5 March 2015

Friends Life Group Limited

Results for the year ended 31 December 2014

Strong cash performance

- Sustainable free surplus £373 million, up 15% (2013: £325 million) and marginally ahead of guidance
- Continued strong performance in Corporate Benefits, positive net fund flows of £0.6 billion, taking assets under administration to £22.0 billion; significant improvement in underlying free surplus, up to £29 million (2013: £11 million)
- IFRS based operating profit before tax of £556 million, up 38% (2013: £402 million)
- MCEV operating profit before tax of £498 million, down 7% (2013: £535 million); mainly due to reduction in VNB
- Value of new business down £47 million to £132 million (including £32 million reduction in Retirement Income VNB) as predicted trends continue

Capital position robust

- Available shareholder assets £1,066 million
- IGCA[(i)] surplus £2.3 billion, coverage ratio 240%
- Economic capital surplus[(i)] £3.7 billion, coverage ratio 196%
- Full year dividend of 31.15 pence per share subject to completion of the Proposed Acquisition by Aviva plc (2013: 21.14 pence per share)[(ii)]

Business highlights

- Successful reallocation of £760 million of annuities from with-profits funds, resulting in a sustainable free surplus ("SFS") benefit of circa £7 million per annum from 2015
- Recapture of £1.6 billion of assets backing annuities in November, resulting in a SFS benefit of circa £13 million per annum from 2015
- Further reallocation of £665 million of annuities completed in the first quarter of 2015 resulting in a SFS benefit of circa £5 million per annum from 2015
- Friends Life has responded strongly to the legislative and regulatory changes to pensions and workplace savings:
    - New individual customer platform My Savings on track to be launched in April 2015
    - Developed a range of products and services to meet new regulatory requirements, including an income tool, investment risk appetite assessments, retirement planning and tax information and tools
    - Invested in the creation of a Retirement Information Centre
    - Annuity sales down only 15%, outperforming the market which is down 38%[(iii)]
- Efficient cost management, with operating expenses down a further 2% to £549 million
- Auto-enrolment activity, which peaked in the first half of 2014, has enrolled 957 schemes this year, contributing to a net increase in members of 169,000 in 2014
- Following the re-platforming of the new business, the International division is on track for re-platforming in-force business during 2015
- Successful sale of Lombard for £316 million, completed in October 2014

Proposed Acquisition of Friends Life Group Limited by Aviva plc

- All share acquisition:
    - 0.74 new Aviva shares for each Friends Life Group share
    - The proposed second interim dividend includes a 10 pence per share enhancement to the 2013 final dividend
    - Value share(iv) will be settled
- Accelerates Friends Life's existing strategy, creating the UK's leading insurance, savings and asset management business:
    - Creates the UK's largest back book(v) with the potential to release substantial capital synergies
    - Leading market positions in corporate pensions and protection; and one in four retiring defined contribution pension customers(vi)
    - Proven track record in the successful integration and delivery of cost savings
- Court and shareholder general meeting to be held on 26 March, completion expected in the second quarter of 2015

Andy Briggs, Group Chief Executive said:

"I am pleased with the progression shown in this year's results, in spite of the unprecedented regulatory and legislative challenges Friends Life, and the UK life insurance industry as a whole, have faced in 2014. We have delivered a substantial improvement in cash today, marginally ahead of guidance, and put ourselves in a strong position to deliver cash tomorrow. I have the utmost confidence in our standalone position, but I'm excited by the opportunity the Aviva deal offers to accelerate our proven, successful strategy."

Enquiries:

<u>Investors / Analysts</u>	
Yana O'Sullivan, Director of Investor Relations, Friends Life Group Limited	+44 (0)845 268 3116
Tom Cannings, Investor Relations, Friends Life Group Limited	+44 (0)845 268 5139
<u>Media</u>	
Ben Woodford, Bell Pottinger	+44 (0)20 3772 2500
Olly Scott, Bell Pottinger	+44 (0)7812 345 205

Notes

(i) Estimated and unaudited.

(ii) In the event that the Proposed Acquisition does not complete, Friends Life expects that its 2014 final dividend and therefore its 2014 full year dividend would be in line with Friends Life's 2013 final dividend and 2013 full year dividend, respectively.

(iii) Based on ABI data for the first three quarters of 2014.

(iv) Details of the value share arrangement can be found on page 74 of the 2013 Report and Accounts.

(v) Based on analysis of 2013 PRA returns of UK gross reserves. Back book defined as per Friends Life's methodology and includes with-profit products, unit-linked bonds and other legacy products.

(vi) 1 in 4 retiring defined contribution pension customers is based on company data and HMT report published September 2014.

Forward-looking statements

This announcement may contain certain "forward-looking statements" with respect to certain of Friends Life'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, Friends Life’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. Friends Life 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.

Analysts/Investors

A full year results presentation will take place at 08:30am (GMT) at the Aviva offices in the Talbot and Hartley Rooms, Level 23, Aviva plc, St Helen’s, 1 Undershaft, London EC3P 3DQ. Dial in telephone number: 020 3059 8125 (UK) + 44 20 3059 8125 (all other locations), Participant password: Friends Life.

A webcast of the presentation and the presentation slides will be available on Friends Life’s website, www.friendslifegroup.com.

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

Financial calendar	
Court meeting and Friends Life Group general meeting	26 March 2015

2014 Second interim dividend	
Dividend amount(i)	24.1 pence
Record date(ii)	9 April 2015
Dividend payment date(ii)	within 14 days of 10 April 2015

(i) The second interim dividend is contingent on shareholder approval of the Proposed Acquisition by Aviva plc, in the event that the Proposed Acquisition does not complete, Friends Life expects that its 2014 final dividend would be in line with Friends Life’s 2013 final dividend.

(ii) The dates given are indicative only and are based on Friends Life’s current expectations and may be subject to change (including as a result of changes to the regulatory timetable).

Website: www.friendslifegroup.com

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Chairman’s statement

Accelerating value creation

On 2 December 2014, we announced that we had agreed the terms of a proposed offer by Aviva plc (“Aviva”) to acquire Friends Life Group Limited (the “Proposed Acquisition”). The combination of Friends Life’s existing customer base with Aviva’s will create the UK’s largest life insurer, and is an attractive opportunity to accelerate the delivery of the Friends Life strategy. The increased scale, brand recognition and resourcing, combined with the expected financial synergies and cost savings strongly supports our focus on generating value for our shareholders and policyholders.

Proposed terms and dividend

Under the terms of the Proposed Acquisition our shareholders will receive 0.74 Aviva shares for each Friends Life share owned. In addition, a proposed second interim dividend of 24.1 pence per share will be paid to Friends Life shareholders after the Scheme is approved, resulting in a 2014 full year dividend of 31.15 pence per share, payable in April 2015 (the 2013 full year dividend was 21.14 pence per share). Full details are set out in the Scheme Document that was published by Friends Life on 19 January 2015, and the Aviva Prospectus which was issued by Aviva on the same day (both documents are available on the Aviva and Friends Life websites). As noted in the Scheme Document, in the event that the Proposed Acquisition does not complete, the proposed second interim dividend will not be paid, and we expect that the 2014 full year dividend would be in line with the 2013 full year dividend.

Next steps

Shareholder and regulatory approval is required for the Proposed Acquisition which, if approved, will be implemented by way of a scheme of arrangement (the “Scheme”). Shareholders will have the opportunity to attend and vote at the required shareholders meetings which will be held on 26 March 2015 to approve the proposals. The relevant documents and voting forms have been sent to shareholders in preparation for the meetings. The Friends Life Directors unanimously recommend that Friends Life shareholders vote in favour of the Scheme and the associated resolutions to be proposed at the shareholders meetings, and it is not too late to submit your vote. Deadlines for submitting your vote are set out in the Scheme document. If the Proposed Acquisition is approved by shareholders and the Court, the Scheme will become effective on 10 April 2015, new Aviva shares will be issued to Friends Life shareholders on 13 April 2015, and the proposed second interim dividend will be paid by 24 April 2015.

Performance

Aside from the Proposed Acquisition, I am pleased to confirm that the Group has performed well throughout 2014. Notwithstanding the historic changes to the pensions market brought about by the UK Chancellor’s 2014 Budget, I am pleased to report that the Company continues to deliver strongly as clearly evidenced in our 2014 results. Highlights of the Group’s delivery throughout the year include sustainable free surplus rising to £373 million in 2014 from £325 million in 2013, and the successful disposal of the Lombard business. The Group is also well placed to support its customers when the pension reforms come into force in April 2015, having developed a new customer platform and enhanced our customer service offering, as detailed in the Group Chief Executive’s Review.

Colleagues and the Board

Finally, I would like to thank the Board and all our employees for their continued commitment, without which the Company would not have had the success it has achieved, nor delivered these returns to our shareholders.

Group Chief Executive's review

Our Strategy

2014 has been a year of unprecedented change for both the UK life and pensions industry and Friends Life itself. Throughout this time, the company has been consistent in the execution of its strategy that can be summarised in three main principles:

- To maximise the value of the Heritage book through efficient management of legacy products, innovative capital and revenue optimisation initiatives and a focus on deepening the relationship with our significant customer base;
- To participate in key growth areas in the UK life and pensions market, where we have scale and a demonstrable competitive advantage, focusing on our existing customers; and
- To look for opportunities to enhance or accelerate value through inorganic activities.

The sweeping reforms to the pensions market resulting from the UK Chancellor's 2014 Budget have meant that every pensions provider, including Friends Life, has needed to adapt to a new approach to retirement provision. I have been extremely pleased with how we have responded to these challenges, making great improvements by enhancing our customer engagement, taking the time to understand our customers' needs and focusing on developing the products and services our customers will require as the pension reforms come into force in April 2015.

Our new individual customer platform My Savings is on track to launch in April 2015. It will enable our existing customers to make the most of the new pension freedoms whilst providing an online system to manage their pensions and other savings in one place. Our goal is to help our customers make informed choices and decisions based on their personal circumstances. We will offer a range of products including flexi-access drawdown, NISAs and a general investment account alongside our standard and enhanced annuity offerings. This will be complemented by a range of other tools and services including an income tool to help customers understand the potential income from the different options available, investment risk appetite assessments, retirement planning, accumulation modelling, and tax information and tools to assist our customers in understanding the tax implications of taking cash from their pension.

Given the volume of legislative and regulatory change to pensions and workplace savings, customers will need more support than ever before to clarify their options. We have enhanced and strengthened our customer service teams, who are well equipped to anticipate, prompt and resolve all kinds of customer enquiries, from the simple to the complex. We know that around half a million of our current customers will be in a position to take advantage of the pension rule changes in April 2015 so we have dedicated significant resources to create a Retirement Information Centre to support customers and intermediaries.

