	**1,302**	1,451
Insurance and other receivables	**639**	723
Cash and cash equivalents	**4,783**	4,835
Total assets	**82,799**	77,685
Net asset value attributable to unit-holders(i) and other payables	**(1,655)**	(1,743)
Total unit-linked net assets	**81,144**	75,942

(i) Represents non-controlling interests in respect of consolidated OEICs, which the Group are deemed to control.

9. Fair values of assets and liabilities

In accordance with the requirements of IFRS 13: Fair value measurement assets and liabilities which are measured at fair value have been classified into three categories as set out below. Financial assets at fair value include shares and other variable yield securities, government securities, corporate bonds (including ABS and loans at fair value), derivative financial instruments and deposits with credit institutions. Financial liabilities at fair value include unit-linked contracts, amounts due to reinsurers, net asset value attributable to unit-holders (non-controlling interest in the OEICs that are consolidated) and derivative financial instruments.

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

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

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

The majority of the Group's assets held at fair value are valued based on quoted market information or market observable data. Approximately 5% (8% excluding unit-linked assets) of the Group's financial assets are based on valuation techniques where significant observable market data is not available or the price is not observable from current market transactions. However, the fair value measurement objective of these assets remains the same, that is, an exit price from the perspective of the Group.

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

Corporate bond valuations are generally obtained from brokers and pricing services. Where the number of transactions has declined under the current market conditions, valuations have become more subjective. Bond prices provided by pricing services are based on the best estimate of market price determined by market makers based on a variety of factors and are considered to be observable prices. In determining fair value, market makers will take into account transactions they have observed in identical or similar assets as well as movements in market indices and any other factors that they regard as relevant. In some cases, consensus prices have been based on fewer, and potentially more historic, transactions.

Exchange-traded derivatives are valued using active market prices. The values of over-the-counter derivative financial instruments are estimated by applying valuation techniques, using pricing models or discounted cash flow methods. Where pricing models are used, inputs – including future dividends, swap rates and volatilities – based on market data at the statement of financial position date are used to estimate derivative values. Where discounted cash flow techniques are used, estimated future cash flows and discount rates are based on current market swap rates at the valuation date.

Investment properties and properties occupied by the Group are measured at fair value at the reporting date. Fair values are measured by external independent valuers, using methods set out in the Royal Institute of Chartered Surveyors' guidelines ("RICS Red Book"). The valuations used are based on valuation techniques using multiples of future rental incomes. The rental multiples are based on multiples observed in recent similar transactions in the market. Key assumptions include occupancy and rental income.

Methods considered when determining fair values of unlisted shares and other variable yield securities include discounted cash flow techniques and net asset valuation. Regular checks are performed of tolerance levels for changes such as percentage movements in prices, excess movements and inter vendor price comparisons, where tolerance levels are pre-defined for security types.

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

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

Loans are valued using a general discounted cash flow methodology, with the discount rates derived from the relevant risk-free curve and a credit spread curve. The valuation process is carried out by the investment manager and reviewed by management. All spreads are reviewed at least twice a year and will be recalibrated accordingly if they appear to be outliers relative to factors such as available market proxies and spreads of underlying securities.

Participation in investment pools mainly relates to property investments. Property is independently valued in accordance with the methods set out in the RICS Red Book at each year end.

The classifications of financial liabilities take into account the types of inputs used to determine the fair value measurements. For unit-linked funds this has been undertaken on a fund-by-fund basis. For the net asset value attributable to unit-holders, this has been analysed in the same proportion as the underlying consolidated investments categorisation.

The Group has financial liabilities which contain discretionary participation features of £8,991 million (2012: £9,543 million) that form part of its with-profits funds. Products giving rise to these liabilities are mainly investment or pension contracts with a unitised with-profits element. The Group is unable to measure the fair value of these financial liabilities reliably due to the lack of a robust basis to measure the supplemental discretionary returns arising on with-profits contracts and because there is not an active market for such instruments. These liabilities have therefore been excluded from the fair value hierarchy analysis below. Investment contract non-unit reserves, relating primarily to deferral of front-end fees in the form of unfunded units, have also been excluded from the fair value hierarchy analysis.

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

a) Recurring fair value measurements

As at 31 December 2013	Including unit-linked				Excluding unit-linked			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Non-financial assets held at fair value								
Investment properties	–	–	2,561	2,561	–	–	1,259	1,259
Owner-occupied property	–	–	40	40	–	–	40	40
Financial assets held at fair value								
Shares and other variable yield securities	64,679	1,943	3,463	70,085	5,725	81	1,134	6,940
Debt securities and other fixed income securities:								
– Government securities	15,716	395	–	16,111	8,885	45	–	8,930
– Corporate bonds and loans at fair value (including ABS)	15,549	4,974	1,855	22,378	12,375	3,200	1,337	16,912
Derivative financial instruments	34	231	–	265	10	189	–	199
Deposits with credit institutions	217	–	–	217	–	–	–	–
Total assets held at fair value	96,195	7,543	7,919	111,657	26,995	3,515	3,770	34,280
Financial liabilities held at fair value								
Unit-linked investment contracts	–	72,682	–	72,682	–	–	–	–
Amounts due to reinsurers	–	1,580	–	1,580	–	1,580	–	1,580
Net asset value attributable to unit holders	621	–	–	621	28	–	–	28
Derivative financial instruments	37	393	–	430	30	375	–	405
Total liabilities held at fair value	658	74,655	–	75,313	58	1,955	–	2,013

There are no non-recurring fair value measurements at 31 December 2013.

As at 31 December 2012			Including unit-linked				Excluding unit-linked	
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Non-financial assets held at fair value								
Investment properties	–	–	2,735	2,735	–	–	1,284	1,284
Owner-occupied property	–	–	40	40	–	–	40	40
Financial assets held at fair value								
Shares and other variable yield securities	53,459	7,608	2,812	63,879	5,156	555	1,228	6,939
Debt securities and other fixed income securities:								
– Government securities	18,209	474	8	18,691	10,917	152	5	11,074
– Corporate bonds and loans at fair value (including ABS)	15,595	5,653	1,148	22,396	12,121	3,788	596	16,505
Derivative financial instruments	52	760	–	812	32	758	–	790
Deposits with credit institutions	206	–	–	206	–	–	–	–
Total assets held at fair value	87,521	14,495	6,743	108,759	28,226	5,253	3,153	36,632
Financial liabilities held at fair value								
Unit-linked investment contracts	–	67,428	–	67,428	–	–	–	–
Amounts due to reinsurers	–	1,767	–	1,767	–	1,767	–	1,767
Net asset value attributable to unit holders	754	–	–	754	17	–	–	17
Derivative financial instruments	8	222	–	230	4	220	–	224
Total liabilities held at fair value	762	69,417	–	70,179	21	1,987	–	2,008

There are no non-recurring fair value measurements at 31 December 2012.

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

Derivative financial instruments and amounts due to reinsurers are managed on the basis of net exposure, after taking into account related collateral, with fair value determined on the basis of the price of the net position.

For the Friends Life Group plc £162 million subordinated debt due 2021, Friends Life Group plc £500 million subordinated debt due 2022 and the Friends Life Group plc US$575 million reset perpetual subordinated debt, the fair value measurements (as disclosed in note 10) are categorised as level 1.

b) Transfers between level 1 and level 2

During the year, £2,175 million (2012: £3,732 million) of corporate bonds, shares and other variable yield securities were transferred from level 1 to level 2 and £6,102 million (2012: £10,496 million) of corporate bonds, shares and other variable yield securities were transferred from level 2 to level 1. These movements arose from changes in the availability of current quoted prices, market activity and refinements to the methodology under which shares and other variable yield securities are classified. There were no significant transfers between level 1 and level 2 for other assets.

c) Level 3 assets

The following table shows a reconciliation of Level 3 assets which are recorded at fair value.

	Investment property £m	Owner-occupied property £m	Shares and other variable yield securities £m	Government securities £m	Corporate bonds and loans at fair value (including ABS) £m	Total assets held at fair value £m
At 1 January 2013	**2,735**	**40**	**2,812**	**8**	**1,148**	**6,743**
Total gains/(losses) in consolidated income statement(i)	**46**	**–**	**(33)**	**–**	**(153)**	**(140)**
Purchases	**45**	**–**	**226**	**–**	**103**	**374**
Sales	**(265)**	**–**	**(221)**	**–**	**(93)**	**(579)**
Issues	**–**	**–**	**12**	**–**	**174**	**186**
Settlements	**–**	**–**	**–**	**–**	**(19)**	**(19)**
Net transfer from/(to) level 1 and level 2(ii)	**–**	**–**	**632**	**(8)**	**681**	**1,305**
Foreign exchange adjustments	**–**	**–**	**35**	**–**	**14**	**49**
At 31 December 2013	**2,561**	**40**	**3,463**	**–**	**1,855**	**7,919**
Total unrealised gains/(losses) for the year included in profit or loss for assets held at 31 December 2013	**47**	**–**	**26**	**–**	**(7)**	**66**

	Shares and other variable yield securities £m	Government securities £m	Corporate bonds and loans at fair value (including ABS) £m	Total financial assets held at fair value £m
At 1 January 2012	3,210	5	1,259	4,474
Total gains/(losses) in consolidated income statement(i)	66	(1)	46	111
Purchases	1,262	–	247	1,509
Sales	(1,340)	–	(502)	(1,842)
Issues	–	–	58	58
Settlements	–	–	(24)	(24)
Net transfer (to)/from level 1 and level 2(ii)	(349)	4	84	(261)
Foreign exchange adjustments	(37)	–	(20)	(57)
At 31 December 2012	2,812	8	1,148	3,968
Total unrealised gains/(losses) for the year included in profit or loss for assets held at 31 December 2012	57	(1)	37	93

(i) Gains and their reversal on owner occupied property are recognised in the consolidated statement of comprehensive income, losses and their reversal are recognised in the income statement within investment return. All other gains and losses on assets held at fair value are recognised in the income statement within investment return.

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

Comparative figures for investment property and owner occupied property for the year ended 31 December 2012 are not available and the costs to develop them would be excessive.

The Group's Securities Pricing Committee provides oversight of the valuation of securities, including the review of valuation methodologies, appropriateness of prices provided by external valuers, and fair value hierarchy disclosures made by the Group.

IFRS 13 requires the disclosure, where available, of quantitative information relating to significant unobservable inputs used to derive the valuation of investments classified within the fair value hierarchy as level 3. The majority of the Group's investments are valued by third parties, resulting in limited availability of unobservable inputs used. Available unobservable inputs are as follows:

- Corporate bonds include £331 million of private loans; credit rating assumptions, ranging between AA- and BB-, have been used to derive discounted cash flow fair values.
- Shares and other variable yield securities include private equity investments, £268 million of which are valued using multiples of earnings before interest, tax, depreciation and amortisation ranging between 5 and 11.5.

- Investment properties have typically been valued based on equivalent rental multiples, ranging between 4 and 30.

d) Level 3 financial assets sensitivity analysis

As at 31 December	2013		2012	
	Carrying amount £m	Effect of reasonably possible alternative assumptions £m	Carrying amount £m	Effect of reasonably possible alternative assumptions £m
Unit-linked investments	**2,847**	**–**	2,139	–
Shares and other variable yield securities	**1,134**	**227**	1,228	246
Government securities	**–**	**–**	5	1
Corporate bonds and loans at fair value (including ABS)	**1,337**	**134**	596	60
Total level 3 financial assets	**5,318**	**361**	3,968	307

For unit-linked investments, the policyholders bear the investment risk and any change in asset values is matched by a broadly equivalent change in the liability. Shareholder profits from annual management charges levied on such funds will, however, vary according to the change in asset values leading to some limited investment risk.

For shares and other variable yield securities, where there is no active market the price at year end could reasonably be expected to be higher or lower by approximately 20%.

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

e) Creditworthiness of financial assets

The following table gives an indication of the level of creditworthiness of those categories of assets which are neither past due nor impaired and are most exposed to credit risk using principally ratings prescribed by Standard & Poor's and Moody's. Assets held within unit-linked funds have been excluded from the table 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 consolidated statement of financial position represents the maximum credit exposure.

As at 31 December 2013	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m	Collateral held £m
Corporate bonds and loans at fair value	**210**	**3,626**	**5,139**	**3,404**	**297**	**53**	**59**	**12,788**	**-**
Asset-backed securities	**1,395**	**825**	**1,326**	**498**	**47**	**29**	**4**	**4,124**	**-**
Derivative financial instruments	**-**	**30**	**149**	**-**	**-**	**-**	**20**	**199**	**46**
Reinsurance assets	**-**	**2,736**	**101**	**-**	**-**	**-**	**-**	**2,837**	**-**
Cash and cash equivalents	**3,460**	**555**	**754**	**21**	**-**	**-**	**117**	**4,907**	**-**
Insurance and other receivables	**30**	**118**	**120**	**106**	**6**	**1**	**80**	**461**	**-**
Total	**5,095**	**7,890**	**7,589**	**4,029**	**350**	**83**	**280**	**25,316**	**46**
%	**20%**	**31%**	**30%**	**16%**	**1%**	**1%**	**1%**	**100%**	

As at 31 December 2012	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m	Collateral held £m
Corporate bonds and loans at fair value	1,037	3,043	5,035	2,945	417	44	44	12,565	–
Asset-backed securities	1,493	1,007	873	423	67	58	19	3,940	–
Derivative financial instruments	–	6	760	–	–	–	24	790	564
Reinsurance assets	–	3,021	131	–	–	–	1	3,153	–
Cash and cash equivalents	2,579	270	1,644	–	25	–	86	4,604	–
Insurance and other receivables	68	61	107	71	8	1	86	402	–
Total	5,177	7,408	8,550	3,439	517	103	260	25,454	564
%	20%	29%	34%	13%	2%	1%	1%	100%	

The Group holds collateral in respect of over the counter derivatives. Such collateral held by the Group consists of gilts, non-Sterling government bonds and cash. Collateral is valued at bid price.

The direct exposure of the Group to government and corporate debt of Ireland, Portugal, Italy and Spain (being countries where the risk of credit default is perceived as higher) in shareholder and annuity funds at 31 December 2013 and 2012 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.