Friends Life has successfully managed a number of major change programmes and their impact on customers in recent years. Following the changes brought about by the Budget, our UK business has already been restructured into a more customer centred model, fostering better collaboration across the business and enabling us to engage better with our customers.

In October 2014, we announced completion of the disposal of the Lombard business to the Blackstone Group. Lombard, although a good business, has always had a different profile to the rest of the Group. The disposal was in the best interests of both Friends Life and Lombard and allowed us to deliver on our commitment to secure maximum value for shareholders.

Our other international business, Friends Provident International, has faced a number of challenges this year, particularly in Asia where difficult market conditions impacted the business performance in the first half of the year. However, I have been encouraged by how the team responded to these challenges and we have started to see improved momentum in the business in the second half, particularly in the Middle East.

Our journey so far

The amount of change we have undergone this year is substantial, but it is not dissimilar to the transformation the business has been undergoing over the last four years.

When we started our restructuring and transformation journey four years ago, the Group was generating less than £100 million of sustainable free surplus. In 2014, this has risen to £373 million. This turnaround in cash generation has been delivered by applying rigorous financial discipline including delivering run-rate cost savings of £140 million and contractually securing total run-rate cost savings of £160 million by the end of 2015.

Beyond the cost synergies, we have delivered substantial capital synergies. Through the capital optimisation programme, in which the seven UK life companies were re-organised into two UK life companies for closed and open business, we drove efficiencies which have delivered a benefit of nearly £300 million to total free surplus over three years.

To enhance value further, our Heritage management team has carried out revenue optimisation initiatives since 2012 that have generated increases of over £40 million per annum in future cash generation through:

- The reallocation of three tranches of annuity policies from with-profits funds to the shareholder fund;
- The strategic partnership with Schroders;
- The establishment of Friends Life Investments Limited ("FLI") for the management of fixed income assets; and
- The recapture of £1.6 billion of assets backing annuities in November 2014.

For the last of these revenue optimisation initiatives, our Heritage division has undertaken the recapture in November 2014 of £1.6 billion of assets backing annuities where the investment risk was previously reinsured, which is expected to deliver a benefit of circa £13 million of sustainable free surplus per annum from 2015 onwards at a cost of £4 million in 2014. This clearly demonstrates the skills and capabilities that the Friends Life team has in enhancing value for shareholders.

We have rationalised our open business in the UK, reducing the number of open lines of business to three. The UK division is focused on Retirement Income, Corporate Benefits and Protection, where we have the scale and expertise to grow new business and where we have delivered a turnaround in value generation. In 2010, when we started our transformation project, the UK business was loss making, with a negative value of new business ("VNB") of £10 million. In 2014, we have delivered UK VNB of £141 million, a strong achievement considering the business has seen much lower VNB from Retirement Income this year. Retirement Income VNB has been affected by both the improved competitiveness of our offering as we entered the open market in December 2013 and the impact of pension reforms on volumes. I am particularly pleased with the progress we have made in our Corporate Benefits business. Positive net fund flows of £0.6 billion in 2014 have driven assets under administration up to £22.0 billion. The business continues to enjoy the benefits of scale and cost efficiency. Having turned cash positive a year ago, Corporate Benefits underlying free surplus generation has more than doubled in 2014 to £29 million. As the cost base is relatively fixed, further growth in assets under administration will only further enhance the operating leverage effect.

Outlook

Looking back over what we have achieved in 2014, I have absolute confidence in Friends Life's strategy and future prospects. However it would be remiss of me not to mention the Proposed Acquisition of the Group by Aviva. My belief is that the standalone future of Friends Life is attractive, but the opportunity to accelerate the Friends Life strategy through the combination with Aviva is even more attractive. The combination is expected to create the leading player in the UK life and pensions market, with even greater scale in the key markets that Friends Life already participates in.

In terms of enhancing cash generation capacity, the combined entity is expected to have the UK's largest back book[(i)] and the combined group could potentially release substantial capital synergies through:

- Diversification of economic capital with general insurance and international businesses;
- Optimisation of the Friends Life businesses on an economic capital basis;
- Further capital initiatives on the combined back book; and
- Leveraging Friends Life's capital strength as part of a larger group.

Furthermore, the combined group expects to have a significant scale advantage and hence, post-delivery of synergies, significant cost advantage. So, if completed, the transaction is expected to not only benefit cash today, but also support growth in the future.

The combination of Aviva and Friends Life also offers attractive growth opportunities for the UK open businesses, as the increased scale will drive better profitability and improved service to customers with easier access to a broader range of products. The deal creates the UK's leading insurance, savings and asset management business with leadership positions in Corporate Benefits and Protection and one in four retiring defined contribution pension customers. All of this is underpinned by an in-house asset manager, with a broad product set, and an established track record.

The complementary benefits of the Proposed Acquisition from both a financial and strategic perspective are compelling and with our proven track record in the successful integration of UK Life businesses, we would be well placed to ensure the successful integration of the two businesses.

All in all it has been a good year for Friends Life and I would like to give my thanks to all of our staff, whose dedication and hard work have made Friends Life the success it is.

(i) Based on analysis of 2013 PRA returns of UK gross reserves. Back book defined as per Friends Life's methodology and includes with-profits products, unit-linked bonds and other legacy products.

Chief Financial Officer's review

Introduction

I am delighted that the product of our consistent strategy to maximise cash generation is clearly evident in our 2014 results. Sustainable free surplus has grown 15% on last year, an excellent result, enabled by carefully targeted growth within the UK division alongside the ability demonstrated by our expert team in the Heritage division to optimise cash generation from the in-force book. Our focus on maximising the cash generation of the Group is unwavering; further initiatives have also been completed in 2014 which are expected to contribute to increased cash generation in future years and we have more opportunities in 2015 to explore. Notwithstanding this, and despite the higher sustainable free surplus in 2014, the adverse impact from falls in long-term interest rates during the year have resulted in lower free surplus generation.

Whilst 2014 provided many new challenges for the Group, I am proud of how we have been able to react quickly and decisively. Once again, the strict financial discipline that underpins everything that we do has also ensured that our balance sheet has stayed both strong and resilient.

Financial performance

£m (unless otherwise stated)			2014	Restated[i] 2013
Cash today	**KPI**[ii]	Sustainable free surplus	**373**	325
	KPI	Free surplus generation	**160**	377
Cash tomorrow	**KPI**	Value of new business	**132**	179
	KPI	Group Embedded Value (MCEV)	**5,529**	6,065
		Open insurance business IRR	**15.1%**	18.1%
		Group IRR	**16.7%**	15.4%
		UK Corporate Benefits net fund flows (£bn)	**0.6**	(0.2)
Returns	**KPI**	IFRS based operating profit	**556**	402
	KPI	MCEV operating profit	**498**	535
		Cash return	**25.1%**	23.8%
Expenses		Operating expenses	**549**	563
Capital strength	**KPI**	IGCA surplus coverage ratio[iii]	**240%**	238%
	KPI	Economic capital surplus coverage ratio[iii]	**196%**	193%
	KPI	Group available shareholder assets	**1,066**	917

(i) With the exception of the capital strength measures, the 2013 results have been restated to exclude the results of Lombard, which has been classified as discontinued in the year.
(ii) Key performance indicator.
(iii) Capital strength coverage ratios are estimated and unaudited.

Cash today

We are reporting strong growth in sustainable free surplus, with a 15% increase to £373 million (2013: £325 million). This is an excellent result, marginally ahead of our own expectations of "low double digit percentage growth" communicated in August 2014, and demonstrates our continuing delivery on growing the cash generation of the Group.

The targeted increase of £39 million in free surplus expected returns from the UK and Heritage divisions, as set out in our 2013 results, has also been delivered in line with previous guidance with expected returns totalling £600 million in 2014. This strong growth in expected cash generation has been driven by the profitable new business written by the UK division and the benefits of the revenue optimisation initiatives undertaken in 2013, with these more than offsetting the run-off of the in-force book.

The growth in sustainable free surplus has been achieved whilst simultaneously increasing the investment in writing profitable new business in the UK division, helping to generate the cash for tomorrow and offsetting the run-off of the Heritage book. Overall however, the investment in new business is still lower than in the previous year due to the closure to new business of the non-core OLAB business during 2013.

Cash tomorrow

In addition to the growth in sustainable free surplus in 2014, further revenue optimisation initiatives have been undertaken during the year to help offset the Heritage run-off and drive further cash generation growth in future years. In 2014 we have:

- Completed a £760 million reallocation of annuities from with-profits funds, which is expected to generate circa £7 million per annum of sustainable free surplus from 2015 onwards. In addition to this, in the first quarter of 2015 we have completed a transfer of a further £665 million of annuities from with-profits funds, generating circa £5 million per annum of sustainable free surplus from 2015 onwards;
- Completed the previously announced £14 billion transfer of investment management of assets (£12 billion to Schroders and £2 billion to Friends Life Investments) previously managed by F&C. This is expected to generate circa £3 million per annum of sustainable free surplus from 2015 onwards;
- Undertaken a recapture of £1.6 billion of assets backing annuities, which is expected to result in a benefit of circa £13 million per annum of sustainable free surplus from 2015 onwards; and
- Made investments into a number of different asset classes to drive increased yield within the annuity portfolio and shareholder funds across the Group.

The benefits to cash generation from these initiatives are not one-off; they provide continued free surplus generation year-on-year. This is *sustainable* free surplus generation in its truest sense.

In line with expectations, and as previously communicated, VNB has been impacted by both the increased competitiveness of our annuity offering and the impact of pension reforms on annuity volumes, in addition to the continuing challenges for the International division. However, even though the headline VNB figure is lower than in 2013, there are many aspects of our new business performance to be pleased with.

The Corporate Benefits business has developed strongly during 2014. As an asset-based business, Corporate Benefits focuses primarily on the net fund flows metric for measuring performance. Positive net fund flows of £0.6 billion in 2014 is a pleasing result, considering this incorporates the previously guided loss of one very large scheme (£0.4 billion) in the fourth quarter to pursue an unbundled proposition. The continuing growth in this business is driving increased operating leverage, illustrated by the 164% increase in underlying free surplus to £29 million (2013: £11 million).

The Protection business has also performed well during 2014. APE volumes are up 6%, due to strengthened relationships with financial advisers. In line with our guidance at the start of the year, VNB of £69 million (2013: £75 million) is lower than in 2013 due to a change in mix to lower margin life business and less favourable economics. However, the free surplus investment in new business has been reduced despite the higher volumes, driven by pricing discipline and rigorous cost control.

The Retirement Income business has achieved resilient results despite the changes announced in the UK Chancellor's 2014 Budget, with sales volumes down only 15%, outperforming our peer group and exceeding expectations. This was a result of more competitive pricing, strong customer engagement and the significant proportion of policies with Guaranteed Annuity Options ("GAO"s), where new volumes are not expected to fall as significantly from their pre-Budget levels. 51% of new annuity volumes in 2014 arose from pension policies with GAOs. The move to an increasingly competitive annuity pricing position has lowered the IRR for our open insurance businesses to 15.1% (2013: 18.1%), in line with our performance ambition of 15% set a year ago. Including the benefit of discretionary investment of shareholder assets in the with-profits annuity reallocation and the recapture of assets backing annuities, the 2014 Group IRR is 16.7%.

Challenging trading conditions within the International division have led to a disappointing new business performance in the year, with VNB of £12 million (2013: £21 million). There are however causes for optimism with sales in the second half of 2014 up 34% on the first half, reflecting the benefits of sales initiatives and regulatory changes in the UAE and Hong Kong. The International IT platform development has been progressing to plan and the business is now focused on re-platforming the in-force book in 2015.

In light of recent trading performance, adverse foreign exchange movements and the current low long-term interest rates the International division will, not pay a dividend for 2014. The International division continues to work with the Japanese regulator on its licence application and expects to be authorised to distribute investments business in Japan in the second quarter of 2015. Our access to the market for expatriates and affluent Japanese to purchase multi-currency savings products is an exciting opportunity for the next phase of International's growth.

Returns

IFRS based operating profit has grown by 38% to £556 million (2013: £402 million). The growth was positively impacted by a number of one-off benefits including a change to annuitant longevity assumptions (£103 million), the recapture of £1.6 billion of assets backing annuities (£90 million) and a reallocation of annuities from with-profits funds (£19 million). Notwithstanding the benefits from these one-off items, IFRS in-force surplus has increased by £31 million, which principally reflects the benefit from management actions undertaken during 2013 and improved economic conditions.

MCEV operating profit is lower at £498 million (2013: £535 million) and principally reflects the £47 million lower VNB as described above. However, the MCEV operating profit metric does illustrate the value created by the cash optimisation activities undertaken in the year. The recapture of £1.6 billion of assets backing annuities has generated £97 million of MCEV operating profit and the previously announced £760 million reallocation of annuities from with-profits funds generated £68 million.

The cash return ratio is up to 25.1% in 2014 (2013: 23.8%), in line with our performance ambition of 25%. The growth in sustainable free surplus has been partially offset by an increased shareholder net worth, primarily due to positive economic variances in 2013 which increased the 2014 opening position.

Operating expenses

Following the 4% reduction in operating expenses in 2013 (restated to exclude Lombard), I am pleased to confirm that our operating expenses have reduced by a further 2% in 2014 to £549 million (2013: £563 million). The reduction in 2014 represents the continued realisation of benefits from the integration programme including contractual savings arising from the outsourcing agreement with Diligenta. This more than offsets the modest cost increases to support new business growth in the UK and International divisions in addition to further improvements made to customer service and engagement in the year. This demonstrates that efficient management of the cost base is a core competence of the Group.

Consistent with previous communications, all costs associated with new retirement income product and platform development have been reported within non-recurring items.

Capital strength

Our consistent financial discipline across all areas of the business has maintained the strong balance sheet and robust capital position of the Group. Our estimated and unaudited coverage ratios on both an IGCA and economic capital basis are both higher at 240% and 196% respectively (31 December 2013: 238% and 193% respectively).

Group available shareholder assets are higher at £1,066 million (31 December 2013: £917 million). The movement over the year principally reflects the proceeds from the Lombard disposal net of the £30 million utilised for the share buyback programme prior to its suspension upon the announcement of the Proposed Acquisition by Aviva. Should the Proposed Acquisition not proceed, Friends Life would look to reinstate the buyback programme at the earliest opportunity. The receipt of the Lombard disposal proceeds are partially offset by working capital which we have decided to set aside now to meet the additional capital requirements of £138 million expected to arise in relation to the Department of Work and Pensions "charge cap", which will be introduced in April 2015. Note this capital will not be required upon transition to the Solvency II regime in 2016.

Regulatory developments

2014 has been a year which has seen some major regulatory developments in the industry. I am pleased with how we have been able to respond to these developments and I believe we are well positioned to benefit from them.

We remain fully engaged with the Financial Conduct Authority ("FCA") on their legacy review. Our Heritage division was established specifically to cater to the needs of legacy business customers so we have been in a good position to respond to the FCA's questions and we look forward to learning the outcomes of their review.

The UK Chancellor's 2014 Budget dramatically changed the UK pensions market landscape and I am pleased with the way we have been able to adapt in the 12 months since the announcement. As referred to in the Group Chief Executive's review, we have developed new products and a new platform, all designed specifically for the new world of retirement provision. Our strong customer service and engagement model is an area of focus for the Group and we expect this to be an even greater differentiator in the new world. On 27 February, we received final rules from the FCA (PS15/4: "Retirement reforms and the guidance guarantee") requiring providers to give appropriate risk warnings to customers accessing their pension savings. This Policy Statement also sets out how this interacts with the new free guidance regime and with customers who have received independent regulated advice. We are adapting our processes and procedures to meet these significant additional requirements which take effect from 6 April, with the aim of providing our customers with the support they require to navigate through the choices and flexibility available to them.

We have made good progress in the year in preparation for the move to the Solvency II regime in 2016. As previously announced, we intend to use the standard formula from the beginning of 2016 and apply for internal model approval subsequent to this. In light of the Proposed Acquisition by Aviva, we are reviewing our Solvency II programme and internal model application plans.

Sesame

In February 2013, we commenced a strategic review of the businesses of the Sesame Bankhall Group, including Sesame Limited. This strategic review is still ongoing with a number of potential options and outcomes being considered. There remains the risk of further adverse financial and reputational impacts to the Group, due to the ongoing trading performance of Sesame Limited, the potential future liabilities of the Sesame business and the outcomes of the strategic review.

Outlook

The continued growth in sustainable free surplus demonstrates our consistent focus on maximising the generation of cash for shareholders, and the continued delivery against that strategy. Our rigorous financial discipline and strong balance sheet have underpinned this delivery, and by carefully selecting the markets that we play in, we have the right strategy to build further on our success in the future.

Business review

2014 highlights

Heritage division

- Sustainable free surplus generation up to £462 million (2013: £445 million), reflecting £19 million higher expected return from in-force business and reduced levels of free surplus invested in new business from the closed non-core OLAB business.
- Phase 2 reallocation of with-profits fund annuities completed in the third quarter of 2014, with £760 million of annuities transferred from with-profits funds to non-profit funds. This transfer is expected to provide future sustainable free surplus benefits of circa £7 million per annum for an upfront cost of £(11) million.
- Phase 3 reallocation of with-profits fund annuities to non-profit funds has been completed in the first quarter of 2015, which transferred a further £665 million of annuities. This transfer is expected to provide future sustainable free surplus benefits of circa £5 million per annum for an upfront cost of circa £(25) million.
- The transfer of investment management of assets to Schroders was completed in the fourth quarter of 2014 with £12 billion of equity and multi-asset funds transferred from F&C. As part of this transaction a further £2 billion of fixed interest assets was transferred from F&C to Friends Life Investments. These transfers are expected to provide future sustainable free surplus benefits of circa £3 million per annum.
- Recapture of £1.6 billion of assets backing annuities in November 2014 where the investment risk was previously reinsured. This is expected to deliver a benefit of circa £13 million of sustainable free surplus from 2015 onwards, when gilt assets received are invested in higher yielding assets, at a cost of £(4) million in 2014.

UK division

- Sustainable free surplus generation up £13 million to £(27) million, principally reflecting a £20 million increase in expected return, driven by strong growth in the Corporate Benefits business.
- New business APE up 5% from increased sales in the Corporate Benefits and Protection businesses and a lower than expected fall of 15% in annuity sales despite the UK Chancellor's 2014 Budget announcement.
- VNB down £43 million to £141 million due to the increased competitiveness of our annuity offering and the impact of pension reforms on annuity volumes. However, Retirement Income PVNBP margin has been maintained in excess of 9%.
- Strong Protection business IRR of 19.2% (2013: 13.8%) delivered through pricing discipline and optimisation of reinsurance arrangements. Retirement Income IRR at 14.6% (2013: 25%+) despite improvements in the competitiveness of the annuity proposition.
- Positive net fund flows in Corporate Benefits of £0.6 billion despite the previously announced loss of one very large scheme, taking assets under administration to £22.0 billion.
- IFRS based operating profit up £65 million to £105 million driven by a revision to long-term longevity assumptions.

International division

- Sustainable free surplus generation has increased to £25 million (2013: £20 million) due to favourable movements in investment in new business and operating variances, which more than offset a reduction in expected returns.
- International assets under administration continue to grow and total £7.0 billion (31 December 2013: £6.6 billion).
- Full year performance in 2014 continues to reflect the difficult market conditions throughout the business' regions. As a result, sales volumes have fallen by 13% to £110 million. However, sales volumes in the second half of the year are up 34% compared with the first half of 2014 to £63 million.
- VNB is also lower at £12 million (2013: £21 million) as a result of the difficult trading conditions.
- IFRS based operating profit of £54 million is £9 million lower than in 2013 due to reduced in-force surplus resulting from increased expenses and adverse experience.
- Following the re-platforming of new business, the International division is on track for re-platforming in-force business during 2015.