	2013			2012		
As at 31 December	**Govt. debt £m**	**Corporate debt £m**	**Total £m**	Govt. debt £m	Corporate debt £m	Total £m
Ireland	**–**	**26**	**26**	–	38	38
Portugal	**–**	**6**	**6**	–	5	5
Italy	**10**	**100**	**110**	7	145	152
Spain	**3**	**80**	**83**	–	146	146
Total	**13**	**212**	**225**	7	334	341

10. Loans and borrowings

	Coupon %	**2013 £m**	2012 £m
Subordinated liabilities:			
Lombard undated subordinated loans	Various	**-**	1
Friends Life Group plc £162 million LT2 subordinated debt due 2021	12.00	**178**	181
Friends Life Group plc £500 million LT2 subordinated debt due 2022	8.25	**497**	496
Friends Life Group plc US$575 million UT2 reset perpetual subordinated debt	7.875	**339**	346
Financial reinsurance:			
Lombard financial reinsurance treaties	Various	**3**	4
International financial reinsurance treaties	Various	**28**	57
Other:			
Amounts owed to credit institutions (overdrafts)		**5**	14
Total loans and borrowings		**1,050**	1,099

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

Subordinated liabilities

The FLG LT2 subordinated debt 2021 is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost based on the fair value at the date of acquisition of Friends Provident by FLG. The fair value of this subordinated debt at 31 December 2013 is £210 million (2012: £215 million).

On 21 April 2011, FLG issued a £500 million LT2 subordinated debt instrument with a coupon of 8.25% and a maturity of 2022, which is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being £500 million principal less capitalised issue costs of £3 million (2012: £4 million). The fair value of this subordinated debt at 31 December 2013 is £550 million (2012: £554 million).

On 8 November 2012, FLG issued a US$575 million UT2 reset perpetual subordinated debt instrument with a coupon of 7.875%, which is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being the US$575 million principal translated at the effective exchange rate less capitalised issue costs of £8 million. The debt does not have a fixed repayment date but is callable in five years' time (initial call in November 2018) and on every subsequent interest payment date from the initial call date. With effect from the initial call date, and for so long as the debt is outstanding, the interest coupon will be reset every six years at a rate equal to the six year US dollar mid swap rate plus a margin of 6.828%. The fair value of this subordinated debt at 31 December 2013 is £378 million (2012: £378 million). A derivative instrument was entered into on 8 November 2012 to manage the risks associated with fluctuations in exchange rates on the issue of this debt.

Financial reinsurance

FLL has three financial reinsurance contracts with Munich Reinsurance Company UK Limited ("Munich Re") to finance new German unit-linked pensions business written in the years ended 31 December 2010, 2011 and 2012 respectively. The total amount owed to Munich Re under these financial reinsurance arrangements as at 31 December 2013 was £17 million (31 December 2012: £37 million).

During 2013, FPIL entered into a financial reinsurance agreement with Munich Re to finance new Rest of World Premier regular premium savings business written between 1 January 2013 and 31 December 2013 in certain territories. The total amount owed to Munich Re under this financial reinsurance agreement as at 31 December 2013 was £11 million (31 December 2012: £nil).

In 2012, FPIL entered into a financial reinsurance agreement with Munich Re to finance new Rest of World Premier regular premium savings business written between 1 January 2012 and 31 December 2012. The total amount owed to Munich Re under this financial reinsurance agreement as at 31 December 2013 was £nil (31 December 2012: £20 million).

Other

Amounts owed to credit institutions (overdrafts) include £5 million (31 December 2012: £4 million) relating to credit balances held within OEICs that have been consolidated as the Group's holding is 50% or more. Such overdrafts are fully repayable out of the assets of the OEICs.

The Group benefits from a £250 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. The £250 million facility was entered into by FLL on 10 May 2013 and replaces the previous £500 million facility entered into by FLG. If a third party, who does not presently have control of FLG or FLL, acquires such control, FLL must notify the agent immediately. In this circumstance, the lenders are not obliged to fund utilisation and may notify the agent to cancel their commitments under the facility. This would have the effect of rendering all of their loans repayable within ten business days from the date of notice. As at the date of this report, the facility remains undrawn.

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

As at 31 December	**2013 £m**	2012 £m
Within one year or on demand	**31**	61
Between one and two years	**9**	14
Between two and three years	**2**	8
Between three and four years	**2**	2
Between four and five years	**2**	2
In more than five years	**1,004**	1,012
Total loans and borrowings	**1,050**	1,099

Included in the carrying amount above, £1,019 million (2012: £1,038 million) is expected to be settled more than 12 months after the reporting date.

Total interest expense for financial liabilities not measured at fair value through profit or loss, which arises solely from interest-bearing loans and borrowings, is £95 million (2012: £92 million).

11. Contingent liabilities and commitments

a) Contingent liabilities

In the normal course of its business, the Group is subject to matters of litigation or dispute and interpretation of tax law. 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.

Friends Life Group plc has given a letter of support to SBG to assist them in meeting their liabilities as they fall due. A number of business reviews are currently being undertaken in these companies and provisions of £35 million have been included in respect of customer redress. There is considerable uncertainty surrounding the outcome of these reviews, the number of future complaints and the associated costs for dealing with redress and complaint administration activities. Any costs arising from this are not expected to have a material adverse impact for the Group.

b) Commitments

Operating leases where the Group is lessee

The Group leases a number of properties under operating leases with the most material running to 2026. Lease terms include annual escalation clauses to reflect current market conditions. The future minimum rentals payable under all non-cancellable leases are as follows:

	2013			2012		
	Land and buildings £m	**Other £m**	**Total £m**	Land and buildings £m	Other £m	Total £m
Within one year	**15**	**1**	**16**	14	1	15
Between one and five years	**55**	**1**	**56**	54	1	55
In more than five years	**81**	**1**	**82**	101	–	101
Total operating lease payables	**151**	**3**	**154**	169	2	171

Other commitments

The Group has investment property commitments of £16 million (2012: £6 million) relating to ongoing construction, renovation costs and costs of acquiring existing properties.

The Group has potential commitments of £213 million (2012: £218 million) to venture capital vehicles (partnerships and similar vehicles) that allow exposure to private equity investments in UK, US and European markets. All investments are held under agreements between the private equity managers and the Group which have committed the Group to providing an agreed maximum level of funding to the managers to invest. As at 31 December 2013 there are still funds that have yet to be utilised that, under the agreements, are still available to the private equity managers and hence are classified as potential commitments.

The Group has entered into a number of outsourcing arrangements which have resulted in financial commitments amounting to £1,501 million as at 31 December 2013 (2012: £1,641 million). The average weighted years remaining on these outsourcing contracts is 13 years as at 31 December 2013 (31 December 2012: 14 years). Included within these amounts is £1,157 million (2012: £1,274 million) relating to the outsourcing arrangement with Diligenta announced in November 2011.

12. Related parties

In the ordinary course of business, the Group and its subsidiary undertakings carry out transactions with related parties, as defined by IAS 24: Related party disclosures. Material transactions for the year are set out below.

a) Key management personnel compensation

From 1 January to 27 March 2013 the key management personnel were considered to be the directors of Resolution Limited, executive directors of FLG and Resolution Operations LLP ("ROL") as a body corporate. On implementation of governance simplification changes, from 28 March 2013 the key management personnel of Resolution Limited became the directors of the Company and the members of its Group Executive Committee. The directors and the Group Executive Committee have responsibility for planning, directing and controlling the activities of the Group.

In aggregate the compensation paid to key management personnel, excluding the fees paid to ROL, in respect of the year ending 31 December 2013 is as set out below:

	2013 Number	**2013 £m**	2012 Number	2012 £m
Salary and short-term employee benefits	**30**	**10**	16	6
Post-employment benefits (excluding defined benefit scheme)	**1**	**–**	–	–
Share-based payments	**7**	**2**	–	–
Total key management personnel compensation charged to the income statement		**12**		6
Post-employment benefits: defined benefit schemes	**–**	**–**	–	–
Total key management personnel compensation		**12**		6

There were £nil balances outstanding at the year end with key management (2012: £nil).

Salary and short-term employment benefits include £0.9 million of payments for loss of office (2012: £ 0.3 million). As at 31 December 2013, there were £nil balances outstanding in respect of these payments (31 December 2012: £0.3 million outstanding).

b) Other related parties

Operating agreement – ROL
Until 27 March 2013, the Company had outsourced most of its operating functions to ROL under the terms of an Operating Agreement. On 28 March 2013 the Operating Agreement was novated to Friends Life Management Services Limited ("FLMS") as a result of the business sale agreement between the Company and FLMS signed on 10 December 2012. This Operating Agreement was subsequently terminated on 10 December 2013.

Under the terms of the agreement:

- the Company paid ROL an annual operating fee; under which the total amount charged in the period between 1 January and 28 March 2013 amounted to £5 million (amount charged for the full year to 31 December 2012: £18 million). Between 28 March and 10 December 2013 the Company paid FLMS operating fees amounting to £15 million in accordance with the terms of the same agreement. Following termination of the agreement, FLMS continues to provide management services to the Company and recharges the Company for the services provided. £3 million was recharged from FLMS to the Company for other corporate costs during the year, this amount was outstanding as at 31 December 2013.
- the Company could, subject to certain conditions, advance funds to ROL for development work on new projects outside the UK Life Project. No funding remained in place at 31 December 2013 (31 December 2012: £1 million); and
- subject to certain exceptions, members of The Resolution Group, including Clive Cowdery, were restricted from selling or pledging as security for a loan any of their shares in the Company held as at 13 January 2012, with a total number of locked–up shares of 8,247,184. As a result of the termination of the Operating Agreement these shares were transferred to RCAP UK LP and the lock-up agreement was terminated. The Resolution Group is not controlled by the Company, or linked in any way other than through Clive Cowdery, John Tiner and Jim Newman (a member of the GEC).

Resolution Holdco No.1 LP and RCAP UK LP

The Company has a 99.99% interest in, and is the general partner in, Resolution Holdco No.1 LP ("RHN1"), a Guernsey limited partnership. The limited partner in RHN1 is RCAP UK LP ("RCAP"). RCAP is an entity established by current and former partners and employees of ROL and is entitled to share in the value created in RHN1, which owns the Friends Life group.

The value share arrangement was established at the time the Company was formed and, in broad terms, entitles RCAP to 10% of all distributions made from RHN1 where the accumulated value of the deployed equity capital contributed into RHN1 (as set out below), plus an agreed return, has been returned to the Company or its shareholders, or there has been a change of control of the Group. There is no time limit applying to the value share arrangements and the arrangements are not affected by the termination of the operating agreement between ROL and the Company.

Deployed equity capital has been contributed to RHN1, by the Company and RCAP, to fund the acquisitions of both Friends Provident Group plc in 2009 and the majority of AXA S.A.'s UK life business in 2010. The agreed return is the greater of 4% and a three year risk free rate. The risk free rate is recalculated at three yearly intervals following the initial contribution in November 2009. The agreed return is currently 4% per annum.

Total gross equity deployed in RHN1 is approximately £4,056 million and the accumulated value of net equity deployed (at 4% per annum and after the return of £1,066 million of capital returned to the Company to date) is approximately £3,543 million as shown below.

	Gross equity deployed		
Transaction	**The Company £m**	**RCAP £m**	**Total £m**
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**

(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.

Accumulated value of net equity deployed	**2013 £m**	2012 £m
At 1 January	**3,752**	3,844
Distributions from RHN1	**(350)**	(240)
Accumulations in the year	**141**	148
At 31 December	**3,543**	3,752

The Company's share price does not itself influence whether payments are made under the terms of the value share. The payment under the value share depends on the aggregate amount of distributions made to the Company by RHN1, including to fund payments to shareholders (dividends or returns of capital), or there being a relevant change of control event.

If Resolution Limited were to undertake further acquisitions, the agreement with RCAP means that RCAP would be required to contribute 0.01% of any capital involved; this would increase the amount of deployed equity capital and increase the potential added value to which RCAP would be entitled in excess of the accumulated value of net equity deployed.

Resolution (Brands) Limited

The Company is party to an amended and restated trademark licensing agreement with Resolution (Brands) Limited, a company wholly owned by Clive Cowdery, under which the Company has been granted a licence to use the "Resolution" trademark. There were no fees payable under the agreement in 2013 (2012: £0.1 million). The agreement was amended in 2014 to enable both parties 30 days' written notice.

MCEV FINANCIAL INFORMATION

Consolidated income statement – MCEV basis

For the year ended 31 December 2013

	Notes	2013 £m	2012 £m
Covered business			
Value of new business	6	**204**	194
Expected existing business contribution		**248**	325
Operating experience variances		**(57)**	(56)
Operating assumption changes		**19**	(9)
Other operating variances		**178**	27
Development costs	10	**(50)**	(50)
Covered business operating profit before tax	3	**542**	431
Other income and charges		**(53)**	(49)
Operating profit before tax		**489**	382
Economic variances	3	**412**	154
Amortisation and impairment of non-covered business intangible assets		**–**	(15)
Non-recurring items and non-operating variances	3	**(143)**	(127)
Profit from continuing operations before tax		**758**	394
Tax on operating profit		**(117)**	(120)
Tax on other activities		**(62)**	(6)
Profit for the year[(i)]		**579**	268

(i) Profit for the year is attributable to equity holders of the parent.

The notes 1 to 13 form an integral part of these financial statements.

The consolidated income statement for the year ended 31 December 2012 includes the results of AmLife Insurance Berhad and AmFamily Takaful Berhad (collectively "AmLife"). The consolidated income statement for the year ended 31 December 2013 includes the results of AmLife up until the date of disposal on 4 January 2013.

Earnings per share – MCEV basis

For the year ended 31 December 2013

	Note	2013 pence	2012 pence
Earnings per share			
Operating earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**26.24**	18.83
– Diluted	4	**26.22**	18.83
Earnings per share on MCEV basis after tax, attributable to equity holders of the parent			
– Basic	4	**40.84**	19.26
– Diluted	4	**40.81**	19.26

MCEV operating profit arises from continuing operations, incorporates an expected investment return and excludes:

- amortisation and impairment of non-covered business intangible assets;
- the effect of economic variances (including the impact of economic assumption changes); and
- significant non-recurring items and non-operating items.

Given the long-term nature of the Group's operations, operating profit is considered to be a better measure of the performance of the Group and this measure of profit is used internally to monitor the Group's MCEV results.

Consolidated statement of comprehensive income – MCEV basis

For the year ended 31 December 2013

	2013 £m	2012 £m
Profit for the year	**579**	268
Remeasurement losses on defined benefit pension schemes, net of tax	**(77)**	(35)
Foreign exchange adjustments	**16**	(16)
Other comprehensive loss for the year, net of tax	**(61)**	(51)
Total comprehensive income for the year(i)	**518**	217

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

Consolidated statement of changes in equity – MCEV basis

For the year ended 31 December 2013

	2013 £m	2012 £m
Opening ordinary shareholders' equity	**5,831**	5,796
Disposal of AmLife as at 4 January 2013	**7**	–
Total comprehensive income for the year	**518**	217
Issue of share capital (net of capitalised expenses)	**–**	90
Movement in own shares held by the Group	**(2)**	7
Dividends on equity shares	**(300)**	(283)
Share-based payments	**7**	4
Other movements[i]	**4**	–
Increase in MCEV reserves for the year	**234**	35
Closing ordinary shareholders' equity	**6,065**	5,831

(i) Other movements comprise the release of a share entitlement provision (£2 million) and consolidation of the Group's Employee Benefit Trust (£2 million). Following demutualisation of Friends Provident in 2001, share and cash entitlements that were not claimed were placed into two trusts. The trusts were wound up in 2004 and the liability for any future claims in respect of demutualisation was transferred to the Group. This provision was released following expiry of the Group's obligation on 9 July.