Cash today

Sustainable free surplus generation

	2014				
£m	**Heritage**	**UK**	**Int'l**	**Corporate**	**Total**
Expected return from in-force business	**481**	**119**	**52**	**–**	**652**
Investment in new business	**(35)**	**(105)**	**(29)**	**–**	**(169)**
Underlying free surplus generation	**446**	**14**	**23**	**–**	**483**
Development costs	**(11)**	**(19)**	**(4)**	**–**	**(34)**
Coupon on external debt	–	**–**	**–**	**(94)**	**(94)**
	435	**(5)**	**19**	**(94)**	**355**
Operating experience variances	**(3)**	**(25)**	**3**	**–**	**(25)**
Other operating variances	**30**	**2**	**3**	**–**	**35**
Other income and charges	**–**	**1**	**–**	**7**	**8**
Sustainable free surplus generation	**462**	**(27)**	**25**	**(87)**	**373**
Operating assumption changes	**79**	**52**	**(18)**	**-**	**113**
Operating free surplus generation(i)	**541**	**25**	**7**	**(87)**	**486**

	Restated(ii) 2013				
£m	Heritage	UK	Int'l	Corporate	Total
Expected return from in-force business	462	99	77	–	638
Investment in new business	(52)	(98)	(39)	–	(189)
Underlying free surplus generation	410	1	38	–	449
Development costs	(9)	(23)	(7)	–	(39)
Coupon on external debt	–	–	–	(92)	(92)
	401	(22)	31	(92)	318
Operating experience variances	45	(11)	–	–	34
Other operating variances	(1)	15	(9)	–	5
Other income and charges	–	(22)	(2)	(8)	(32)
Sustainable free surplus generation	445	(40)	20	(100)	325
Operating assumption changes	36	17	(1)	–	52
Operating free surplus generation(i)	481	(23)	19	(100)	377

(i) Operating free surplus generation excludes corporate costs relating to the Friends Life Group Limited holding company.
(ii) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division and to exclude the results of Lombard, which has been classified as discontinued in the year.

Heritage

The Heritage sustainable free surplus generation of £462 million is £17 million higher than 2013 due to higher expected returns from in-force business and an improvement in investment in new business.

Expected return from in-force business at £481 million is £19 million higher than 2013 with the run-off of in-force business being more than offset by the ongoing benefits from the first phase of the with-profits annuity reallocation programme, FLI asset recaptures, the benefit of 2013 being the last year of repayment of a previous loan with a with-profits fund, together with improved economic conditions and increased recognition of tax relief on expenses.

The £17 million improvement in investment in new business reflects the cessation of new business sales within the transferred OLAB business.

Other operating variances include a positive impact from modelling changes offset by the day one cost of completing the second phase of the with-profits fund annuity reallocation programme with this resulting in a free surplus cost of £(11) million in 2014. A further £(4) million impact is also reflected as a result of a recapture of £1.6 billion of assets backing annuities in November 2014.

Operating assumption changes of £79 million principally reflect a change to annuitant longevity assumptions.

UK

Sustainable free surplus of £(27) million represents a £13 million improvement on 2013, driven by a £13 million increase in underlying free surplus generation, as set out in the table below.

Underlying free surplus generation by UK business unit

	2014				2013			
£m	**Protection**	**Retirement Income**	**Corporate Benefits**	**Total UK**	Protection	Retirement Income	Corporate Benefits	Total UK
Expected return from in-force business	**31**	**15**	**73**	**119**	30	10	59	99
Investment in new business	**(37)**	**(24)**	**(44)**	**(105)**	(44)	(6)	(48)	(98)
Underlying free surplus generation	**(6)**	**(9)**	**29**	**14**	(14)	4	11	1

UK underlying free surplus of £14 million is £13 million higher than 2013, due to a significant improvement in the contribution from Corporate Benefits resulting from growth in assets under administration and strong cost control. The investment in new business within the Protection business has improved by £7 million reflecting a disciplined approach to pricing and optimisation of reinsurance arrangements, including the use of a modest amount of financial reinsurance. These impacts more than offset the increased cost of writing new business in Retirement Income which reflects improvements made to the competitiveness of the annuity offering as we entered the open market in December 2013.

The 2014 sustainable free surplus reflects £(14) million lower operating experience variances than 2013, driven by a reduced utilisation of brought forward tax losses which resulted from a reduction in Retirement Income free surplus generated and adverse claims experience within the Protection business. This is more than offset by a £23 million improvement in other income and charges due to non-recurrence of 2013 provisioning within Sesame.

Operating assumption changes of £52 million principally reflect a change to annuitant longevity assumptions.

International

Sustainable free surplus generation has increased to £25 million (2013: £20 million), principally reflecting a favourable movement in operating variances.

Expected returns have decreased due to lower volumes of regular premium savings business written in 2013 compared with 2012. The surplus emergence on the regular premium savings business is weighted towards the early years of such contracts.

The decrease in expected returns is partially offset by a lower investment in new business of £(29) million (2013: £(39) million) which is partly due to lower sales volumes, but also the benefit of recognising indemnity commission over the initial period of each policy.

Operating assumption changes of £(18) million principally relate to a change to maintenance expense assumptions.

Corporate

The sustainable free surplus contribution from Corporate principally reflects the debt costs (net of tax) incurred by the Group. The 2014 result of £(87) million represents a £13 million improvement on 2013 primarily due to a lower level of holding company costs in sustainable free surplus in 2014 and a higher expected investment return as a result of the syndicated loan investments made in the year.

Cash tomorrow

New business profitability

£m (unless otherwise stated)	**VNB**	**INB**	**2014** **IRR**	**APE**	**PVNBP Margin**
Protection	**69**	**(37)**	**19.2%**	**89**	**10.8%**
Retirement Income	**51**	**(24)**	**14.6%**	**56**	**9.1%**
Corporate Benefits	**21**	**(44)**	**8.3%**	**614**	**0.7%**
Total UK	**141**	**(105)**	**13.0%**	**759**	**3.5%**
Heritage	**(21)**	**(35)**	**(2.7)%**	**43**	**(8.1)%**
International	**12**	**(29)**	**9.4%**	**110**	**1.5%**
Total Group	**132**	**(169)**	**16.7%**	**912**	**2.6%**

2014 Group IRR of 16.7% includes the benefit of discretionary investment of shareholder assets in the with-profits annuity reallocation and the recapture of £1.6 billion of assets backing annuities. Excluding these, the Group IRR is 10.5%.

The open insurance business (UK Protection, UK Retirement Income and International) IRR in 2014 is 15.1% (2013: 18.1%), in line with the performance ambition of 15% set a year ago.

£m (unless otherwise stated)	VNB	INB	Restated(i) 2013 IRR	APE	PVNBP Margin
Protection	75	(44)	13.8%	84	12.0%
Retirement Income	83	(6)	25%+	66	12.5%
Corporate Benefits	26	(48)	8.4%	574	0.9%
Total UK	184	(98)	15.3%	724	4.5%
Heritage	(26)	(52)	(1.0)%	68	(6.0)%
International	21	(39)	11.0%	127	2.3%
Total Group	179	(189)	15.4%(ii)	919	3.3%

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division and to exclude the results of Lombard, which has been classified as discontinued in the year.
(ii) 2013 Group IRR includes the benefit of discretionary investment of shareholder assets in the with-profits annuity reallocation. Excluding this, the Group IRR was 11.0%.

UK

The UK division delivered good growth in volumes during 2014, with APE up 5% to £759 million. Growth has been delivered in the Corporate Benefits and Protection business units, up 7% and 6% respectively. Retirement Income volumes are showing a smaller fall than expected, outperforming the market.

Protection

The Protection business has delivered growth in sales volumes of 6% compared to 2013, with much of this driven through strengthened relationships with financial advisers. VNB is 8% lower than 2013 driven by an increase in the start of year long-term interest rates compared to 2013 (meaning future profits are worth less in today's terms) as well as changes in the mix of new business written in Group Protection, with lower volumes of Income Protection and higher volumes of Life business which is typically less profitable. These impacts have also led to a lower PVNBP margin. The IRR has improved significantly from 13.8% to 19.2% driven by pricing discipline and optimisation of reinsurance arrangements, including the use of a modest amount of financial reinsurance. Investment in new business has improved by £7 million compared to 2013 despite the growth in volumes, for similar reasons as for the growth in IRR.

Retirement Income

The Retirement Income business has delivered strong new sales, with volumes down just 15% on the previous year, despite changes announced in the UK Chancellor's 2014 Budget. This compares favourably to the market where overall annuity sales were down 38% in the first three quarters of 2014 compared to the equivalent period last year. The favourable comparison partly reflects the relatively high proportion of vesting pension policies with guarantees, which represented 51% of new business volumes in 2014. We continue to believe that annuity volumes will fall further and in the fourth quarter Retirement Income sales volumes were 14% down on the third quarter. In addition to the fall in volume, the more competitive pricing position has, as expected, led to adverse VNB and INB compared to 2013, although IRR and PVNBP margins remain satisfactory.

Corporate Benefits

VNB of £21 million is 19% lower than 2013, following some cost and pricing pressure on new scheme wins and the impact of low initial premium levels on auto-enrolment business. Nevertheless policies in force and assets under administration have shown strong growth, supported by this increase in auto-enrolment activity.

Investment in new business has improved by £4 million compared to 2013, principally due to a restructuring of commission terms for new entrants to existing schemes.

Volumes are 7% higher than 2013, driven by good growth in the size of the existing book from higher increments, new entrants to existing schemes and increased single premium business.

Corporate Benefits assets under administration

£bn	**2014**	2013
1 January	**20.1**	17.8
Inflows	**2.5**	2.0
Outflows	**(1.9)**	(2.2)
Net fund flows	**0.6**	(0.2)
Net investment return	**1.3**	2.5
31 December	**22.0**	20.1

The Corporate Benefits business has delivered positive net fund flows of £0.6 billion contributing to assets under administration reaching £22.0 billion. This is despite the previously communicated disinvestment of one very large scheme for £0.4 billion which left to pursue an investment only proposition. Even allowing for this disinvestment, outflows have reduced compared to 2013.

Inflows have benefitted from strong new business volumes, in particular regular premiums have grown from £1,760 million in 2013 to £1,946 million in 2014, in part resulting from auto-enrolment activity which has contributed to a net increase in members of 169,000 in the year taking the total member count to 1,312,000.

Corporate Benefits underlying free surplus

£m (unless otherwise stated)	**2014**	**2014**	2013	2013
Income	**122**	**61bps**	110	62bps
Outgoings	**(92)**	**(46)bps**	(94)	(53)bps
Other	**(1)**		(5)	
Underlying free surplus	**29**		11	

Corporate Benefits underlying free surplus income has increased by £12 million to £122 million as a consequence of growth in assets under administration. At the same time outgoings have fallen reflecting actions taken to contain commission spend and management of investment expenses, including the benefit from the appointment of Schroders as asset managers for a large proportion of the book and increased use of the lower cost My Money platform. "Other" has improved by £4 million which primarily reflects the reclassification of scheme-level expense on new policies in existing schemes from new business to in-force policies, which had a favourable impact on non-unit reserves.

Heritage

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. The reduction in investment in new business and APE reflects the lower sales volumes following the cessation of new business sales within the transferred OLAB business.

International

APE volumes have fallen by 13% to £110 million reflecting difficult market conditions across the regions, especially in the first half of 2014. However, volumes in the second half of the year are up 34% compared with the first half of 2014 to £63 million due to higher bond sales and regulatory changes in UAE and Hong Kong.