Consolidated statement of financial position – MCEV basis

As at 31 December 2013

	2013 £m	2012 £m
Assets		
Pension scheme surplus	**–**	33
VIF of covered business excluding assets of operations classified as held for sale	**4,369**	4,230
Intangible assets	**7**	9
Property and equipment	**50**	53
Investment properties	**2,561**	2,735
Financial assets	**109,064**	105,990
Deferred acquisition costs	**76**	88
Reinsurance assets	**2,837**	3,153
Current tax assets	**33**	8
Insurance and other receivables	**1,134**	1,133
Cash and cash equivalents	**9,690**	9,449
Net assets of operations classified as held for sale	**–**	43
Total assets	**129,821**	126,924
Liabilities		
Insurance contracts	**34,647**	37,294
Unallocated surplus	**627**	656
Financial liabilities		
– investment contracts	**82,574**	77,276
– loans and borrowings	**1,633**	1,641
– amounts due to reinsurers	**1,580**	1,767
Net asset value attributable to unit holders	**621**	754
Provisions	**230**	223
Pension scheme deficit	**52**	–
Deferred tax liabilities	**544**	362
Current tax liabilities	**1**	21
Insurance payables, other payables and deferred income	**1,245**	1,096
Total liabilities	**123,754**	121,090
Equity attributable to:		
– Equity holders of the parent	**6,065**	5,831
– Non-controlling interests	**2**	3
Total equity	**6,067**	5,834
Total equity and liabilities	**129,821**	126,924

Group MCEV analysis of earnings

For the year ended 31 December 2013

	Covered business £m	Non-covered business £m	2013 Total business £m	2012 Total business £m
Opening Group MCEV	**4,923**	**908**	**5,831**	5,796
Opening adjustments:				
– disposal of AmLife	**(43)**	**50**	**7**	–
Adjusted opening Group MCEV	**4,880**	**958**	**5,838**	5,796
Operating MCEV earnings	**422**	**(50)**	**372**	262
Non-operating MCEV earnings	**130**	**77**	**207**	6
Total MCEV earnings	**552**	**27**	**579**	268
Other movements in IFRS net equity	**–**	**(77)**	**(77)**	(28)
Closing adjustments:				
– capital and dividend flows	**(394)**	**103**	**(291)**	(189)
– foreign exchange variances	**16**	**–**	**16**	(16)
Closing Group MCEV	**5,054**	**1,011**	**6,065**	5,831

Notes to the MCEV results

For the year ended 31 December 2013

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 ("the MCEV Principles") (Copyright© Stichting CFO Forum Foundation 2008), issued in June 2008, and re-issued in amended form in October 2009. In accordance with guidance issued by the CFO Forum in September 2012, no allowance has been made for the impacts of the developing Solvency II regulatory regime.

The MCEV results were approved by the Board of Directors on 17 March 2014.

Segmental analysis and definitions

The results for 31 December 2013 have been shown for UK and Heritage divisions separately, reflecting the internal financial information used by the Group to evaluate operating performance. The 2012 comparatives, with the exception of the sensitivity analysis in note 11, have been updated accordingly to show UK and Heritage divisions separately.

Following the simplification of the Group's governance arrangements, the results and comparatives for the non-covered business of Resolution Limited and Friends Life group have been combined.

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 UT2 subordinated debt with associated currency swap, 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. These instruments 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, Friends Life Investments ("FLI") and the net pension deficit of FPPS on an IAS 19 basis. Corporate net assets held at Friends Life and Resolution holding company level, certain holding company costs, the deferred consideration notes issued by Resolution Limited (until the date of their repayment on 20 November 2012) are all non-covered business.

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

Segmental reporting under MCEV

The covered business within the Group has been split into the following segments in line with IFRS reporting:

- UK;
- Heritage;
- FPI; and
- Lombard.

On 4 January 2013 the Company disposed of its entire holding of 30% of the ordinary share capital of AmLife to AmBank Group of Malaysia for RM 245 million (£50 million) resulting in a profit on disposal of £7 million on an MCEV basis.

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. Corporate includes the external STICS, external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021, the external LT2 subordinated debt 2022, internal LT2 subordinated debt 2020, 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, except existing stakeholder-style pensions business where, if a regular pattern in the receipt of premiums for individuals has been established, the regular payment is treated as a renewal of an existing policy and not new business;
- non-contractual increments on existing policies;
- new entrants to existing schemes in the corporate benefits business; and
- immediate pension annuity contracts arising from internal vestings.

New business in 2012 also included Department for Work and Pensions rebate premiums, which are no longer received.

New business includes certain corporate benefit schemes that have been transferred within Friends Life on to the auto-enrolment platform. These are only included in new business where the transfer was instigated by the client and where significant new business activities have been undertaken by Friends Life.

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.

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 UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 at market value, based on listed ask prices.

The MCEV is calculated on a post-tax basis. Where gross results are presented, these have been calculated by grossing up the post-tax results for covered business at the appropriate rate of corporation tax for each segment. For non-covered business the gross results are presented gross of any IFRS tax attributed.

(a) Shareholders' net worth
The shareholders' net worth of the life and pensions covered business consists of free surplus and required capital.

Free surplus is the market value of any assets allocated, but not required, to support the in-force covered business at the valuation date. Required capital is the market value of assets, attributed to the covered business over and above that required to back liabilities for covered business, whose distribution to shareholders is restricted. The Group's required capital is set at the greater of local regulatory capital requirements and those requirements arising from internal capital management policies, which include economic risk capital objectives. The economic risk capital is determined from internal models, based on the Group's risk appetite. The level of required capital is shown in note 10.

(b) Value of in-force covered business
The value of in-force covered business consists of:

- present value of future profits; less
- time value of financial options and guarantees;
- frictional costs of required capital; and
- cost of residual non-hedgeable risks.

Present value of future profits ("PVFP")

The value of existing business is the present value of the future distributable profits available to shareholders from the in-force covered business. Future profits are projected using best estimate non-economic assumptions and market consistent economic assumptions.

The non-economic assumptions include: the behaviour of customers (e.g. persistency), mortality, morbidity, the level of expenses required to maintain the book of business, tax and the regulatory environment. The assumptions are a reflection of best estimates of the likely behaviours, outcomes, or circumstances in the future. The estimates are made, typically, on an annual basis following experience investigations based on the data available at the time both from the book of business and externally sourced information. The aim is to set assumptions at a level that reflects recent or current experience.

The PVFP includes the capitalised value of profits and losses arising in subsidiary companies providing investment management, administration and other services to the extent that they relate to covered business. This is referred to as the "look-through" into investment management and 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 Friends Life group, in the form of the benefits guaranteed to policyholders and the guaranteed annuity rates associated with certain policies. The risk to shareholders is that the assets of the with-profits funds are insufficient to meet these guarantees. While shareholders are entitled to only a small share of profits in the with-profits funds (e.g. via one-ninth of the cost of bonus), they can potentially be exposed to the full cost of fund assets being insufficient to meet policyholder guarantees. The TVOG has been assessed using a stochastic model derived from the current Realistic Balance Sheet ("RBS") model. This model has been calibrated to market conditions at the valuation date. Allowance has been made under the different scenarios for management actions, such as altered investment strategy, consistent with the RBS model. The TVOG would be markedly higher without the hedging activities and management actions currently undertaken. No allowance has been made for the impact of dynamic policyholder behaviour under the different scenarios, however the impact is not considered to be material.

Only modest amounts of new with-profits business are written and the guarantee levels offered are lower, hence there is no material impact in respect of the TVOG on the value of new business.

Frictional costs of required capital

The value of in-force covered business includes a deduction for the additional costs to an investor of holding the assets backing required capital through investment in a life company, rather than investing in the asset directly. These additional frictional costs comprise taxation and investment expenses on the assets backing the required capital.

The frictional costs of required capital are calculated as the difference between the market value of assets backing required capital and the present value of future releases of that capital allowing for future investment return (net of frictional costs) on that capital. The calculation allows for the run-off of the required capital over time using projections of the run-off of the underlying risks and regulatory requirements.

Details of the level of required capital are set out in note 10.

Cost of residual non-hedgeable risks ("CNHR")

The main area of non-hedgeable risk relates to non-financial risks, such as insurance and operational risks, where no deep, liquid market exists to fully mitigate the risk. Allowance for non-financial risk is made directly within:

- the PVFP via an appropriate choice of best estimate assumptions and with the impact of variability of the risk on the level, and hence cost, of required capital; and
- the TVOG for the impact of variations of non-financial risks on the possibility of shareholders needing to meet the guarantees within the with-profits funds of the subsidiary life companies of Friends Life group.

The CNHR covers those non-hedgeable risks that are not already allowed for fully in the PVFP or in the TVOG. The most significant of these risks are those for which the impact of fluctuations in experience is asymmetric; where adverse experience has a higher impact on shareholder value than favourable experience and the best estimate assumptions do not reflect this asymmetry. The areas identified as having the potential for material asymmetry are operational risk, persistency risk and reinsurance counterparty default risk.

The CNHR has been calculated by considering the financial cost to shareholders of the impact of asymmetric risks and with regard to the results of risk-based capital modelling. The risk-based capital is calculated using internal models, consistent with those used in the Group's Individual Capital Assessment, with:

- a 99.5% confidence level over one year;
- allowance for diversification between non-hedgeable risks;
- no allowance for diversification between non-hedgeable and hedgeable risks; and
- no allowance for diversification between covered and non-covered business.

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

Participating business

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

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

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

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

Consolidation adjustments

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

Goodwill and intangible assets

Goodwill and intangible assets relating to the non-covered business are included on an IFRS basis.

Exchange rates

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

Details of the exchange rates used are shown in note 10.

2. Analysis of MCEV earnings

The following tables show the movement in the MCEV of the Group. The analysis is shown separately for free surplus, required capital and the value of the in-force covered business. All figures are shown net of tax.

For the year ended 31 December 2013

	Covered business					
Net of tax	**Free surplus £m**	**Required capital £m**	**VIF £m**	**Total £m**	**Non–covered business £m**	**Total MCEV £m**
Opening Group MCEV	**641**	**40**	**4,242**	**4,923**	**908**	**5,831**
Opening adjustments:						
– acquired/divested businesses	**(3)**	**(25)**	**(15)**	**(43)**	**50**	**7**
Adjusted opening Group MCEV	**638**	**15**	**4,227**	**4,880**	**958**	**5,838**
Value of new business	**(213)**	**89**	**285**	**161**	**–**	**161**
Expected existing business contribution:						
– reference rate	**13**	**(8)**	**30**	**35**	**–**	**35**
– in excess of reference rate	**7**	**(49)**	**202**	**160**	**–**	**160**
Transfers from VIF and required capital to free surplus	**570**	**(16)**	**(554)**	**–**	**–**	**–**
Operating experience variances and development costs	**(16)**	**(36)**	**(37)**	**(89)**	**–**	**(89)**
Operating assumption changes	**52**	**5**	**(38)**	**19**	**–**	**19**
Other operating items	**2**	**93**	**41**	**136**	**(50)**	**86**
Operating Group MCEV earnings	**415**	**78**	**(71)**	**422**	**(50)**	**372**
Economic variances	**264**	**(80)**	**135**	**319**	**–**	**319**
Other non-operating items	**(231)**	**(21)**	**63**	**(189)**	**77**	**(112)**
Total Group MCEV earnings	**448**	**(23)**	**127**	**552**	**27**	**579**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**(77)**	**(77)**
Closing adjustments:						
– capital and dividend flows	**(422)**	**27**	**1**	**(394)**	**103**	**(291)**
– foreign exchange variances	**–**	**2**	**14**	**16**	**–**	**16**
Closing Group MCEV	**664**	**21**	**4,369**	**5,054**	**1,011**	**6,065**

For the year ended 31 December 2012

Net of tax	Covered business Free surplus £m	Required capital £m	VIF £m	Total £m	Non-covered business £m	Total MCEV £m
Opening Group MCEV	821	747	3,844	5,412	384	5,796
Value of new business	(285)	97	340	152	–	152
Expected existing business contribution:						
– reference rate	26	(10)	57	73	–	73
– in excess of reference rate	9	(47)	215	177	–	177
Transfers from VIF and required capital to free surplus	560	(18)	(542)	–	–	–
Operating experience variances and development costs	(69)	(12)	(3)	(84)	–	(84)
Operating assumption changes	(67)	–	54	(13)	–	(13)
Other operating items	86	(37)	(29)	20	(63)	(43)
Operating Group MCEV earnings	260	(27)	92	325	(63)	262
Economic variances	119	(200)	197	116	1	117
Other non-operating items	(107)	(120)	120	(107)	(4)	(111)
Total Group MCEV earnings	272	(347)	409	334	(66)	268
Other movements in IFRS net equity	–	–	–	–	(28)	(28)
Closing adjustments:						
– capital and dividend flows	(452)	(356)	1	(807)	618	(189)
– foreign exchange variances	–	(4)	(12)	(16)	–	(16)
Closing Group MCEV	641	40	4,242	4,923	908	5,831

3. Segmental analysis of MCEV earnings

The table below shows a further breakdown of the MCEV earnings. All earnings are shown on a gross of tax basis with attributed tax shown separately.

For the year ended 31 December 2013

Gross of tax	**Covered business UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Non-covered business £m**	**Total £m**
Value of new business	**184**	**(19)**	**14**	**25**	**–**	**–**	**204**
Expected existing business contribution	**60**	**211**	**19**	**33**	**(75)**	**–**	**248**
Operating experience variances	**(33)**	**(12)**	**13**	**(25)**	**–**	**–**	**(57)**
Operating assumption changes	**(6)**	**93**	**14**	**(82)**	**–**	**–**	**19**
Other operating variances	**36**	**127**	**9**	**6**	**–**	**–**	**178**
Development costs	**(30)**	**(7)**	**(10)**	**(3)**	**–**	**–**	**(50)**
Covered business operating profit/(loss) before tax	**211**	**393**	**59**	**(46)**	**(75)**	**–**	**542**
Other income and charges	**–**	**–**	**–**	**–**	**–**	**(53)**	**(53)**
Operating profit/(loss) before tax	**211**	**393**	**59**	**(46)**	**(75)**	**(53)**	**489**
Economic variances	**60**	**405**	**7**	**11**	**(71)**	**–**	**412**
Other non-operating items	**(5)**	**(241)**	**(1)**	**–**	**–**	**104**	**(143)**
Profit/(loss) before tax	**266**	**557**	**65**	**(35)**	**(146)**	**51**	**758**
Attributed tax on operating result	**(49)**	**(98)**	**(1)**	**10**	**18**	**3**	**(117)**
Attributed tax on other activities	**(18)**	**(27)**	**(3)**	**(3)**	**16**	**(27)**	**(62)**
Profit/(loss) after tax	**199**	**432**	**61**	**(28)**	**(112)**	**27**	**579**

For the year ended 31 December 2012

Gross of tax	Covered business UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Non-covered business £m	Total £m
Value of new business	142	2	5	45	–	–	194
Expected existing business contribution	61	281	23	35	(75)	–	325
Operating experience variances	(30)	9	(12)	(23)	–	–	(56)
Operating assumption changes	(3)	65	(107)	36	–	–	(9)
Other operating variances	11	8	(5)	13	–	–	27
Development costs	(36)	(6)	(6)	(2)	–	–	(50)
Covered business operating profit/(loss) before tax	145	359	(102)	104	(75)	–	431
Other income and charges(i)	–	–	–	–	–	(49)	(49)
Operating profit/(loss) before tax	145	359	(102)	104	(75)	(49)	382
Economic variances	117	342	(19)	17	(304)	1	154
Other non-operating items	23	(162)	1	(4)	–	–	(142)
Profit/(loss) before tax	285	539	(120)	117	(379)	(48)	394
Attributed tax on operating result	(35)	(88)	23	(24)	18	(14)	(120)
Attributed tax on other activities	(34)	(43)	2	(3)	76	(4)	(6)
Profit/(loss) after tax	216	408	(95)	90	(285)	(66)	268

(i) Other income and charges were previously disclosed separately for those arising within FLG (£(21) million) and those arising within the RSL holding companies (£(28) million). Following the simplification of the governance structure these are now shown as a single item. The 31 December 2012 comparative has been updated accordingly.

UK covered business

The life and pensions covered business operating profit before tax for the UK segment was £211 million (2012: £145 million).

Value of new business
Further details of the calculation and analysis of the value of new business ("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 immediate annuity business only, an illiquidity premium equivalent to 75bps (2012: 90bps) 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 £60 million (2012: £61 million) comprises £53 million from applying expected rates of return to the value of in-force of £925 million at the start of the period, and £7 million of expected return on shareholders' net assets. The UK expected contribution on shareholders' net assets of £7 million primarily reflects the return based on the reference rate.

Operating experience variances

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

Operating experience variances totalled £(33) million (2012: £(30) million) and comprise the following elements:

- £(17) million charge from worse than expected persistency experience primarily as a result of the Retail Distribution Review ("RDR"). At 31 December 2012 a provision of £33 million was held to cover adverse persistency experience as a result of the RDR and this has been fully released to partially offset the adverse experience during 2013;
- £(10) million charge from short term expense overrun on the corporate benefits platform as the volume of business gets up to scale;
- £(5) million charge from worse than assumed mortality experience, in particular in the individual protection business; and
- £(1) million net charge from other sources.

Operating assumption changes

Operating assumption changes of £(6) million in the year (2012: £(3) million) comprise:

- £(50) million charge from updating the long-term persistency assumptions for corporate pensions business to reflect recent experience which cannot be attributed to the RDR, including establishing a £35 million provision to cover renegotiation of terms on existing schemes;
- £(9) million charge from strengthening the morbidity assumptions primarily on critical illness business;
- £46 million benefit from an increase in deferred tax assets following a review of assumptions driving the valuation of deferred acquisition expenses; and
- £7 million benefit from reducing the long-term maintenance and investment expense assumptions.

Other operating variances
Other operating variances of £36 million in the year (2012: £11 million) comprise:

- £15 million benefit from lower maintenance expenses from migrating group income protection business to the target platform;
- £8 million benefit from restructuring reinsurance contracts on group protection business;
- £8 million benefit from modelling changes; and
- £5 million benefit from other sources.

Development costs
Development costs of £(30) million (2012: £(36) 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 for the introduction of auto-enrolment; and
- the development of the protection proposition.

Heritage covered business

The life and pensions covered business operating profit before tax for the Heritage segment was £393 million (2012: £359 million).

Value of new business

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The total expected contribution of £211 million (2012: £281 million) comprises £196 million from applying expected rates of return to the value of in-force of £2,267 million at the start of the period, and £15 million of expected return on shareholders' net assets. The Heritage expected contribution on shareholders' net assets of £15 million primarily reflects the return based on the reference rate.

Operating experience variances

Operating experience variances totalled a charge of £(12) million (2012: benefit of £9 million) and comprise the following elements:

- £(16) million charge from actual expenses being higher than long-term expense assumptions, the majority of which relates to costs incurred during the period that will not form part of the ongoing cost base;
- £(6) million charge from persistency experience being worse than anticipated on pensions business partially offset by persistency experience being better than anticipated on unit linked bonds;
- £9 million benefit from better than assumed mortality experience, in particular on the life protection business and long-term care business; and
- £1 million net benefit in respect of changes in statutory and tax provisions in respect of legacy business.

Operating assumption changes

Operating assumption changes of £93 million in the year (2012: £65 million) comprise:

- £46 million benefit from an increase in deferred tax assets following a review of assumptions driving the valuation of deferred acquisition expenses;
- £37 million benefit from an increase in fees payable by certain with-profits funds following a review of fees;
- £35 million benefit reflecting savings on future investment expenses following the recapture of certain asset portfolios by FLI;
- £30 million benefit from a revision of inception and recovery rates on income protection business;
- £13 million benefit from adopting longevity assumptions that assume a shorter expectation of life on annuity business;
- £12 million benefit from updating of mortality assumptions on a small block of legacy protection business to reflect recent experience;
- £(66) million charge from the strengthening of maintenance expense assumptions; and
- £(14) million net charge from updating persistency assumptions reflecting a benefit of £22 million from investment bond business, a charge of £8 million from unitised whole of life business, and the establishment of a £25 million short-term provision to cover anticipated adverse persistency on group pensions business following the introduction of auto-enrolment.

Other operating variances

Other operating variances of £127 million (2012: £8 million) comprise:

- £96 million benefit reflecting the impact of the with-profit annuity reallocation activity;
- £16 million benefit from an increase in deferred tax assets on pensions business following a review of methodology; and
- £15 million other benefits, primarily from various modelling changes.

Development costs

Development costs of £(7) million (2012: £(6) million) relate to costs that are expected to generate future profits which are not captured in the MCEV. These costs relate to a number of small development projects.

FPI covered business

The life and pensions covered business operating profit before tax for the FPI segment was £59 million (2012: £(102) million).

Value of new business

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The expected contribution of £19 million (2012: £23 million) comprises £18 million (2012: £21 million) which reflects the expected return on the opening value of in-force of £515 million at 1 January 2013 (2012: £502 million), and £1 million (2012: £2 million) from the expected return on shareholders' net assets.

Operating experience variances

Operating experience variances of £13 million (2012: £(12) million) comprise:

- £12 million benefit from better than expected persistency experience, primarily on regular savings plans;
- £3 million benefit from mortality experience being better than anticipated; and
- £(2) million charge from other operational elements and other minor variances.

Operating assumption changes

Operating assumption changes of £14 million in the year (2012: £(107) million) comprise:

- £14 million benefit from updating mortality assumptions;
- £4 million net benefit from updating the long-term expense assumptions partially offset by a short-term provision to cover the future costs of the development of the International platform;
- £(7) million charge from updating persistency assumptions principally from an increase in partial withdrawal assumptions; and
- £3 million net change from other assumption changes.

The operating assumption changes of £(107) million in 2012 included the impacts of the FPI strategic review which are not repeated in 2013.

Other operating variances

Other net positive operating variances amounting to £9 million in the year (2012: £(5) million) principally reflect enhancements to models following internal review, including enhancements to the modelling of return of premium guarantees and movements in the cost of non-hedgeable risk.

Development costs

Development costs of £(10) million (2012: £(6) million) primarily relate to the development of the International platform.

Lombard covered business

The life and pensions covered business operating result before tax for the Lombard segment was £(46) million loss (2012: £104 million profit).

Value of new business

Further details of the calculation and analysis of the VNB are discussed in note 6.

Expected existing business contribution

The expected contribution of £33 million (2012: £35 million) reflects the expected return on the opening value of in-force of £535 million at 1 January 2013 (2012: £457 million). The impact of the higher opening value of in-force has been offset by the lower expected rates of return.

Operating experience variances

Operating experience variances of £(25) million (2012: £(23) million) comprise:

- £(18) million charge resulting from persistency experience being worse than anticipated in a number of territories, predominantly Belgium. At 31 December 2012, an £8 million provision was established for short-term adverse persistency experience in the Belgian market and this has been released to partially offset the adverse experience during 2013; and
- £(7) million charge from share-based payments representing the fair value charge of the Lombard long-term incentive plans and other project costs.

Operating assumption changes

Operating assumption changes of £(82) million in the year (2012: £36 million) comprise:

- £(61) million charge from strengthening of the long-term persistency assumptions, primarily in the Belgian market, reflecting recent experience;
- £(22) million charge from updating the long-term per policy expense assumptions following the adverse persistency and new business experience which resulted in a lower number of policies; and
- £1 million benefit from updates to mortality assumptions to reflect experience.

Other operating variances

Other operating variances of £6 million (2012: £13 million) primarily relate to the reduction in cost of non-hedgeable risk resulting from an updated economic capital model.

Development costs

Development costs of £(3) million (2012: £(2) million) relate to the development of new products throughout the year.

Corporate covered business

Corporate includes the external STICS, the external UT2 subordinated debt with associated currency swap, 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 £(75) million (2012: £(75) million) represents the expected interest costs arising on the debt held within the life and pensions covered business. The increase driven by the issuance of the new UT2 subordinated debt in November 2012 has been offset by the change in expected return due to market movements.

Non-covered business

The non-covered business generated an operating loss of £(53) million (2012: £(49) million) which comprises £(32) million of corporate costs, the £(19) million operating result of Sesame Bankhall and the £(2) million operating result of fpb AG, the Group's distributor of German business. The £(19) million operating loss from Sesame Bankhall includes a regulatory fine and a provision that has been set up following a review of past business including pensions transfers.

Economic variances

Economic variances combine the impact of changes to economic assumptions with the investment return variances to expected investment returns over the year. The total economic variances were £412 million (2012: £154 million) and these comprise:

- £354 million as a result of better than expected investment returns on equities which increased the value of future charges, and hence the PVFP, on unit-linked business;
- £318 million due to the narrowing of credit spreads on corporate bonds;
- £94 million tax benefit due to losses brought into value by equity realisations and gilt and bond gains during the year;
- £(210) million from a reduction in value of fixed interest assets which for unit-linked business also reduces the value of future charges.;
- £(71) million from an increase in the market value of debt;
- £(56) million from an increase in inflation assumptions; and
- £(17) million of other minor economic variances.

Other non-operating items

Total other non-operating items of £(143) million (2012: £(142) million) comprise:

- £(59) million of non-recurring project costs within the covered business in respect of Solvency II costs, £10 million incurred during 2013 and an increase of £49 million in the provision for future costs;
- £(59) 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 10);
- £(34) million of non-recurring project costs, net of provision releases, within the covered business in respect of separation and integration of UK and Heritage businesses and financial reporting improvements;
- £(9) million of cost related to the capital optimisation programme;
- £(4) million of costs related to the potential sale of Lombard;
- £31 million benefit from tax related non-operating items including a £38 million benefit on the UK value of in-force business of changing the ultimate corporation tax rate effective from April 2015 from 21% to 20%, following the Chancellor's Budget in March 2013; and
- £(9) million of other non-recurring items.

4. Earnings per share

Basic and operating earnings per share

For the year ended 31 December 2013	2013 Earnings £m	2013 Pence per share	2012 Earnings £m	2012 Pence per share
Profit after tax attributable to ordinary equity holders of the parent	**579**	**40.84**	268	19.26
Add back:				
– Economic variances	**(412)**	**(29.06)**	(154)	(11.07)
– Amortisation of non-covered business intangible assets	**–**	**–**	15	1.08
– Non-recurring items and non-operating variances	**143**	**10.09**	127	9.13
– Tax credit on items excluded from operating profit	**62**	**4.37**	6	0.43
Operating profit after tax attributable to ordinary equity holders of the parent	**372**	**26.24**	262	18.83

Diluted earnings per share from continuing operations

(i) Based on profit after tax attributable to ordinary equity holders of the parent

For the year ended 31 December	2013 Earnings £m	2013 Weighted average number of shares	2013 Pence per share
Profit after tax attributable to ordinary equity holders of the parent	**579**	**1,417,808,590**	**40.84**
Dilutive effect of share awards	**–**	**904,272**	**(0.03)**
Diluted basic earnings per share on profit after tax attributable to ordinary equity holders of the parent	**579**	**1,418,712,862**	**40.81**

(ii) Based on operating profit after tax attributable to ordinary equity holders of the parent

For the year ended 31 December	2013 Earnings £m	2013 Weighted average number of shares	2013 Pence per share
Operating profit after tax attributable to equity ordinary holders of the parent	**372**	**1,417,808,590**	**26.24**
Dilutive effect of share awards	**–**	**904,272**	**(0.02)**
Diluted basic earnings per share on operating profit after tax attributable to ordinary equity holders of the parent	**372**	**1,418,712,862**	**26.22**

There were no dilutive factors for the year ended 31 December 2012.

Weighted average number of ordinary shares

For the year ended 31 December 2013	Actual	Weighted
Issued ordinary shares at beginning of period	**1,418,109,028**	**1,418,109,028**
Effect of:		
– purchase of own shares held	**(600,877)**	**(300,438)**
Number of ordinary shares at end of period	**1,417,508,151**	**1,417,808,590**

For the year ended 31 December 2012	Actual	Weighted
Issued ordinary shares at beginning of period	1,376,188,989	1,376,188,989
Own shares held by the Group at beginning of period	(2,661,384)	(2,661,384)
Effect of:		
– scrip dividend (final 2011)	15,484,945	9,477,125
– scrip dividend (interim 2012)	26,435,094	6,283,752
– reduction in own shares held by the Group	2,661,384	1,999,674
Number of ordinary shares at end of period	1,418,109,028	1,391,288,156

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:

	2013 £m	2012 £m
Equity attributable to ordinary shareholders on an IFRS basis	**5,229**	5,377
Less items only included on an IFRS basis (net of tax):		
– IFRS reserving and other IFRS adjustments	**540**	(32)
– Deferred front end fees	**58**	47
– Deferred acquisition costs	**(795)**	(708)
– Acquired present value of in-force	**(2,933)**	(3,159)
– Other intangible assets	**(186)**	(246)
Add items only included on a MCEV basis (net of tax):		
– Adjustment for long-term debt to market value	**(217)**	310
Net worth on a MCEV basis	**1,696**	1,589
Value of in-force covered business	**4,369**	4,242
Equity attributable to ordinary shareholders on a MCEV basis	**6,065**	5,831

6. New business

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

New business volumes have been shown using two measures:

- Present Value of New Business Premiums ("PVNBP") 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") is calculated as the new regular premium per annum plus 10% of single premiums.