VNB has decreased 43% to £12 million, reflecting lower sales volumes and the impact of adverse operating assumption changes, particularly in respect of maintenance expenses.

Recent regulatory changes in the Middle East to prevent sales by unlicensed companies are expected to strengthen our competitive position in that region. Elsewhere, the regulators in Hong Kong and Singapore have initiated changes to their respective unit-linked markets which will see a move away from upfront commission. Whilst we see this as a positive move for the long term benefit of both customers and providers, it will cause some challenges and market disruption in the short term.

Returns

IFRS based operating profit

£m	Heritage	UK	Int'l	Corporate	Total
			2014		
New business strain	**(24)**	**(28)**	**(21)**	**–**	**(73)**
In-force surplus	**323**	**92**	**89**	**–**	**504**
Long-term investment return	**(61)**	**16**	**3**	**–**	**(42)**
Principal reserving changes and one-off items	**190**	**49**	**(4)**	**–**	**235**
Development costs	**(14)**	**(19)**	**(13)**	**–**	**(46)**
Other income and charges	**7**	**(5)**	**–**	**(24)**	**(22)**
IFRS based operating profit/(loss) before tax	**421**	**105**	**54**	**(24)**	**556**

£m	Heritage	UK	Int'l	Corporate	Total
			Restated(i) 2013		
New business strain	(41)	(1)	(24)	–	(66)
In-force surplus	304	69	100	–	473
Long-term investment return	(84)	13	(1)	3	(69)
Principal reserving changes and one-off items	159	8	(3)	–	164
Development costs	(10)	(30)	(7)	–	(47)
Other income and charges	2	(19)	(2)	(34)	(53)
IFRS based operating profit/(loss) before tax	330	40	63	(31)	402

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division and to exclude the results of Lombard, which has been classified as discontinued in the year.

Heritage

The 2014 Heritage IFRS based operating profit of £421 million is £91 million higher than in 2013. This improvement has been driven by lower new business strain, higher in-force surplus and improved long-term investment return as a result of higher expected rates of return.

The reduction in new business strain reflects the cessation of new business sales within the transferred OLAB business.

In-force surplus is favourable compared to 2013 with the run-off of the closed book of business being more than offset by the benefit from the first phase of the with-profits annuity reallocation programme, the benefit of partial repayment of a previous loan to a with-profits fund and higher management charges, due to improved economic conditions. In-force surplus has been further increased by a reduction in the level of provision movements in respect of operational items, arising from the review of the legacy business, noted in 2013.

Principal reserving changes and one-off items are higher than in 2013 with the key items in 2014 being a recapture of £1.6 billion of assets backing annuities generating a £90 million benefit, alongside £19 million from the second phase of the with-profits annuity reallocation programme. There was a favourable impact from assumption changes, principally resulting from changes to annuitant longevity assumptions (£65 million).

UK

IFRS based operating profit of £105 million has increased by £65 million compared to 2013 driven by a revision to the long-term longevity assumptions in the Retirement Income business, higher in-force surplus due to the growth of the business and lower development costs. This is partly offset by an increase in new business strain principally driven by improvements made to the competitiveness of the Retirement Income business' annuity proposition.

International

IFRS based operating profit was lower in 2014 at £54 million (2013: £63 million) due to reduced in-force surplus primarily as a result of increased expenses and adverse experience. This was partially offset by a £3 million reduction in new business strain due to lower volumes.

Increased development costs relate to investment in the new International IT platform.

Corporate

The Corporate IFRS based operating result is principally driven by external finance costs and corporate costs, offset by interest on internal debt. The £7 million improvement in 2014 is primarily due to a lower level of holding company costs in 2014.

MCEV operating profit

£m	2014				
	Heritage	**UK**	**Int'l**	**Corporate**	**Total**
Value of new business	**(21)**	**141**	**12**	**–**	**132**
Expected existing business contribution	**211**	**73**	**21**	**(64)**	**241**
Operating experience variances	**(17)**	**(35)**	**(13)**	**–**	**(65)**
Operating assumption changes	**13**	**14**	**2**	**–**	**29**
Other operating variances	**228**	**(15)**	**6**	**–**	**219**
Development costs	**(12)**	**(19)**	**(4)**	**–**	**(35)**
Other income and charges	**1**	**(5)**	**–**	**(19)**	**(23)**
MCEV operating profit/(loss) before tax	**403**	**154**	**24**	**(83)**	**498**

£m	Restated(i) 2013				
	Heritage	UK	Int'l	Corporate	Total
Value of new business	(26)	184	21	–	179
Expected existing business contribution	214	60	16	(75)	215
Operating experience variances	(2)	(33)	3	–	(32)
Operating assumption changes	96	(6)	11	–	101
Other operating variances	138	36	(2)	–	172
Development costs	(10)	(30)	(7)	–	(47)
Other income and charges	–	(19)	(2)	(32)	(53)
MCEV operating profit/(loss) before tax	410	192	40	(107)	535

For details of VNB please see "new business profitability" section.
(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division and to exclude the results of Lombard, which has been classified as discontinued in the year.

Heritage

The Heritage MCEV operating profit of £403 million is in line with the £410 million reported in 2013, with an increase in other operating variances offsetting a reduction in operating assumption changes.

Expected existing business contribution is in line with 2013 with the ongoing benefit from the first phase of the with-profits annuity reallocation programme and improved economic conditions offsetting the general run off of in-force business.

Other operating variances of £228 million include a £68 million benefit from the second phase of the with-profits annuity reallocation, the £97 million impact of a recapture of £1.6 billion of assets backing annuities and £63 million of benefits from modelling changes primarily as a result of revised modelling of the Time Value of Options and Guarantees.

UK

MCEV operating profit before tax of £154 million is £38 million lower than 2013 largely driven by a reduction in the value of new business, as referred to earlier, partially offset by a £13 million increase in expected existing business contribution due to growth in the business.

Adverse operating experience variances of £(35) million are driven by higher than expected claims in Protection, adverse persistency in Group Protection and re-pricing activity in Corporate Benefits in response to increasing competition in the market.

International

MCEV operating profit has decreased to £24 million (2013: £40 million). This reflects a £(9) million reduction in VNB, adverse experience variances of £(13) million primarily driven by adverse persistency, and the non-recurrence of favourable assumption changes from 2013. This is offset by an improvement in the expected existing business contribution from £16 million to £21 million reflecting higher assets under administration combined with higher rates of expected return on all assets.

Corporate

The Corporate MCEV operating result is principally driven by expected external finance costs and corporate costs. The 2014 operating profit of £(83) million represents a £24 million improvement on 2013 due to lower expected debt servicing costs as a result of a reduction in spreads on the debt in 2013 and a lower level of corporate costs.

Cash Return

The cash return ratio of 25.1% is calculated by dividing the Group sustainable free surplus of £373 million by the shareholder net worth (that is, total free surplus and required capital). The 15% growth in sustainable free surplus was partially offset by a higher shareholder net worth in 2014, primarily as a result of positive economic variances during 2013 which increased the 2014 opening position.

£m (unless otherwise stated)	**2014**	Restated(i) 2013
Sustainable free surplus	**373**	325
Adjusted shareholder net worth(ii)	**1,489**	1,368
Cash return (%)	**25.1%**	23.8%

(i) 2013 results have been restated to exclude the results of Lombard, which has been classified as discontinued in the year.
(ii) Adjusted shareholder net worth is calculated as the opening position (1 January 2014: £1,608 million, 1 January 2013: £1,504 million) with allowance for the timing of dividend payments, the receipt of the Lombard sale proceeds in October 2014, the share buyback programme in November 2014 and the AmLife sale in January 2013.

Operating expenses

£m	2014 Heritage	2014 UK	2014 Int'l	2014 Total	Restated[(i)] 2013 Heritage	Restated[(i)] 2013 UK	Restated[(i)] 2013 Int'l	Restated[(i)] 2013 Total
Acquisition	**30**	**112**	**22**	**164**	37	99	21	157
Maintenance	**225**	**63**	**25**	**313**	254	48	23	325
Development[(ii)]	**14**	**19**	**13**	**46**	10	30	7	47
	269	**194**	**60**	**523**	301	177	51	529
Corporate				**26**				34
Total				**549**				563

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division and to exclude the results of Lombard, which has been classified as discontinued in the year.
(ii) As reported under IFRS.

Consistent with previous communications, the costs associated with new retirement income product and platform development have been reported within non-recurring items and are therefore excluded from the table above.

Heritage

2014 acquisition costs are lower than 2013, mainly driven by the cessation of new business sales within the transferred OLAB business.

Maintenance costs of £225 million are lower than 2013 due to contractual savings in expenses achieved through the Diligenta partnership and a reduction in costs following the successful completion of the separation programme to move all IT infrastructure and business applications hosted by AXA to Friends Life in 2013.

Development spend of £14 million is higher than 2013 reflecting the cost of the transfer of investment management of assets to Schroders and FLI, together with improvements to existing products and systems to support the in-force business.

UK

Acquisition costs have increased by £13 million compared to 2013 driven by structural changes within the UK division to build capability pending the new pension related freedoms from April 2015, and an expected movement in overheads from maintenance to acquisition as the Heritage book runs off. Maintenance costs have increased by £15 million reflecting growth in each of the three business units. This increase is in line with our expectations as the business grows. The growth is enabling increased operational leverage, as can be seen by the significant improvement in underlying free surplus generation in the year.

Despite reduced overall development spend, there has been considerable investment in the Retirement Income proposition and in enhancing the Protection proposition and the auto-enrolment hub in Corporate Benefits. As mentioned above, the costs associated with new retirement income product and platform development have been reported within non-recurring items and are therefore excluded from the table above.

International

Acquisition and maintenance costs have increased marginally despite lower new business volumes, reflecting increases in regional branch costs and maintenance project spend.

Development expenses amounting to £13 million principally reflect investment in the new International IT platform. Following the re-platforming of new business, the division is on track for re-platforming in-force business during 2015.

Corporate

Corporate expenses are those incurred at holding company level. Lower costs were incurred in 2014 principally due to changes made to the corporate governance structure during 2013.