The MCEV new business definition is consistent with the quarterly new business disclosures.

The premium volumes and projection assumptions used to calculate the present value of regular premiums within PVNBP are the same as those used to calculate the value of new business.

The value of new business is calculated using economic assumptions at the beginning of the period for all products except immediate annuities.

For annuity business, as the contribution is sensitive to the interest rate at outset, the appropriate rate for each month's new business is used. In addition for Retirement Income the investment strategy for new annuity business targets assets with higher illiquidity premiums. The illiquidity premium assumption within the value of new business is also recalculated monthly and over the year has ranged from 65 bps to 85 bps.

The value of new business is calculated using operating assumptions at the end of the period for all products. The operating assumptions are consistent with those used to determine the embedded value.

For Corporate Benefits new business the maintenance expenses within the value of new business reflect:

- the level of maintenance expense expected to be incurred once the Corporate Benefits platform has reached anticipated scale in 2016. Any short term expense overruns are shown in operating experience variance. In 2013 this short term overrun was £10 million; and
- the marginal maintenance expense for new members to existing growing schemes, given scheme costs were included in the value of new business when the scheme was originally set up.

For corporate benefit schemes, the value of new business assumes no salary inflation and does not anticipate any benefit from future increments as a result of increases in the statutory minimum contribution levels on auto-enrolment business, which rise from 2% to 8% by 2018.

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.

New business value

Year ended 31 December 2013	**New business premiums Single £m**	**New business premiums Regular £m**	**APE £m**	**Average annual premium multiplier(i)**	**PVNBP £m**	**Post-tax VNB £m**	**Pre-tax VNB £m**	**New business margin %**
UK Corporate Benefits	**542**	**520**	**574**	**4.3**	**2,799**	**20**	**26**	**0.9**
UK Protection	**–**	**84**	**84**	**7.4**	**623**	**57**	**75**	**12.0**
UK Retirement Income	**664**	**–**	**66**	**–**	**664**	**63**	**83**	**12.5**
UK total	**1,206**	**604**	**724**	**4.8**	**4,086**	**140**	**184**	**4.5**
Heritage	**189**	**35**	**54**	**4.6**	**351**	**(14)**	**(19)**	**(5.4)**
FPI	**607**	**80**	**141**	**5.0**	**1,007**	**16**	**14**	**1.4**
Lombard	**1,983**	**–**	**198**	**–**	**1,983**	**19**	**25**	**1.3**
Total	**3,985**	**719**	**1,117**	**4.8**	**7,427**	**161**	**204**	**2.7**

Year ended 31 December 2012	New business premiums Single £m	New business premiums Regular £m	APE £m	Average annual premium multiplier(i)	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
UK Corporate Benefits	844	451	535	4.1	2,714	16	21	0.8
UK Protection	–	90	90	6.6	590	47	62	10.5
UK Retirement Income(ii)	436	–	44	–	436	44	59	13.5
UK total	1,280	541	669	4.5	3,740	107	142	3.8
Heritage	550	47	102	4.9	780	2	2	0.3
FPI	633	139	202	4.9	1,315	8	5	0.4
Lombard	2,376	–	238	–	2,376	35	45	1.9
Total	4,839	727	1,211	4.6	8,211	152	194	2.4

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums) this is shown as zero for UK Retirement Income and Lombard as these businesses have only single premium business therefore PVNBP is the same as the premiums received in the period.

(ii) The value of new business for annuities shown in the table above has been valued assuming an illiquidity premium of 90bps from 1 January 2012 to 30 June 2012 and 80bps from 1 July 2012 to 31 December 2012 and over 2013 has ranged from 65bps to 85bps.

UK

The VNB from the UK segment was £184 million (2012: £142 million), comprising:

- UK Corporate Benefits VNB of £26 million (2012: £21 million), reflecting higher volumes of business and the benefits of the migration to target platforms with the associated longer term lower maintenance costs once the platform has reached anticipated scale;
- UK Protection VNB of £75 million (2012: £62 million), driven by improved margins on lower volumes in 2013. The margins have improved following migration to the lower cost strategic platforms and the benefit from restructuring reinsurance contracts; and
- UK Retirement Income VNB of £83 million (2012: £59 million), driven by a significant increase in the volume of business written.

Heritage
Heritage VNB of £(19) million (2012: £2 million), reflects the fact that Heritage now only writes increments to products no longer actively marketed, where VNB is negative. The 2012 VNB included £13 million in respect of Department of Work and Pensions rebate premiums, which are no longer received.

FPI
FPI VNB was £14 million (2012: £5 million), comprising;

- Core VNB of £21 million (2012: £17 million), reflecting improved margins on lower volumes, particularly following favourable expense and mortality assumption changes; and
- Non-core VNB of £(7) million (2012: £(12) million), reflecting the closure of business in non-core markets and lower volumes following the sale of the Group's 30% stake in AmLife.

Lombard
Lombard VNB was £25 million (2012: £45 million); reflecting a reduction in volumes and the strengthening of the basis assumptions following a review of recent experience.

New business performance metrics
New business written requires an initial capital investment to meet the set-up costs and capital requirements.

The internal rate of return ("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 Lombard IRR (and therefore the blended Group IRR) takes account of the Luxembourg regulatory regime in which DAC is an allowable asset.

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.

New business key performance metrics

	2013			2012		
	Pre-tax value of new business £m	**Internal rate of return on new business %**	**Cash payback on new business Years**	Pre-tax value of new business £m	Internal rate of return on new business %	Cash payback on new business Years
Corporate Benefits	**26**	**8.4**	**11**	21	7.2	12
Protection	**75**	**13.8**	**7**	62	13.8	6
Retirement Income	**83**	**>25.0**	**2**	59	n/a(i)	n/a(i)
UK total	**184**	**15.3**	**7**	142	13.3	8
Heritage	**(19)**	**(1.9)**	**n/a**	2	4.6	14
FPI	**14**	**6.4**	**10**	5	5.4	12
Lombard	**25**	**13.3**	**8**	45	22.5	5
Total	**204**	**11.2**	**9**	194	10.4	9

(i) Strong new business margin in 2012 meant the initial capital invested in writing Retirement Income new business was fully recouped by the single premium paid. This also means that an IRR for this business was not relevant.

The Group new business IRR was 11.2% (2012: 10.4%) and the payback period on new business was 9 years (2012: 9 years). These metrics include positive movements for UK and FPI, offset by adverse movements for Heritage and Lombard.

The increase in UK reflects an increase in volumes of business from Retirement Income, and also higher Corporate Benefits IRR where lower acquisition and maintenance costs more than offset the reduced margins and lower assumed investment returns. The stable Protection IRR reflects the offsetting effects of lower volumes and lower acquisition costs, which also slightly increased the payback period. The Retirement Income IRR remains high but has reduced from 2012 reflecting the competitive pricing undertaken in 2013.

The Heritage IRR and payback period reflect the fact that the new business written in Heritage focuses on increments to products no longer actively marketed. The associated investment in new business is not expected to be recouped and hence results in a negative IRR. In 2012 the metrics included the benefits of Department of Work and Pensions rebate premiums.

The FPI IRR has increased reflecting the actions taken following the strategic review in 2012, which reduced the proportion of new business received from the less profitable non-core business.

The Lombard IRR has reduced significantly reflecting the combination of reduced volumes and relatively fixed acquisition costs.

The Group new business IRR does not include the impact of the with-profit annuity reallocation activity. If this activity, which represents a discretionary use of capital for the purposes of generating returns, was to be included within the IRR, then the Group IRR would increase to 15.3%.

7. Segmental analysis of Group MCEV

	2013									2012
	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	**16**	**369**	**385**	**1,121**	**–**	**(29)**	**(59)**	**1,033**	**1,418**	1,227
Heritage	**590**	**1,174**	**1,764**	**2,615**	**(114)**	**(80)**	**(119)**	**2,302**	**4,066**	4,080
FPI	**58**	**26**	**84**	**547**	**–**	**(3)**	**(25)**	**519**	**603**	612
Lombard	**–**	**83**	**83**	**544**	**–**	**(4)**	**(25)**	**515**	**598**	615
Corporate(i)										
– IFA and distribution	**41**	**–**	**41**	**–**	**–**	**–**	**–**	**–**	**41**	39
– Pension deficit of FPPS	**(18)**	**–**	**(18)**	**–**	**–**	**–**	**–**	**–**	**(18)**	38
– Other(ii)	**988**	**(8)**	**980**	**–**	**–**	**–**	**–**	**–**	**980**	816
Gross Group MCEV(iii)	**1,675**	**1,644**	**3,319**	**4,827**	**(114)**	**(116)**	**(228)**	**4,369**	**7,688**	7,427
Corporate– external STICS	**–**	**(478)**	**(478)**	**–**	**–**	**–**	**–**	**–**	**(478)**	(443)
Corporate– external debt(iv)	**–**	**(1,145)**	**(1,145)**	**–**	**–**	**–**	**–**	**–**	**(1,145)**	(1,153)
Net Group MCEV	**1,675**	**21**	**1,696**	**4,827**	**(114)**	**(116)**	**(228)**	**4,369**	**6,065**	5,831

(i) Corporate excludes external STICS, the external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022.
(ii) Other includes £164 million (2012: £133 million) in respect of the Resolution holding companies.
(iii) For the purposes of this table "Gross" refers to the MCEV gross of the clean market value of the external STICS, the external UT2 subordinated debt with associated currency swap, 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 Corporate.
(iv) The Corporate external debt comprises: the external LT2 subordinated debt 2021; the external LT2 subordinated debt 2022; and the external UT2 subordinated debt with associated currency swap.

i) Required capital

Each life company within the Group has an individual capital management policy which, whilst aligned to Group policies, will take account of local regulatory requirements. All the life companies in the Group meet their individual capital management policies.

Required capital within MCEV is calculated and allocated to business units based on the Group's capital management policy of holding 150% of the Group CRR (excluding WPICC) even where this allocation is in excess of local capital management policies. In practice the extra required capital held to meet the Group's capital management policy can be covered by any of the companies within the Group.

The external STICS, external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are included within the MCEV at market value, as detailed in note 10.

ii) PVFP

The PVFP at 31 December 2013 includes a £27 million net of tax (2012: nil) deduction in respect of anticipated adverse persistency on corporate pensions business in the UK segment to cover renegotiation of terms on existing schemes, and a £19 million net of tax (2012: nil) deduction in respect of anticipated short term adverse persistency on group pensions business in the Heritage segment following the introduction of auto-enrolment.

At 31 December 2012 provisions of £25 million net of tax and £9 million net of tax were held in UK and Lombard respectively against short term adverse persistency experience. Both these provisions have been released against the actual experience in 2013 and no additional provisions are held at 31 December 2013.

iii) TVOG

The TVOG at 31 December 2013 of £114 million (2012: £126 million), is split between £79 million (2012: £90 million) market risk and £35 million (2012: £36 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 (2012: 150%). The cost of holding any additional capital is shown in the FLG covered business segment. At 31 December 2013 no additional capital was required to meet the Group capital management policy and hence no additional cost was required.

v) CNHR

The cost of residual non-hedgeable risk of £228 million (2012: £222 million) is presented as an equivalent annual cost of capital charge of 1.2% (2012: 1.5%) 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 comprising the MCEV earnings for the life and pensions covered business and the IFRS earnings for the non-covered businesses.

All figures are shown net of attributed tax.

	Covered business						
Year ended 31 December 2013	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Non-covered business £m**	**Total £m**
Opening Group MCEV	**1,227**	**4,080**	**612**	**615**	**(1,611)**	**908**	**5,831**
Opening adjustments:							
– disposal of AmLife	**–**	**–**	**(43)**	**–**	**–**	**50**	**7**
Adjusted opening Group MCEV	**1,227**	**4,080**	**569**	**615**	**(1,611)**	**958**	**5,838**
Operating MCEV earnings	**162**	**295**	**58**	**(36)**	**(57)**	**(50)**	**372**
Non-operating MCEV earnings	**37**	**137**	**3**	**8**	**(55)**	**77**	**207**
Total Group MCEV earnings	**199**	**432**	**61**	**(28)**	**(112)**	**27**	**579**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**–**	**(77)**	**(77)**
Closing adjustments:							
– capital and dividend flows	**(8)**	**(446)**	**(27)**	**(5)**	**92**	**103**	**(291)**
– foreign exchange variances	**–**	**–**	**–**	**16**	**–**	**–**	**16**
Closing Group MCEV	**1,418**	**4,066**	**603**	**598**	**(1,631)**	**1,011**	**6,065**

	Covered business						
Year ended 31 December 2012	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Non-covered business £m	Total £m
Opening Group MCEV	1,011	4,330	571	541	(1,041)	384	5,796
Operating MCEV earnings	110	271	(79)	80	(57)	(63)	262
Non-operating MCEV earnings	106	137	(16)	10	(228)	(3)	6
Total Group MCEV earnings	216	408	(95)	90	(285)	(66)	268
Other movements in IFRS net equity	–	–	–	–	–	(28)	(28)
Closing adjustments:							
– capital and dividend flows	–	(658)	136	–	(285)	618	(189)
– foreign exchange variances	–	–	–	(16)	–	–	(16)
Closing Group MCEV	1,227	4,080	612	615	(1,611)	908	5,831

9. Maturity profile of value of in-force business by proposition

		Years								
At 31 December 2013	**Total £m**	**1–5 £m**	**6–10 £m**	**11–15 £m**	**16–20 £m**	**21–25 £m**	**26–30 £m**	**31–35 £m**	**36–40 £m**	**41+ £m**
Corporate Benefits	**708**	**277**	**192**	**126**	**66**	**31**	**12**	**3**	**1**	**–**
Protection	**238**	**92**	**49**	**39**	**29**	**17**	**8**	**3**	**1**	**–**
Retirement Income	**87**	**8**	**9**	**12**	**15**	**16**	**13**	**8**	**4**	**2**
UK	**1,033**	**377**	**250**	**177**	**110**	**64**	**33**	**14**	**6**	**2**
Heritage	**2,302**	**1,107**	**505**	**313**	**186**	**96**	**51**	**25**	**11**	**8**
FPI	**519**	**261**	**131**	**70**	**34**	**12**	**5**	**3**	**3**	**–**
Lombard	**515**	**203**	**123**	**77**	**46**	**28**	**17**	**10**	**6**	**5**
Total VIF	**4,369**	**1,948**	**1,009**	**637**	**376**	**200**	**106**	**52**	**26**	**15**

10. MCEV assumptions

10.1 Economic assumptions – deterministic calculations

Economic assumptions are derived actively, based on market yields on risk-free fixed interest assets at the end of each reporting period.

Reference rates – risk free

The risk free reference rate is determined with reference to the swap yield curve appropriate to the currency of the cash flows. For some business types, where the impact on the VIF is small, a long-term risk free reference rate has been used.

For annuity business the swap yield curve is extrapolated where necessary, assuming the last observable forward rate is constant thereafter, to provide rates appropriate to the duration of the liabilities.

No adjustment has been made to the reference rate for current sovereign debt market conditions because the exposure of the Group to such debt is minimal.

	Reference rate – risk free	
	2013 %	2012 %
UK and Heritage		
Long-term rate	**3.10**	1.90
Swap yield curve		
– Term 1 year	**0.71**	0.67
– Term 5 years	**2.18**	1.03
– Term 10 years	**3.11**	1.93
– Term 15 years	**3.48**	2.58
– Term 20 years	**3.58**	2.94
FPI long-term rate	**3.10**	1.90
Lombard long-term rate	**2.62**	2.13

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 and Heritage 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. Two of the main approaches being commonly used to determine the illiquidity premium within the life insurance industry are:

- 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 and some deferred annuity business.

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

Investment strategy for annuity new business targets assets with higher illiquidity premiums than the back book portfolio. Given the contribution to new business is sensitive to the interest rate and illiquidity premium at outset, an appropriate rate for each month’s new business is used.

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

	Embedded value		New business	
	2013	2012	**2013**	2012
UK and Heritage immediate annuities	**60bps**	75bps	**65-85bps**	80-90bps

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 (2012: 3%) and 2% for property (2012: 2%).

For cash and government bonds no excess over the one-year risk free reference rate has been assumed for UK, Heritage or FPI. Lombard assumes the long-term rate is achieved. 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 UK, Heritage and FPI. For Lombard the corporate bond return is derived using the long-term rate plus a risk premium of 1% (2012: 1%).

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, Heritage and FPI business are assumed to increase in the future at a rate of 1% (2012: 1%) per annum in excess of the assumed long-term rate of inflation. Long-term inflation assumptions are set relative to gilt curves at appropriate durations.

Maintenance expenses for Lombard are assumed to increase in the future at a rate of 0.75% (2012: 0.75%) per annum in excess of the assumed long-term rate of inflation. This is derived from an inflation swap curve based on a Eurozone price index taking into account the run-off profile of the business.

	Expense inflation	
	2013 %	2012 %
UK	**4.30**	3.70
Heritage	**4.30**	3.70
FPI	**4.30**	3.70
Lombard	**2.75**	3.00

Exchange rates
The results and cash flows of all businesses, except Lombard, are calculated in Sterling. The results and cash flows for Lombard are calculated in Euros and converted to Sterling at the following rates:

	Exchange rates	
	2013	2012
Closing exchange rate	**0.832**	0.811
Average exchange rate	**0.847**	0.813

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:

- Friends Life FP With-Profits Fund ("FP WPF")
- Friends Life FLAS With-Profits Fund ("FLAS WPF")
- Friends Life FLC Old With-Profits Fund ("FLC Old WPF")
- Friends Life FLC New With-Profits Fund ("FLC New WPF")
- Friends Life WL With-Profits Fund ("WL WPF")
- The distribution is at the current rate of one-ninth of the cost of bonus with the following exceptions:
- Within the FP WPF it is assumed that the shareholder interest in the pre-demutualisation non-profit and unitised business (excluding the investment element) continues at the current rate of 60% of future profits;
- For certain policies in FLC with-profits funds with guaranteed bonus rates shareholders do not receive one ninth of guaranteed bonuses; and
- Where elements of the non-profit fund policies are invested in the WL with-profits fund, the shareholder receives the management charges in the non-profit fund for these.

Following the Part VII transfer of business from FLC to FLL, the requirement to retain the FLC reattributed inherited estate ("RIE") to support FLC Old WPF and FLC New WPF along with other previously existing with-profit fund support arrangements have been incorporated into one FLL Scheme effective from 28 December 2012.

The FLL Scheme rules require that a test be undertaken every five years to determine the level of shareholder capital support required for FLC Old WPF and FLC New WPF. The test also determines whether it is possible to distribute any of the inherited estate retained in the FLC Old WPF in the form of Special Bonuses (and associated transfer to the shareholders' fund). The latest five yearly test was undertaken as at 31 December 2010.

The remaining RIE in the FLL NPF is predominantly in the form of the VIF of non-profit business written within the fund. To the extent that this VIF emerges into cash during the period 31 December 2013 to the next five year test date at 31 December 2015, the cash may be available to be transferred to the FLL shareholders' fund subject to passing the relevant financial strength tests. The MCEV allows for best estimate projections of the amounts to be transferred in future.

10.2 Economic assumptions – stochastic calculations

Model
The time value of financial options and guarantees and the OLAB return of premium guarantee are determined using a Barrie & Hibbert economic scenario generator and are calculated using 2,000 simulations. The with-profits 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. The OLAB return of premium guarantee model is calibrated to market conditions at the valuation date using a Euro swap curve and implied volatilities in the market. Correlations between the asset classes are derived from historic data.

Swaption implied volatilities – with-profits time value of financial options and guarantees

Option term	**2013 Swap term**				2012 Swap term			
	10 yrs %	**15 yrs %**	**20 yrs %**	**25 yrs %**	10 yrs %	15 yrs %	20 yrs %	25 yrs %
UK Sterling								
10 years	**18**	**17**	**16**	**15**	18	17	16	15
15 years	**19**	**18**	**17**	**16**	18	17	16	16
20 years	**17**	**16**	**15**	**14**	16	16	15	15
25 years	**16**	**15**	**14**	**13**	16	16	16	15

Swaption implied volatilities – OLAB return of premium guarantee

Option term	2013 Swap term				2012 Swap term			
	10 yrs %	**15 yrs %**	**20 yrs %**	**30 yrs %**	10 yrs %	15 yrs %	20 yrs %	30 yrs %
Euro								
10 years	**23**	**22**	**21**	**20**	24	24	23	20
15 years	**25**	**23**	**22**	**20**	27	26	24	20
20 years	**22**	**20**	**19**	**18**	26	24	21	17
25 years	**21**	**19**	**18**	**16**	23	20	18	15

Equity and property implied volatilities – with-profits time value of financial options and guarantees

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% (2012: 15%) and a running yield of 4.3% (2012: 4.3%). Sample implied volatilities are shown in the table below.

Option term	**2013**		2012	
	Equity %	**Property %**	Equity %	Property %
5 years	**19**	**15**	24	15
10 years	**22**	**15**	26	15
15 years	**24**	**15**	27	15

Equity implied volatilities – OLAB return of premium guarantee

Equity volatility is calibrated to put options on the EUROSTOXX50 index as an objective measure of market implied volatility. Sample implied "at-the-money" volatilities are shown in the table below.

Option term	**2013**	2012
	Equity %	Equity %
5 years	**20**	25
10 years	**21**	25
15 years	**21**	25

10.3 Other assumptions

Required capital

Required capital under MCEV amounted to £21 million (2012: £40 million). The required capital is shown net of £1,631 million (2012 £1,611 million) representing the market value of the external debt.

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 ICA plus ICG. In addition the Group's capital management policy is to hold 150% of Group CRR excluding WPICC, and any cost of holding this additional capital is shown within the Corporate covered business segment. These policies are unchanged from 2012. At 31 December 2013 no additional capital, and hence no cost of additional capital was included within the Corporate covered business segment (2012: nil).

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 and Luxembourg. Deferred tax is provided on the mark-to-market revaluation of the external STICS, external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 allocated to the life and pensions covered business within Corporate. For UK, Heritage 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 2013 reflects the reduction in corporation tax that took effect from April 2013.

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

	Tax rates	
	2013 %	2012 %
UK	**23.25**	24.5
Heritage	**23.25**	24.5
FPI		
– OLAB (UK)	**23.25**	24.5
– FPIL (Isle of Man)	**0.0**	0.0
Lombard	**22.5**	22.5

The PVFP for UK, Heritage 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 subsequent Budgets. The MCEV allows for anticipated future annual reductions in corporation tax from 23% to 20% over the period to 2015 (2012: 24% to 21% over the period to 2014) and for an ultimate rate of 20% from April 2015 (2012: 21% from April 2014).

Legislation in respect of the new life tax regime was included in Finance Act 2012, which received Royal Assent on 17 July 2012. The new life tax regime took effect from 1 January 2013 and a best estimate of its effect is therefore included in MCEV, being a forward-looking measure. There remains an element of risk and uncertainty in estimating its effects given that the legislation is newly introduced therefore the outcomes may be subject to change as a result of either legislative update or by development in interpretation.

VAT in the UK of 20.0% (2012: 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 came into effect from 1 January 2013 and a £33 million provision (gross of tax) was held at 31 December 2012, to cover negative variances expected on initial commission business written pre-RDR in 2012 where long-term assumptions were expected to be temporarily inadequate. Following the release of £33 million against adverse experience in the UK segment in 2013, no provision for this business is held at 31 December 2013.

A provision of £35 million (gross of tax) is held at 31 December 2013 in respect of anticipated adverse persistency on corporate pensions business in the UK segment to cover renegotiation of terms on existing schemes, and a provision of £25 million (gross of tax) is held to cover anticipated short term adverse persistency on group pensions business in the Heritage segment following the implementation of auto-enrolment.

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 (2012: 1.25%).

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. For new corporate benefit schemes, the value of new business and value of in force reflect the anticipated maintenance expenses once the level of business on the corporate benefit platform has reached anticipated scale in 2016. Whilst the business reaches scale any temporary expense overrun will be reflected in operating experience variance.

At 31 December 2012 a £2 million deduction to PVFP was made to reflect a short-term expense overrun in 2013 for Lombard. There is no deduction at 31 December 2013, and the maintenance expense assumptions reflect the ongoing expense levels required to manage the Lombard in-force business.

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. 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 costs, which result in an overall expense overrun in FLSL.

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. Allowance was made in 2011 for the initial significant development expenditure, with the establishment of a specific provision. In 2013, initial development costs of £(87) million have been incurred in relation to the Diligenta arrangement which have been partially offset by a £28 million utilisation of the remaining £92 million provision. The net cost of £(59) 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 £50 million (2012: £50 million) have been excluded from the calculation of unit costs and have been recognised in operating profits. Development costs relate to investment in activities expected to create value in the future, but where that expected value cannot be anticipated within the current period's financial results until the value is realised.

Development costs

	2013 £m	2012 £m
UK	**30**	36
Heritage	**7**	6
FPI	**10**	6
Lombard	**3**	2
Total	**50**	50

Non-hedgeable risks
A charge equivalent to 1.2% (2012: 1.5%) 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 UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are included within the MCEV at market value, based on listed ask price.

At 31 December 2013	**Principal £m**	**Clean market value of debt £m**	**Accrued interest £m**	**Tax adjustment on market valuation £m**	**Value of debt included in Corporate(i) £m**
STICS 2003	**210**	**210**	**2**	**(1)**	**211**
STICS 2005	**268**	**268**	**8**	**(3)**	**273**
LT2 subordinated debt 2021	**162**	**210**	**12**	**(14)**	**208**
LT2 subordinated debt 2022	**500**	**550**	**29**	**(19)**	**560**
UT2 subordinated debt(ii)	**356**	**378**	**4**	**(8)**	**374**
Currency swap	**–**	**7**	**–**	**(2)**	**5**
Total	**1,496**	**1,623**	**55**	**(47)**	**1,631**

At 31 December 2012	Principal £m	Clean market value of debt £m	Accrued interest £m	Tax adjustment on market valuation £m	Value of debt included in Corporate(i) £m
STICS 2003	210	193	2	4	199
STICS 2005	268	250	8	1	259
LT2 subordinated debt 2021	162	215	12	(16)	211
LT2 subordinated debt 2022	500	554	29	(21)	562
UT2 subordinated debt(ii)	356	378	4	(8)	374
Currency swap	–	6	–	–	6
Total	1,496	1,596	55	(40)	1,611

(i) The value of debt included in the corporate category is the market value of debt, including accrued interest, and the tax asset/liability on the market value adjustment.
(ii) The UT2 subordinated debt was issued in US Dollars with principal of $575 million, equivalent to £356 million at issue in November 2012.

The deferred consideration notes, issued in September 2010 in connection with the acquisition of the AXA UK Life Business, were repaid on 20 November 2012.

11. Sensitivity analysis

The following tables show the sensitivity of the embedded value and the value of new business to changes in assumptions. The sensitivities below apply to covered business only and include the impact on both shareholder net worth and VIF.

For each sensitivity, the other future experience assumptions remain unchanged, except where changes in economic assumptions directly affect them. Any changes in the assumptions underlying the statutory reserving calculations have no material impact on the MCEV sensitivities shown. For Heritage, Lombard and UK businesses statutory assumptions have not been changed in applying the MCEV sensitivities, but for FPI the statutory assumptions have been changed to fit with regulatory requirements. There are no additional management actions or changes in policyholder behaviour assumed within any of the sensitivities.

Sensitivities shown in a single direction have broadly symmetrical impacts.