Non-operating results

£m Group IFRS results	2014	Restated[i] 2013
IFRS based operating profit before tax	**556**	402
Short-term fluctuations in investment return	**(207)**	184
Gain on sale of associates (AmLife)	**–**	20
Other non-recurring items	**(184)**	(151)
STICS[ii] interest adjustment to reflect IFRS accounting for STICS as equity	**31**	31
IFRS profit before acquisition accounting adjustments and shareholder tax	**196**	486
Amortisation and impairment of acquired in-force business	**(302)**	(342)
Amortisation and impairment of other intangible assets	**(52)**	(63)
IFRS (loss)/profit before shareholder tax from continuing operations	**(158)**	81
Shareholder tax	**91**	178
IFRS (loss)/profit after tax from continuing operations	**(67)**	259
Loss after tax from discontinued operations	**(71)**	(24)
IFRS (loss)/profit after tax	**(138)**	235

Group free surplus generation	2014	Restated[i] 2013
Operating free surplus generation	**486**	377
Economic variances	**(144)**	265
Other non-operating items	**(158)**	(249)
Friends Life Holdings free surplus generated	**184**	393
Friends Life Group Limited income and charges	**(21)**	(21)
Total free surplus generated from continuing operations	**163**	372
Free surplus generated from discontinued operations	**(3)**	5
Total free surplus generated	**160**	377

Group MCEV results	2014	Restated[i] 2013
MCEV operating profit before tax	**498**	535
Economic variances	**(143)**	401
Non-recurring costs	**(211)**	(181)
Other non-recurring items and non-operating variances	**(66)**	38
MCEV profit from continuing operations before tax	**78**	793
Tax	**(3)**	(186)
MCEV profit from continuing operations after tax	**75**	607
Profit from discontinued operations	**14**	(28)
MCEV profit/(loss) after tax	**89**	579

(i) 2013 results have been restated to exclude the results of Lombard, which has been classified as discontinued in the year.
(ii) 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 £(207) million in 2014. This principally reflects £(104) million due to the incomplete trading of gilt assets into higher yielding assets as part of the recapture of £1.6 billion of assets backing annuities in November 2014 (this variance is expected to reverse as the assets are reinvested in 2015). There was a further negative impact due to reductions in long-term interest rates during the year.

Other non-recurring items of £(184) million include:

- outsourcing implementation costs, net of provision releases, of £(71) million;
- finance transformation costs, largely relating to Solvency II and net of provision movements, of £(36) million;
- costs relating to the Sesame strategic review, of £(25) million;
- project costs incurred in responding to significant regulatory changes in the year, of £(21) million;
- separation and integration programme costs of £(11) million; and
- other strategic project costs of £(20) million, including costs incurred in relation to the Proposed Acquisition by Aviva.

The costs reported above in respect of separation and integration complete this programme and no future costs are anticipated relating to the activities of bringing together the entities and operations that form Friends Life today.

We are pleased with the progress on the outsourcing implementation work which is being undertaken in conjunction with Diligenta and a number of successful migrations have completed in 2014. Total spend under this programme to date amounts to £261 million. As a result of the new pensions and annuity legislation, we have decided to defer parts of the programme until later in 2015. This deferral is expected to result in a modest increase in total programme spend compared to the most recent guidance given in March 2013 of circa £280 million.

As communicated in August 2014, the Group's intention is to report the costs associated with the new retirement income product and platform development within non-recurring items. Given the UK Chancellor referred to the changes announced in his 2014 Budget as "the most far-reaching reform to the taxation of pensions since the regime was introduced in 1921", the Group believes this approach is appropriate in this instance. In accordance with this intention, £21 million of costs associated with responding to significant regulatory changes in the year have been reported within other non-recurring items. In addition to this, for free surplus and MCEV reporting only, a further provision of £45 million has been established for the anticipated future costs in response to significant regulatory changes in the year.

Group free surplus generation: non-operating results

Total economic variances had a £(144) million impact on free surplus in the year, principally as a result of falls in long-term interest rates during the year which increased liabilities and subsequently, required capital. Similar to the IFRS result, there was a £(104) million impact due to the incomplete trading of gilt assets into higher yielding assets as part of the recapture of £1.6 billion of assets backing annuities in November 2014 (this variance is expected to reverse as the assets are reinvested in 2015). Offsetting positive variances arose from gains in equities and bonds over the period, which have allowed historic taxable losses to be valued, and a decrease in expense inflation assumptions.

Other non-operating items of £(158) million include £(184) million of non-recurring items, consistent with those reported within the IFRS result. In addition, there is a net impact of £26 million from items specific to free surplus, including £21 million benefit from the release of required capital due to a lower level of non-recurring expense in 2013.

Friends Life Group Limited ("FLGL") income and charges of £(21) million relate to costs incurred within the FLGL holding company.

Group MCEV: non-operating results

Total economic variances had a £(143) million impact on MCEV profit before tax. This principally reflects a £(119) million impact due to the incomplete trading of gilt assets into higher yielding assets as part of the recapture of £1.6 billion of assets backing annuities in November 2014 (this variance is expected to reverse as the assets are reinvested in 2015). A negative impact from an increase in the market value of the Group's external debt is largely offset by favourable movements in interest rates and expense inflation.

Non-recurring costs had a £(211) million impact on MCEV profit before tax, £(184) million of which is consistent with that reported within the IFRS result. In addition, there was a £(27) million impact from net costs specific to MCEV. This includes £(57) million due to the establishment of a provision to cover anticipated future costs in response to significant regulatory changes in the year (being a provision of £45 million notionally grossed up for tax).

Other non-recurring items and non-operating variances of £(66) million include, as announced in our interim results, a £50 million provision established to cover the anticipated impact of the imposition of a charge cap of 0.75% per annum on default funds for qualifying auto-enrolment schemes and a £10 million provision established to cover the anticipated impact on future profits from the removal of Active Member Discounts ("AMD") on existing schemes.

Group net assets and shares in issue

£m (unless otherwise stated)	**2014**	2013
Total IFRS net assets	**5,115**	5,549
Net Group MCEV	**5,529**	6,065
Shares in issue(i)	**1,405,179,597**	1,417,508,151

(i) Adjusted to exclude 3,872,431 FLGL shares held by the Employee Benefit Trust ("EBT") at 31 December 2014 (31 December 2013: 600,877). The increase reflects additional purchases made by the EBT to deliver shares to employees under various Share Based Payment schemes of the Group. 9,057,000 shares were purchased as part of the share buy-back programme which commenced on 31 October 2014 and was suspended as of 21 November 2014.

At 31 December 2014, IFRS total equity was £5,115 million (31 December 2013: £5,549 million), with equity attributable to equity holders of the parent of £4,796 million (31 December 2013: £5,229 million). IFRS net assets per share attributable to equity holders of the parent were £3.41 (31 December 2013: £3.69) based on shares in issue at the balance sheet date.

Net Group MCEV was £5,529 million (31 December 2013: £6,065 million) giving MCEV per share of £3.93 (31 December 2013: £4.28).

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 2014 remains strong with Available Shareholder Assets ("ASA") of £1,066 million and an IGCA[(i)] surplus of £2.3 billion resulting in a coverage ratio, excluding WPICC[(ii)] ("With Profits Insurance Capital Component") of 240%. At 31 December 2014 the estimated and unaudited economic capital[(iii)] surplus at Group level was £3.7 billion corresponding to a coverage ratio of 196%.

Cash and capital definitions

(i) The IGCA position at 31 December 2014 of the Group and its subsidiaries is estimated and unaudited.

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

(iii) 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 economic capital position at 31 December 2014 of the Group and its subsidiaries is estimated and unaudited.

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 2013 full year results. These policies remain unchanged and are summarised below.

Life companies CMP

The CMP of FLL ("Friends Life Limited"), the principal UK life company, is to meet the higher of:

- 150% of Pillar 1 requirements, excluding WPICC and Friends Provident International Life ("FPIL"); and
- 125% of Pillar 2 requirements, including any ICG and excluding FPIL.

In addition to the above, capital within FLL is held to cover at least one year of the FLL debt servicing costs (currently £101 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 broadly designed to cover an additional year of the Company's current dividend and the holding companies' corporate costs and is currently £325 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 2014 the biting capital constraint is the Group IGCA position, and a monitoring buffer of 10% of the IGCA requirements, excluding WPICC, is held within 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. Shareholder resources comprise the free surplus, required capital and inadmissible assets of the business. For the Friends Life holding companies and other non-regulated businesses, free surplus is defined as IFRS net assets less required capital and inadmissible assets on an IGCA basis (for MCEV, where these assets relate to non-covered business, they are all included within free surplus).

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 2014	4,369	245	1,451	6,065
Surplus generated in the period	(170)	82	163	75
Dividend payment	–	–	(299)	(299)
Discontinued operations	15	2	(3)	14
Lombard disposal	(448)	(81)	246	(283)
Other reserve movements	(27)	29	(45)	(43)
Closing MCEV at 31 December 2014	**3,739**	**277**	**1,513**	**5,529**

(i) Required capital at 31 December 2014 includes £257 million in respect of non-covered business required capital and inadmissible assets which are classified as free surplus in MCEV.

Working capital and other assets and liabilities

Working capital represents assets set aside to cover known future requirements and amounts necessary to maintain sufficient flexibility to facilitate compliance with the Group capital policy and additional regulatory requirements. In addition, any assets subject to restriction in their availability to shareholders will be designated as working capital.

The working capital at 31 December 2014 of £447 million has decreased from £534 million at 31 December 2013 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;
- additional capital requirements (at the CMP of 150% of Pillar 1 requirements) expected to arise in relation to the Department of Work and Pensions "charge cap", which will be introduced in April 2015;
- an appropriate monitoring buffer to facilitate ongoing compliance with the Group's CMPs;
- 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.

Available shareholder assets

ASA represents the cash and other assets available to cover Friends Life's corporate costs, to service debt issued by holding companies and, subject to shareholder approval, to pay dividends or return to shareholders. As such, ASA is stated after the deduction of working capital from free surplus.

The ASA of £1,066 million comprises £861 million of shareholder cash at Friends Life holding company level (including the £150 million interim dividend declared by FLL), and £205 million of investments in syndicated loans. Total dividends included from FLL relating to 2014 are £270 million, inclusive of the £120 million paid in the second half of the year

£m	**2014**	2013
Friends Life holding companies' cash	**711**	644
Declared dividend from FLL	**150**	273
Investments in syndicated loans	**205**	–
Available shareholder assets	**1,066**	917

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

£m	**2014**	2013
Settlement of second interim dividend[(i)] (2013: final dividend)	**340**	200
Prudence buffer in accordance with Group policy	**325**	325
Non-specified ASA holdings	**401**	392
Available shareholder assets	**1,066**	917

(i) Assumes the Proposed Acquisition by Aviva completes. In the event that the Proposed Acquisition does not complete, Friends Life expects that its 2014 final dividend and therefore its 2014 full year dividend would be in line with Friends Life's 2013 final dividend and 2013 full year dividend, respectively.