At 31 December 2013 Change in MCEV (net of tax)	Covered business UK £m	 Heritage £m	 UK & Heritage £m	 FPI £m	 Lombard £m	 Corporate £m	 Total £m
Base MCEV	**1,418**	**4,066**	**5,484**	**603**	**598**	**(1,631)**	**5,054**
Market risk							
100bps increase in reference rates	**(21)**	**(90)**	**(111)**	**27**	**(2)**	**109**	**23**
100bps decrease in reference rates	**20**	**118**	**138**	**(32)**	**–**	**(124)**	**(18)**
Removal of illiquidity premium for immediate annuities	**(118)**	**(399)**	**(517)**	**–**	**–**	**–**	**(517)**
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield	**(48)**	**(149)**	**(197)**	**(26)**	**(36)**	**–**	**(259)**
25% increase in equity/property volatility at the valuation date	**–**	**(12)**	**(12)**	**(18)**	**–**	**–**	**(30)**
25% increase in swaption implied volatility at the valuation date	**–**	**(4)**	**(4)**	**–**	**–**	**–**	**(4)**
100bp increase in corporate bond spreads[(i)]	**(72)**	**(286)**	**(358)**	**–**	**(9)**	**109**	**(258)**
100bp decrease in corporate bond spreads[(i)]	**77**	**274**	**351**	**–**	**9**	**(124)**	**236**
10% adverse movement in Sterling/overseas exchange rate[(ii)]	**(7)**	**(25)**	**(32)**	**(26)**	**(52)**	**–**	**(110)**
10% fall in value of unit linked funds	**(62)**	**(212)**	**(274)**	**(31)**	**(63)**	**–**	**(368)**
100bps increase in expense inflation	**(30)**	**(81)**	**(111)**	**(22)**	**(9)**	**–**	**(142)**
100bps decrease in expense inflation	**26**	**70**	**96**	**18**	**7**	**–**	**121**
Insurance and other risk							
Reduction to EU minimum capital or equivalent[(iii)]	**9**	**42**	**51**	**–**	**–**	**–**	**51**
10% decrease in maintenance expenses	**30**	**59**	**89**	**29**	**16**	**–**	**134**
10% proportionate decrease in lapse rates	**36**	**58**	**94**	**8**	**37**	**–**	**139**
10% proportionate decrease in PUP rates	**9**	**1**	**10**	**4**	**–**	**–**	**14**
5% decrease in mortality/morbidity – life assurance							
– Before reinsurance	**27**	**47**	**74**	**9**	**3**	**–**	**86**
– After reinsurance	**12**	**16**	**28**	**6**	**2**	**–**	**36**
5% decrease in mortality/morbidity – annuity business							
– Before reinsurance	**(17)**	**(129)**	**(146)**	**–**	**–**	**–**	**(146)**
– After reinsurance	**(17)**	**(51)**	**(68)**	**–**	**–**	**–**	**(68)**

At 31 December 2012 Change in MCEV (net of tax)	Covered business UK & Heritage[iv] £m	 FPI[v] £m	 Lombard £m	 Corporate £m	 Total £m
Base MCEV	5,307	612	615	(1,611)	4,923
Market risk					
100bps increase in reference rates	(160)	(3)	–	107	(56)
100bps decrease in reference rates	156	19	(4)	(119)	52
Removal of illiquidity premium for immediate annuities	(544)	–	–	–	(544)
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield	(181)	(23)	(37)	–	(241)
25% increase in equity/property volatility at the valuation date	(32)	–	–	–	(32)
25% increase in swaption implied volatility at the valuation date	(4)	–	–	–	(4)
100bp increase in corporate bond spreads[i]	(310)	–	(11)	107	(214)
100bp decrease in corporate bond spreads[i]	380	–	11	(119)	272
10% adverse movement in Sterling/overseas exchange rate[ii]	(30)	(39)	(53)	–	(122)
10% fall in value of unit linked funds	(207)	(27)	(69)	–	(303)
100bp increase in expense inflation	(65)	(24)	(15)	–	(104)
100bp decrease in expense inflation	57	20	12	–	89
Insurance and other risk					
Reduction to EU minimum capital or equivalent[iii]	40	–	–	–	40
10% decrease in maintenance expenses	109	31	19	–	159
10% proportionate decrease in lapse rates	83	12	37	–	132
10% proportionate decrease in PUP rates	13	12	–	–	25
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	79	9	3	–	91
– After reinsurance	38	6	2	–	46
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	(132)	–	–	–	(132)
– After reinsurance	(67)	–	–	–	(67)

(i) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 40bps (2012: 40bps) for in-force business and 40bps (2012: 40 bps) for the value of new business.
(ii) Currency risk is expressed in terms of total overseas exposure; the Group's principal currency exposures other than sterling are the Euro and US Dollar.
(iii) Required capital is set at the greater of regulatory capital and requirements arising from internal capital management policies. In aggregate, the required capital is higher than the regulatory requirement by £812 million (2012: £886 million). This sensitivity shows the impact on embedded value and value of new business of using the lower regulatory capital requirement.
(iv) Comparative figures for splits to the UK and Heritage operating segments for the year ended 31 December 2012 are not available and the costs to develop them would be excessive.
(v) The 2012 FPI embedded value included £43 million in respect of AmLife. This was sold on 4 January 2013 and consequently there is no sensitivity included in respect of AmLife in 2012.

At 31 December 2013 Change in value of new business (gross of tax)	Covered business UK £m	Heritage £m	UK & Heritage £m	FPI £m	Lombard £m	Total £m
Base value of new business	**184**	**(19)**	**165**	**14**	**25**	**204**
Market risk						
100bps increase in reference rates	**(3)**	**–**	**(3)**	**–**	**–**	**(3)**
100bps decrease in reference rates	**1**	**–**	**1**	**2**	**–**	**3**
Removal of illiquidity premium for immediate annuities	**(44)**	**–**	**(44)**	**–**	**–**	**(44)**
100bps increase in corporate bond spreads(i)	**(18)**	**–**	**(18)**	**–**	**–**	**(18)**
100bps decrease in corporate bond spreads(i)	**19**	**–**	**19**	**–**	**–**	**19**
100bps increase in expense inflation	**(7)**	**–**	**(7)**	**–**	**–**	**(7)**
100bps decrease in expense inflation	**5**	**–**	**5**	**–**	**–**	**5**
Insurance and other risk						
Reduction to EU minimum capital or equivalent	**2**	**–**	**2**	**–**	**–**	**2**
10% decrease in maintenance expenses	**8**	**–**	**8**	**2**	**2**	**12**
10% proportionate decrease in lapse rates	**14**	**–**	**14**	**1**	**4**	**19**
10% proportionate decrease in PUP rates	**5**	**–**	**5**	**1**	**–**	**6**
5% decrease in mortality/morbidity – life assurance						
– Before reinsurance	**8**	**–**	**8**	**–**	**–**	**8**
– After reinsurance	**3**	**–**	**3**	**–**	**–**	**3**
5% decrease in mortality/morbidity – annuity business						
– Before reinsurance	**(3)**	**–**	**(3)**	**–**	**–**	**(3)**
– After reinsurance	**(5)**	**–**	**(5)**	**–**	**–**	**(5)**
Impact of end of period assumptions on VNB	**(11)**	**–**	**(11)**	**(2)**	**(1)**	**(14)**

(i) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 40bps (2012: 40bps) for in-force business and 40bps (2012: 40bps) for the value of new business.

At 31 December 2012 Change in value of new business (gross of tax)	Covered business UK & Heritage(ii) £m	 FPI £m	 Lombard £m	 Total £m
Base value of new business	144	5	45	194
Market risk				
100bps increase in reference rates	(6)	(2)	–	(8)
100bps decrease in reference rates	5	2	–	7
Removal of illiquidity premium for immediate annuities	(31)	–	–	(31)
100bps increase in corporate bond spreads(i)	(14)	–	–	(14)
100bps decrease in corporate bond spreads(i)	13	–	–	13
100bps increase in expense inflation	(7)	(5)	–	(12)
100bps decrease in expense inflation	6	4	–	10
Insurance and other risk				
Reduction to EU minimum capital or equivalent	2	–	–	2
10% decrease in maintenance expenses	8	6	2	16
10% proportionate decrease in lapse rates	13	–	5	18
10% proportionate decrease in PUP rates	5	1	–	6
5% decrease in mortality/morbidity – life assurance				
– Before reinsurance	10	3	1	14
– After reinsurance	5	1	–	6
5% decrease in mortality/morbidity – annuity business				
– Before reinsurance	(4)	–	–	(4)
– After reinsurance	(4)	–	–	(4)
Impact of end of period assumptions on VNB	4	(1)	–	3

(i) See previous page.
(ii) Comparative figures for splits to the UK and Heritage operating segments for the year ended 31 December 2012 are not available and the costs to develop them would be excessive.

12. Comparison of MCEV and IFRS classification and segments

The covered business segments within MCEV are consistent with the IFRS business segments.

The split of the MCEV by IFRS business segment is shown in the tables below:

At 31 December 2013	**MCEV classification** **UK** **£m**	 **Heritage** **£m**	 **FPI** **£m**	 **Lombard** **£m**	 **Corporate** **£m**	 **Non-covered business(i)** **£m**	**Total MCEV by IFRS segments** **£m**
IFRS segment							
UK	**1,418**	**–**	**–**	**–**	**–**	**2**	**1,420**
Heritage	**–**	**4,066**	**–**	**–**	**–**	**40**	**4,106**
FPI	**–**	**–**	**603**	**–**	**–**	**(1)**	**602**
Lombard	**–**	**–**	**–**	**598**	**–**	**5**	**603**
Corporate	**–**	**–**	**–**	**–**	**(1,631)**	**965**	**(666)**
Total MCEV (by MCEV segments)	**1,418**	**4,066**	**603**	**598**	**(1,631)**	**1,011**	**6,065**

At 31 December 2012	MCEV classification UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Non-covered business(i) £m	Total MCEV by IFRS segments £m
IFRS segment							
UK	1,227	–	–	–	–	26	1,253
Heritage	–	4,080	–	–	–	12	4,092
FPI	–	–	612	–	–	1	613
Lombard	–	–	–	615	–	5	620
Corporate	–	–	–	–	(1,611)	864	(747)
Total MCEV (by MCEV segments)	1,227	4,080	612	615	(1,611)	908	5,831

(i) The non-covered business includes £164 million (2012: £133 million) within Corporate representing the MCEV of the Resolution holding companies.

13. FLG return on embedded value

	2013		2012	
	£m	**% p.a.**	£m	% p.a.
Value of new business	**204**	**2.9**	194	2.8
Expected existing business contribution(i)	**323**	**4.5**	400	5.7
Operating experience variances	**(57)**	**(0.8)**	(56)	(0.8)
Operating assumption changes	**19**	**0.3**	(9)	(0.1)
Other operating variance	**178**	**2.5**	27	0.4
Development costs	**(50)**	**(0.7)**	(50)	(0.7)
Other income and charges(i)	**(26)**	**(0.4)**	(5)	(0.1)
FLG MCEV operating profit before tax and financing	**591**	**8.3**	501	7.2
Impact of financing(i)	**(75)**	**1.1**	(91)	–
Attributed tax charge on MCEV operating profit	**(122)**	**(2.2)**	(120)	(2.1)
FLG MCEV operating profit after tax	**394**	**7.2**	290	5.1
Economic variances	**412**	**7.5**	154	2.7
Other non-operating items	**(143)**	**(2.7)**	(140)	(2.5)
Attributed tax on other activities	**(62)**	**(1.1)**	(6)	(0.1)
FLG MCEV profit after tax	**601**	**10.9**	298	5.2
Remeasurement losses on defined benefit pension schemes	**(77)**	**(1.4)**	(35)	(0.5)
Foreign exchange adjustments	**16**	**0.3**	(16)	(0.3)
Total return on FLG MCEV over the year	**540**	**9.8**	247	4.4

(i) Impact of financing comprises the expected impact of financing of covered debt of £75 million for 2013 (2012: £75 million). In 2012 it also contained the impact of financing the non-covered debt of £200 million which was repaid in November 2012 (with an impact of financing of £16 million for 2012). These amounts have been deducted from the expected existing business contribution and other income and charges respectively.

The table above provides an analysis of the return on FLG embedded value, excluding the Resolution holding companies. The starting FLG embedded value for 2013 is £5,698 million, net of the market-consistent value of debt instruments of £1,596 million and having excluded £133 million in respect of the Resolution holding companies. The 2013 embedded value has been adjusted to allow for the timing of dividend payments and the proceeds from the disposal of AmLife on 4 January 2013.

The starting embedded value for 2012 is £5,949 million, net of the market-consistent value of debt instruments of £1,159 million and having excluded £(153) million in respect of the Resolution holding companies. The 2012 embedded value has been adjusted to allow for the timing of dividend payments, the repayment of the internal LT2 subordinated debt 2020 issued to Resolution holding companies by FLG and the new external UT2 subordinated debt and associated currency swap 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: New business information

Analysis of life and pensions new business

In classifying new business premiums the following basis of recognition is adopted:

- 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;
- the Group does not take credit for the future contractual increments on auto-enrolment business; instead, these will emerge in reported new business figures as they occur;
- transfers between products where open market options are available are included as new business; and
- regular new business premiums are included on an annualised basis.

Regular and single premiums

	Regular premiums			Single premiums		
	FY 2013 £m	FY 2012 £m	Change %	**FY 2013 £m**	FY 2012 £m	Change %
UK division						
– Corporate Benefits	**520**	451	15	**542**	844	(36)
– Protection	**84**	90	(7)	**-**	-	-
– Retirement Income	**-**	-	-	**664**	436	52
Total UK division	**604**	541	12	**1,206**	1,280	(6)
Heritage division	**35**	47	(26)	**189**	550	(66)
International division						
– FPI	**80**	139	(42)	**607**	633	(4)
– Lombard	**-**	-	-	**1,983**	2,376	(17)
Total International division	**80**	139	(42)	**2,590**	3,009	(14)
Total life and pensions	**719**	727	(1)	**3,985**	4,839	(18)

	Regular premiums			Single premiums		
	Q4 2013 £m	Q4 2012 £m	Change %	**Q4 2013 £m**	Q4 2012 £m	Change %
UK division						
– Corporate Benefits	**145**	106	37	**209**	92	127
– Protection	**21**	25	(16)	**-**	-	-
– Retirement Income	**-**	-	-	**164**	157	4
Total UK division	**166**	131	27	**373**	249	50
Heritage division	**9**	10	(10)	**44**	71	(38)
International division						
– FPI	**16**	31	(48)	**167**	179	(7)
– Lombard	**-**	-	-	**829**	1,189	(30)
Total International division	**16**	31	(48)	**996**	1,368	(27)
Total life and pensions	**191**	172	11	**1,413**	1,688	(16)

Group new business - APE

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

	FY 2013 £m	FY 2012 £m	Change %	**Q4 2013 £m**	Q4 2012 £m	Change %
UK division						
– Corporate Benefits	**574**	535	7	**166**	115	44
– Protection	**84**	90	(7)	**21**	25	(16)
– Retirement Income	**66**	44	50	**16**	16	-
Total UK division	**724**	669	8	**203**	156	30
Heritage division	**54**	102	(47)	**13**	17	(24)
International division						
– FPI	**141**	202	(30)	**33**	49	(33)
– Lombard	**198**	238	(17)	**83**	119	(30)
Total International division	**339**	440	(23)	**116**	168	(31)
Total life and pensions	**1,117**	1,211	(8)	**332**	341	(3)

	Q4 2013 £m	Q3 2013 £m	Q2 2013 £m	Q1 2013 £m
UK division				
– Corporate Benefits	**166**	155	144	109
– Protection	**21**	24	21	18
– Retirement Income	**16**	18	17	15
Total UK division	**203**	197	182	142
Heritage division	**13**	14	14	13
International division				
– FPI	**33**	29	39	40
– Lombard	**83**	28	40	47
Total International division	**116**	57	79	87
Total life and pensions	**332**	268	275	242

FPI

APE by region (actual exchange rates)	FY 2013 £m	FY 2012 £m	Change %
North Asia (excluding Japan)	**30**	31	(3)
Japan	**-**	25	(100)
South Asia	**19**	23	(17)
Middle East	**35**	46	(24)
Europe (Excl UK)	**16**	29	(45)
UK	**20**	21	(5)
Rest of World	**21**	22	(5)
Malaysia (AmLife)(i)	**-**	5	(100)
Total	**141**	202	(30)

(i) AmLife joint venture sold on 4 January 2013

Lombard

APE by region (actual exchange rates)	FY 2013 £m	FY 2012 £m	Change %
UK and Nordic	**68**	54	26
Northern Europe	**12**	35	(66)
Southern Europe	**110**	123	(11)
Rest of world	**8**	26	(69)
Total including large cases	**198**	238	(17)
Of which: Large cases (greater than €10m)	**87**	102	(15)
Total excluding large cases	**111**	136	(18)

New business APE at constant exchange rates

All amounts in currency in the tables above other than Sterling are translated into Sterling at a monthly average exchange rate. The estimated new business assuming constant currency rates would be as follows:

	FY 2013 £m	FY 2012 £m	Change %	**Q4 2013 £m**	Q4 2012 £m	Change %
FPI	**139**	202	(31)	**31**	49	(37)
Lombard	**190**	238	(20)	**79**	119	(34)

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. All amounts in currency other than Sterling are translated into Sterling at a monthly average exchange rate.

	FY 2013 £m	FY 2012 £m	Change %	**Q4 2013 £m**	Q3 2013 £m	Q2 2013 £m	Q1 2013 £m
UK division							
– Corporate Benefits	**2,799**	2,714	3	**836**	750	668	545
– Protection	**623**	590	6	**158**	175	171	119
– Retirement Income	**664**	436	52	**164**	176	179	145
Total UK division	**4,086**	3,740	9	**1,158**	1,101	1,018	809
Heritage division	**351**	780	(55)	**84**	86	91	90
International division							
– FPI	**1,007**	1,315	(23)	**248**	202	264	293
– Lombard	**1,983**	2,376	(17)	**829**	282	405	467
Total International division	**2,990**	3,691	(19)	**1,077**	484	669	760
Total life and pensions	**7,427**	8,211	(10)	**2,319**	1,671	1,778	1,659

Appendix 2: IFRS new business strain and in-force surplus analysis

Analysis of new business strain

A reconciliation of free surplus investment in new business to cash strain to IFRS strain is set out below. 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. IFRS strain also includes DAC/DFF and other IFRS adjustments.

£m	UK	Heritage	FPI Core	FPI Non-core	Lombard	2013 Full year	2012 Full year
Investment in new business	(98)	(30)	(39)	(22)	(24)	(213)	(285)
Movement in required capital, tax and other items	78	(2)	2	(7)	2	73	71
New business cash strain	(20)	(32)	(37)	(29)	(22)	(140)	(214)
DAC/DFF	15	5	96	13	(9)	120	199
Other IFRS adjustments	4	2	(83)	-	-	(77)	(127)
IFRS new business strain	(1)	(25)	(24)	(16)	(31)	(97)	(142)

Analysis of IFRS in-force surplus

A reconciliation from free surplus expected return on in-force business to cash surplus to the IFRS surplus is set out below.

£m	UK	Heritage	FPI Core	FPI Non-core	Lombard	2013 Full year	2012 Full year
Expected return from in-force business	99	442	77	20	44	**682**	668
Movement in required capital, tax and other items	(23)	(196)	(1)	39	(2)	**(183)**	(177)
In-force cash surplus	76	246	76	59	42	**499**	491
DAC/DFF	(15)	(10)	(38)	(23)	26	**(60)**	4
Other IFRS adjustments	8	28	62	4	-	**102**	55
IFRS in-force surplus	**69**	**264**	**100**	**40**	**68**	**541**	550

Appendix 3: International additional information

Analysis of International segment

MCEV

Year ended 31 December 2013 £m	Lombard	FPI Core	FPI Non-core	Total International
Net assets	89	84	-	**173**
VIF	515	424	95	**1,034**
Total MCEV	**604**	**508**	**95**	**1,207**

Appendix 4: Underlying free surplus by business line

A reconciliation of underlying free surplus split by insurance and asset-based business is shown below.

Insurance business

2013 (£m)	**Protection**	**Retirement Income**	**FPI**	**Heritage**	**Total**
Expected return from in-force business	30	10	97	442	**579**
Investment in new business	(44)	(6)	(61)	(30)	**(141)**
Underlying free surplus	**(14)**	**4**	**36**	**412**	**438**

2012[2] (£m)	Retirement Income & Protection[1]	FPI	Heritage	Total
Expected return from in-force business	38	93	453	584
Investment in new business	(56)	(101)	(55)	(212)
Underlying free surplus	(18)	(8)	398	372

1. 2012 Investment in new business for Protection and Retirement income are £(65) million and £9 million respectively
2. 2012 analysis is based on management estimates

Asset-based business

2013 (£m)	**Corporate Benefits**	**Lombard**	**Total**
Income	110	139	**249**
Outgoings	(94)	(110)	**(204)**
Other[1]	(5)	(9)	**(14)**
Underlying free surplus	**11**	**20**	**31**

2012[2] (£m)	Corporate Benefits	Lombard	Total
Income	98	125	223
Outgoings	(103)	(99)	(202)
Other[1]	3	(13)	(10)
Underlying free surplus	(2)	13	11

1. Other principally includes movements on required capital, non-unit reserves and regulatory DAC (in Lombard).
2. 2012 analysis is based on management estimates

Appendix 5: Metrics for insurance and asset-based businesses

	Insurance businesses	Asset-based businesses	**Group 2013**	Group 2012	Variance
Insurance metrics					
VNB (£m)	153	51	**204**	194	5%
IRR (%)	18.1%[1]	9.7%	**15.3%[2]**	10.4%	4.9pp
Investment in new business (£m)	(141)	(72)	**(213)**	(285)	(25)%

1. IRR for open insurance businesses
2. Includes the impact of with-profits annuity reallocation

	Asset-based businesses 2013	Asset-based businesses 2012	Variance
Asset-based metrics			
Net fund flows (£bn)	**(0.2)**	1.2	(1.4)
Regular premiums (£m)	**1,760**	1,680	5%
Income (bps)	**68**	68	Leverage +6bps
Outgoings (bps)	**(56)**	(62)	

Definitions

AmFamily means AmFamily Takaful Berhad

AmLife means, collectively, AmFamily and 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 Group MCEV at the start of the period adjusted to allow for the timing of dividend payments and any acquisitions or disposals through 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.

Asset share is a measure of the share of assets attributable to a with-profits policy, calculated by accumulating premiums paid at the rates of return earned on the assets assumed to be backing the policy, after allowing for deductions for partial payments of benefits and charges such as expenses, mortality, distributions to shareholders and tax.

Available shareholder assets (“ASA”) represents assets and other financial instruments available to cover corporate costs, to service debt issued by Resolution holding companies and, subject to shareholder approval, to pay dividends or return to shareholders. ASA reflects the deduction of working capital from free surplus.

AXA UK Life Businesses 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 FLWL 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.

Core International consists of Friends Provident International Limited and excludes all non-core FPI business (OLAB, AmLife and new business to Japanese nationals).

Economic capital surplus is the surplus of the Group’s realistic capital resources over management’s internal risk-based estimate of the amount of capital needed to be held to mitigate the risk of insolvency to a minimum of a 99.5% confidence level over a one year period.

Equity Backing Ratio ("EBR") is the proportion of equities and property backing asset shares.

Free surplus at the end of the period represents the excess of net worth (equivalent to shareholder resources) over required capital and inadmissible items on an MCEV basis for covered businesses plus IFRS net assets, less required capital and inadmissible assets on an IGCA basis for non-covered businesses and holding companies. Free surplus comprises ASA plus working capital.

Free surplus generated comprises the movement in free surplus over the period adjusted for capital, foreign exchange and other reserve movements.

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 FLWL from November 2011).

Friends Life holding companies means Friends Life Group plc, Friends Life FPG Limited and Friends Life FPL Limited.

Group means Resolution Limited and its subsidiaries and subsidiary undertakings from time to time.

Group embedded value on an MCEV basis (“Group MCEV”) is the equity attributable to equity holders of the parent as shown in the consolidated statement of financial position - MCEV basis.

Heritage division means Friends Life's UK based 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 is the Insurance Groups Capital Adequacy surplus capital as defined by the PRA 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 Model Approval Process ("IMAP") is the process whereby the PRA reviews and approves the appropriateness of a firm's internal model for use within the Solvency II framework.

Internal rate of return ("IRR") 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 VNB. IRR assumes best estimate investment returns after an allowance for default risk, whereas VNB assumes (market consistent) risk-free rates. IRR also takes into account the funding and release of regulatory capital requirements.

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.

New business margins are defined as the pre-tax VNB divided by the PVNBP.

New Life Tax Regime ("NLTR") refers to legislation enacted in the Finance Act 2012 and supporting regulations. NLTR applies to life insurance companies with effect from 1 January 2013 and has not altered the "I minus E" basis of taxation.

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 PRA. 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 expressed at the point of sale.

Required capital of the Group is based on the most onerous capital management policy for the Group, currently IGCA.

Resolution Holding companies means the Company, Resolution Holdco No. 1 LP and Resolution Holdings (Guernsey) Limited.

Resolution Operations LLP ("ROL") is a privately owned advisory and operating firm which, as part of the Resolution Group, has provided services to Resolution Limited within the framework of an operating agreement. On 27 March 2013, under a Business Sale Agreement, ROL transferred to the Company business activities that related to the services provided to the Company and the ROL employees who provided the services. At the same time, ROL ceased to provide services to the Company.

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.

Shareholders and Investors in this Report, these terms are used variously to describe investors who hold shares in Resolution Limited and who also invest in the Company through RCAP's limited partnership interest in the economic value and returns being generated through the Group's activities. Generally speaking, the terms used throughout this Report should be interpreted as interchangeable.

Solvency II establishes a revised set of EU-wide capital requirements and risk management standards with the aim of increasing protection for policyholders and reducing the possibility of market disruption in insurance. The new regime will now formally come into force on 1 January 2016.

Sustainable Free Surplus ("SFS") is the surplus generated within FLG based on expected investment return and excludes operating assumption changes, amortisation and impairment of non-covered business, acquired intangible assets, effect of economic variances (including the impact of economic assumption changes) and significant non-recurring items.

Value of new business ("VNB") relates to new business written in the reporting period and reflects the present value of future cash flows on that block of business. It is calculated using economic assumptions at the beginning of the period except for immediate annuities for which the assumptions used are appropriate for each month's new business on account of their interest rate sensitivity. It is also calculated using year end operating assumptions consistent with those used to determine the year end MCEV embedded value. VNB 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.

Value share – refer to note 12 of the IFRS financial statements

Working capital, as a component of the Group's cash and capital management framework, represents free surplus assets set aside to cover known future requirements and amounts necessary to maintain sufficient flexibility to facilitate compliance with the Group capital policy, additional regulatory requirements and any other assets restricted in their availability to shareholders.

Abbreviations

ABI	Association of British Insurers
ABS	Asset-Backed Securities
AC	Audit Committee
AGM	Annual General Meeting
ALM	Asset and Liability Management
AMC	Annual Management Charge
APE	Annual Premium Equivalent
ASA	Available Shareholder Assets
AVIF	Acquired Value of In-Force
AXA IM	AXA Investment Management
BHA	Friends Life BHA Limited
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGU	Cash Generating Unit
CMI	Continuous Mortality Investigations
CMIR	Continuous Mortality Investigations Report
CMPs	Capital Management Policies
CNHR	Cost of Non-Hedgeable Risk
COP	Capital Optimisation Programme
CRO	Chief Risk Officer
CRR	Capital Resource Requirements
DAC	Deferred Acquisition Costs
DCN	Deferred Consideration Notes
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
FAL	Friends Annuities Limited
FASLH	Friends ASLH Limited
FCA	Financial Conduct Authority
FLAS	Friends Life Assurance Society Limited
FLC	Friends Life Company Limited
FLDL	Friends Life Distribution Limited
FLG	Friends Life Group plc
FLI	Friends Life Investments
FLL	Friends Life Limited
FLMS	Friends Life Management Services Limited
FLPL	Friends Life and Pensions Limited
FLSL	Friends Life Services Limited
FLWL	Friends Life WL Limited

fpb	Financial Business Partners AG
FPI	A segment within the International division comprising FPIL, OLAB and AmLife
FPIL	Friends Provident International Limited
FPL	Friends Life FPL Limited
FPPS	Friends Provident Pension Scheme
FRA	Flexible Retirement Account
FRC	Financial Risk Committee
FRS	Financial Reporting Standards
FSG	Free Surplus Generation
FSMA	Financial Services and Markets Act 2000
FTE	Full Time Equivalent
FUM	Funds Under Management
GCE	Group Chief Executive
GEC	Group Executive Committee
GMP	Guaranteed Minimum Pension
HNWI	Higher Net Worth Individuals
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
IMAP	Internal Model Approval Process
INB	Investment in New Business
IPEV	International Private Equity and Venture Capital
IRR	Internal Rate of Return
KPI	Key Performance Indicator
LDI	Liability Driven Investment
LTIP	Long-Term Incentive Plan
LT2	Lower Tier 2
MCEV	Market Consistent Embedded Value
MVR	Market Value Reduction
NBS	New Business Strain
NGP	New Generation Pension
NLTR	New Life Tax Regime
NPF	Non-Profit Fund
OCI	Other Comprehensive Income
OEIC	Open Ended Investment Company
OLAB	Overseas Life Assurance Business
OMO	Open Market Option
PBSE	Post-Balance Sheet Event
PPFM	Principles and Practices of Financial Management
PRA	Prudential Regulation Authority

PUP	Paid Up Policies
PVFP	Present Value of Future Profits
PVNBP	Present Value of New Business Premiums
RCAP	RCAP UK LP. The limited partner in Resolution Holdco No.1 LP.
RCC	Risk and Compliance Committee
RCM	Risk Capital Margin
RDR	Retail Distribution Review
RHG	Resolution Holdings (Guernsey) Limited
RHN1	Resolution Holdco No.1 LP.
RICS	Royal Institution of Chartered Surveyors
RIE	Re-attributed Inherited Estate
ROEV	Return on Embedded Value
ROL	Resolution Operations LLP
RPI	Retail Prices Index
RSL	Resolution Limited
SBG	Sesame Bankhall Group
SFS	Sustainable Free Surplus
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
UT2	Upper Tier 2
VIF	Value of In-Force
VNB	Value of New Business
WPF	With-Profits Fund
WPICC	With Profits Insurance Capital Component