The ASA balance as at 31 December 2014 is held to cover the costs of the second interim dividend which is payable subject to the approval of the Proposed Acquisition by regulators and shareholders; and to maintain a prudence buffer of £325 million, designed to cover approximately an additional year of the Company's current dividend cost (based on the 2013 full year dividends); and the holding companies corporate costs. The Group CMP requirement to hold cash at FLGL sufficient to meet one year of FLGL's debt servicing costs is expected to be met from capital retained in the life companies. As this requirement is not considered a restriction on the availability of FLGL cash, no reduction has been made to the ASA in respect of it.

Cash remittances to the ultimate holding company in 2014 amount to £610 million, comprising £350 million from principal subsidiaries and £260 million of proceeds from the sale of Lombard.

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

The estimated and unaudited Group economic capital surplus above capital requirements as at 31 December 2014 is strong at £3.7 billion (a coverage ratio of 196%). The decrease in capital surplus since 31 December 2013 (surplus of £3.9 billion, coverage ratio 193%) reflects adverse operating variances during the year.

The sensitivities to market shocks show that economic capital surplus at a Group level at 31 December 2014 would change by:

- an estimated £(0.5) billion in the event of a combined 40% fall in equity markets and a 30% fall in property markets;
- an estimated £0.3 billion in the event of a 200bps rise 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).

The sensitivities reflect investment activities, the recapture of £1.6 billion of assets backing annuities, the with-profits annuity reallocation and modelling changes implemented since 31 December 2013.

Insurance Groups Capital Adequacy

In addition to individual company requirements, the Group is required to meet the IGCA requirements of the Insurance Groups Directive. The Group's capital policy is to maintain sufficient Group capital resources to cover 150% of the Group Capital Resource Requirement ("CRR") (excluding WPICC).

The balance sheet remains strong with an estimated and unaudited IGCA surplus of £2.3 billion at 31 December 2014 (1 January 2014: £2.2 billion), with Group capital resources being 240% of the CRR (1 January 2014: 238%) (excluding WPICC of £4.3 billion (1 January 2014: £4.2 billion)).

Movement in IGCA surplus

£m	2014
1 January 2014	**2,236**
Surplus emerging	**301**
Excess of Lombard sale proceeds over IGCA contribution at 1 January 2014	**219**
Dividend paid	**(299)**
Finance costs and other movements[(i)]	**(117)**
31 December 2014	**2,340**

(i) Finance costs and other movements include the £(30) million impact of the share buyback programme prior to its suspension upon the announcement of the Proposed Acquisition.

At 31 December 2014 the capital held to meet CMPs was £836 million (1 January 2014: £812 million) and the excess over the CMPs was £1,504 million (1 January 2014: £1,424 million).

The sensitivities to market shocks show that IGCA surplus at 31 December 2014 would change by:

- an estimated £(0.1) billion in the event of a combined 40% fall in equity markets and a 30% fall in property markets;
- an estimated £0.3 billion in the event of a 200bps rise in interest rates; and
- an estimated £(0.5) 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 recapture of £1.6 billion of assets backing annuities, the with-profits annuity reallocation and modelling changes implemented since 31 December 2013.

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)

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 2014 are presented below.

£m (unless otherwise stated)	Coupon	Principal	Clean market value of debt(i)	Finance costs(iii) IFRS	Finance costs(iii) MCEV
LT2 subordinated debt 2021	12.00%	162	228	(20)	(8)
LT2 subordinated debt 2022	8.25%	500	613	(41)	(22)
UT2 reset perpetual subordinated debt(ii)	7.875%	369	417	(28)	(15)
STICS 2003	6.875%	210	227	(14)	(8)
STICS 2005	6.292%	268	272	(17)	(11)
Total 31 December 2014		**1,509**	**1,757**	**(120)**	**(64)**
Total 31 December 2013		1,496	1,616	(120)	(75)

(i) Market value is based on listed ask price, at 31 December 2014, 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 2014. 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 £(94) million, being the IFRS amount of £(120) million net of tax.

Corporate gearing and liquidity

IFRS gearing (£m)	2014	2013
Equity attributable to equity holders of the parent	**4,796**	5,229
Loans and borrowings(i)	**1,051**	1,050
	18.0%	16.7%

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

MCEV gearing (£m)	2014	2013
Group MCEV, gross of debt	**7,276**	7,688
Debt	**1,747**	1,623
	24.0%	21.1%

At 31 December 2014, the ratio of debt to IFRS equity attributable to equity holders of the parent, gross of debt, was 18.0% (31 December 2013: 16.7%), with the fall in equity principally reflecting the payment of dividends in the period and the loss after tax for the year.

The MCEV gearing of 24.0% (31 December 2013: 21.1%) is up over the period reflecting an increase in the market value of the Group's debt and the decrease in gross Group MCEV, primarily as a result of the Lombard sale.

Discontinued operations – Lombard

On 30 October 2014 the Group completed the sale of its Luxembourg based business, Lombard. The financial impact of the sale, including the operating and non-operating results for the period, is included below:

Financial performance

	IFRS		Free surplus[i]		MCEV	
£m	**2014[ii]**	2013	**2014[ii]**	2013	**2014[ii]**	2013
Operating/Sustainable free surplus results	**23**	34	**7**	6	**13**	(46)
Non-operating results	**(88)**	(80)	**(10)**	(1)	**5**	11
Loss on remeasurement to fair value	**(14)**	n/a	**n/a**	n/a	**n/a**	n/a
Taxation	**8**	22	**n/a**	n/a	**(4)**	7
(Loss)/profit after tax from discontinued operations	**(71)**	(24)	**(3)**	5	**14**	(28)

(i) Free surplus is presented net of tax.
(ii) 2014 figures are up to and including 30 October 2014.

Lombard generated an IFRS based operating profit before tax of £23 million in the first ten months of 2014, £11 million lower than in 2013. The decrease principally reflects one-off costs incurred as a result of the expected sale of the business and lower fee income. The lower fee income results from lapses experienced in 2013 and 2014 and also that the 2014 profit only relates to ten months of the year.

The IFRS non-operating result of £(88) million principally reflects the £(46) million recycling of cumulative foreign exchange adjustments required on disposal and £(35) million amortisation of acquired value of in-force business and other intangible assets.

Sustainable free surplus of £7 million in the first ten months of 2014 is £1 million higher than 2013. Lower investment in new business is offset by reduced expected returns from in-force business.

Lombard generated a MCEV operating profit of £13 million in the first ten months of 2014 (2013: £(46) million). The operating loss in 2013 was principally due to the impact from basis changes to strengthen persistency assumptions. MCEV operating profit was higher in the second half of 2014 principally due to the adverse lapse experience seen in the first two quarters (notably in Belgium) not being repeated in the second half of the year.

Within the MCEV result and consistent with CFO Forum principles, a closing adjustment totalling £(283) million has been made for the remeasurement of the carrying value amount of Lombard. This is excluded from the above table as it does not form part of the profit and loss statement.

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 Committees. 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. In recent years, there have been significant changes in relevant legislation and regulation, a number of which have had a significant impact on the life assurance industry. It is impossible to predict fully 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 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 Group's 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, which comes into effect on 1 January 2016, will have implications for the whole industry as to the way in which companies calculate capital resources and capital requirements. Solvency II continues to be viewed as potentially having a significant impact on the Group.	There remains further work to transition the Group across to a Solvency II basis. Our internal programme is fully mobilised and on track to transition. With greater certainty around the implementation dates, detailed planning work has been completed to ensure readiness. In the absence of final technical implementation standards and guidelines, 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 to optimise this in the manner that best serves our customers and shareholders.
	Pension reforms The UK government has introduced greater flexibility for customers to access their pension savings without the effective requirement to buy an annuity. This means that, from April 2015, people can choose how they access their defined contribution pension savings; for example they could take all their pension savings as a lump sum, draw them down over time, or buy an annuity with part, or all, of their pension.	These developments present both an opportunity and a threat to the Group. Our New World Retirement programme is targeted with developing a range of propositions in response to the increased flexibility. The programme is developing a new individual customer platform and is making enhancements to customer service teams to help customers make appropriate decisions.

Risk	Description and impact	How we manage
Regulatory change, including tax and Solvency II (continued)	**Pension reforms** (continued) Alongside this, the government is introducing a new requirement to make sure that everyone retiring with a defined contribution pension pot has access to free and impartial guidance on the choices they face when deciding how to use their retirement savings. The guidance on pension choices will be provided by independent organisations rather than pension schemes or providers. The Financial Conduct Authority ("FCA") has informed pension providers that they have responsibility to make customers aware of the impact of taking cash from their pension savings. On 27 February, the FCA issued final rules which take effect from 6 April 2015, placing additional requirements on pensions providers to ensure customers understand the implications of the choices they are making in accessing their savings, including tax issues that customers may not anticipate.	We are also working to develop our operational capability to ensure that features, such as request withdrawals and the provision of appropriate information, are implemented in accordance with requirements which is challenging due to the short implementation time since receiving the final regulatory requirements. Furthermore, it is difficult to predict the levels and nature of our customer interaction at the point the changes come into effect and it is possible that there may be some disruption to the provision of customer services.
	OFT / DWP workplace pensions consultation Following a review by the Office of Fair Trading and the Department of Work and Pensions, it has been confirmed that, from April 2015, a 0.75% charge cap will come into effect on auto-enrolment schemes. The cap will cover all member-borne deductions which include all charges on member savings other than transaction costs. Other measures will be implemented in successive years.	The implementation of the OFT and DWP reviews of workplace pension arrangements remains uncertain. The extent of the changes, including the impact from the charge cap (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 2015 and beyond.
	FCA Legacy Review In March 2014, the FCA announced that they would undertake a thematic review into the fair treatment of long standing customers in life insurance. Given the Group's significant book of legacy business within our Heritage business, we are proactively engaging with the FCA review. However, the expected outcome of this review is unclear and there is a risk that the FCA could use its powers of intervention to introduce new rules and/or require firms to take certain action in response to any issues and non-compliance identified pursuant to such review.	The FCA's work commenced in the summer and we await their findings in 2015.
Sesame Bankhall Group ("SBG")	The Group has, for some time had Sesame Limited ("Sesame"), a subsidiary of SBG, under strategic review. Due to potential liabilities from advice related claims, Sesame is reliant on the continued financial support of the Group to be able to continue to trade. If an appropriate strategic solution cannot be agreed, there remains the risk of further adverse financial and reputational impacts to the Group.	The Group and SBG are in discussions with the FCA in connection with elements of the strategic review and the various options under consideration as part of the strategic review of the SBG businesses.

Risk	Description and impact	How we manage
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. In the first half of 2014, weaker than expected global activity led to decreased projections for the remainder of the year through to 2015. Forward looking projections point to: potentially politically motivated changes (including those associated with campaigning for the May 2015 UK General Election), strengthening recovery in North America, revised downward prospects in Germany, France and Italy; China to stabilise at lower growth rates versus recent historical averages. This mixed economic picture paints continued challenges but also potential opportunities for the Group's international subsidiaries. We continue to be in a sustained low interest rate environment. This risk typically reduces with economic growth, which 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 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 Risk	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 2014, the independent credit rating of UK government debt was affirmed and the outlook is now stable; this follows the downgrade in 2013. Given the Group's asset strategy, this had a muted effect. The shareholder funds have also taken on additional credit risk following the movement 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 relatively 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.

Risk	Description and impact	How we manage
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 a long-term strategic partnership with Diligenta who provide specialist IT and business processing. 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 has comprehensive 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 continues to ensure the appropriate risk framework is in place to manage and monitor operational risk, including that which falls within our outsource suppliers. In 2014 a revised Sourcing Policy was developed and a Third Party Risk Management and Control Standards will be implemented and embedded throughout 2015. 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.
Transaction Risk	An all share offer for all of the issued share capital of the Group was made in December 2014. The Group has long maintained a strategy of encouraging consolidation in the market and views the Proposed Acquisition as a positive for shareholders and customers. Should the Proposed Acquisition not proceed to a conclusion, there is a risk that the Friends Life would be vulnerable to adverse market perception.	The risks of the Proposed Acquisition not proceeding have been identified and assessed. Mitigation plans are being developed for such an event.

As stated in note 1 to the IFRS consolidated financial statements, the Directors have considered the Group's risk 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 2014 or 2013, but is derived from those accounts. The statutory accounts for the year ended 31 December 2013 have been delivered to Companies House (in accordance with the requirements of the Overseas Companies Regulations 2009) and those for 2014 will be delivered in due course. 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 2014 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 Strategic report, the Directors' report and the Corporate governance report include 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

4 March 2015

IFRS FINANCIAL INFORMATION

Consolidated income statement

For the year ended 31 December 2014

For the year ended 31 December	Notes	2014 £m	Restated 2013 £m
Revenue			
Gross earned premiums	2	**1,766**	1,971
Premiums ceded to reinsurers	2	**1,000**	(595)
Net earned premiums	2	**2,766**	1,376
Fee and commission income and income from service activities		**693**	715
Investment return		**7,589**	7,959
Total revenue		**11,048**	10,050
Other income	2	**–**	20
Claims, benefits and expenses			
Gross claims and benefits paid		**(4,065)**	(4,494)
Amounts receivable from reinsurers		**672**	688
Net claims and benefits paid		**(3,393)**	(3,806)
Change in insurance contract liabilities		**(2,729)**	2,331
Change in investment contract liabilities		**(2,869)**	(6,170)
Transfer (to)/from unallocated surplus		**(65)**	29
Movement in net asset value attributable to unit-holders		**(60)**	(89)
Movement in policyholder liabilities		**(5,723)**	(3,899)
Acquisition expenses	2	**(554)**	(554)
Administrative and other expenses	2	**(1,183)**	(1,255)
Finance costs	2	**(131)**	(141)
Total claims, benefits and expenses		**(10,984)**	(9,655)
Profit before tax from continuing operations		**64**	415
Policyholder tax	5	**(222)**	(334)
(Loss)/profit before shareholder tax from continuing operations		**(158)**	81
Total tax charge	5	**(131)**	(156)
Policyholder tax	5	**222**	334
Shareholder tax	5	**91**	178
(Loss)/profit after tax from continuing operations		**(67)**	259
Loss after tax from discontinued operations	2	**(71)**	(24)
(Loss)/profit for the year		**(138)**	235
Attributable to:			
Equity holders of the parent			
- From continuing operations		**(98)**	228
- From discontinued operations	2	**(71)**	(24)
Non-controlling interests - continuing operations		**31**	31
(Loss)/profit for the year		**(138)**	235

Basic earnings per share		2014 Pence	Restated 2013 Pence
Basic earnings per share from continuing operations	4	**(6.93)**	16.08
Basic earnings per share from discontinued operations	4	**(5.02)**	(1.69)
Total basic earnings per share		**(11.95)**	14.39

Diluted earnings per share		2014 Pence	Restated 2013 Pence
Diluted earnings per share from continuing operations	4	**(6.93)**	16.07
Diluted earnings per share from discontinued operations	4	**(5.02)**	(1.69)
Total diluted earnings per share		**(11.95)**	14.38

The consolidated income statement includes the results of Lombard as a discontinued operation. A single amount is shown on the face of the income statement representing the operation's post-tax result. 2013 results have also been restated to reflect this classification.

The notes 1 to 14 form an integral part of these financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2014

For the year ended 31 December	2014 £m	Restated 2013 £m
(Loss)/profit from continuing operations(i)	**(67)**	259
Loss from discontinued operations	**(71)**	(24)
(Loss)/profit for the year	**(138)**	235
Other comprehensive income from continuing operations:		
Items that will not be reclassified to profit and loss:		
Remeasurement gains/(losses) on the defined benefit scheme	**26**	(113)
Income tax relating to items that will not be reclassified	**–**	36
Total items that will not be reclassified to profit and loss	**26**	(77)
Items that may be reclassified subsequently to profit and loss:		
Foreign exchange adjustments(ii)	**4**	(5)
Shadow accounting(iii)	**(4)**	4
Total items that may be reclassified subsequently to profit and loss	**–**	(1)
Other comprehensive income/(loss), net of tax, from continuing operations	**26**	(78)
Other comprehensive income, net of tax, from discontinued operations(iv)	**27**	10
Total other comprehensive income/(loss), net of tax	**53**	(68)
Total comprehensive (loss)/income, net of tax, from continuing operations	**(41)**	181
Total comprehensive loss, net of tax, from discontinued operations	**(44)**	(14)
Total comprehensive (loss)/income, net of tax	**(85)**	167

(i) The (loss)/profit from continuing operations includes £31 million (31 December 2013: £31 million) attributable to non-controlling interests. There are no amounts included in other comprehensive income which are attributable to non-controlling interests (2013: £nil).

(ii) Foreign exchange adjustments relate to the translation of the results and financial position of overseas subsidiaries.

(iii) Shadow accounting that may be reclassified subsequently to profit and loss is as a result of a gain of £4 million (31 December 2013: loss of £(4) million) included within foreign exchange adjustments on translation of overseas subsidiaries held by a with-profits fund of Friends Life Limited ("FLL").

(iv) Other comprehensive income from discontinued operations includes £46 million due to the recycling of cumulative foreign exchange adjustments on disposal of a foreign operation (2013: £nil) offset by a £(19) million foreign exchange loss relating to translation of the results and financial position of the foreign operation in 2014 to the date of disposal (2013: £10 million gain).

Consolidated statement of IFRS based operating profit

For the year ended 31 December 2014

For the year ended 31 December	Notes	2014 £m	Restated 2013 £m
Profit before tax from continuing operations	2	**64**	415
Policyholder tax	5	**(222)**	(334)
(Loss)/profit before shareholder tax excluding returns generated within policyholder funds		**(158)**	81
Non-recurring items	2	**184**	131
Amortisation and impairment of acquired present value of in-force business ("AVIF")	7	**302**	342
Amortisation and impairment of other intangible assets	7	**52**	63
Interest payable on Step-up Tier one Insurance Capital Securities ("STICS")	2	**(31)**	(31)
Short-term fluctuations in investment return	2	**207**	(184)
IFRS based operating profit before tax from continuing operations	2	**556**	402
Tax on operating profit		**(17)**	4
IFRS based operating profit after tax from continuing operations attributable to equity holders of the parent[(i)]		**539**	406

Earnings per share		2014 Pence	Restated 2013 Pence
Operating earnings per share from continuing operations	4	**38.14**	28.64
Diluted operating earnings per share from continuing operations	4	**38.08**	28.62

(i) IFRS based operating profit excludes:
- (a) profit or loss from discontinued operations;
- (b) investment variances on unit-linked sterling reserves and the assets backing these reserves, which in previous periods were included within operating profit. This is a change in approach for 2014 but does not materially impact the 2013 comparative results and these have not been restated for this change;
- (c) investment variances from expected investment return for non-linked business which is calculated using a longer term rate of return;
- (d) returns attributable to non-controlling interests in policyholder funds;
- (e) significant non-recurring items;
- (f) 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 2014

As at 31 December	Notes	2014 £m	2013 £m
Assets			
Intangible assets	7	**3,110**	3,855
Property and equipment		**44**	50
Investment properties		**2,690**	2,561
Investment in associate		**4**	4
Financial assets	8,9	**92,768**	109,064
Deferred acquisition costs		**853**	897
Reinsurance assets		**1,231**	2,837
Current tax assets		**24**	33
Insurance and other receivables		**873**	1,100
Cash and cash equivalents		**7,924**	9,690
Total assets		**109,521**	130,091
Liabilities			
Insurance contracts		**35,750**	34,590
Unallocated surplus		**692**	627
Financial liabilities:			
– Investment contracts		**64,087**	83,502
– Loans and borrowings	10	**1,051**	1,050
– Amounts due to reinsurers		**–**	1,580
Net asset value attributable to unit-holders		**589**	621
Provisions		**176**	227
Pension scheme deficit	6	**7**	52
Deferred tax liabilities		**961**	980
Current tax liabilities		**–**	1
Insurance payables, other payables and deferred income		**1,093**	1,312
Total liabilities		**104,406**	124,542
Equity attributable to equity holders of the parent			
– Share capital	11	**4,181**	4,223
– Other reserves		**615**	1,006
		4,796	5,229
Attributable to non-controlling interests		**319**	320
Total equity		**5,115**	5,549
Total equity and liabilities		**109,521**	130,091

The financial statements were approved by the Board of Directors on 4 March 2015.

Consolidated statement of changes in equity

For the year ended 31 December 2014

For the year ended 31 December 2014	Attributable to equity holders of the parent: Share capital £m	Other reserves £m	Total £m	Non-controlling interests £m	Total £m
At 1 January 2014	**4,223**	**1,006**	**5,229**	**320**	**5,549**
(Loss)/profit for the year	**–**	**(169)**	**(169)**	**31**	**(138)**
Other comprehensive income	**–**	**53**	**53**	**–**	**53**
Total comprehensive (loss)/income	**–**	**(116)**	**(116)**	**31**	**(85)**
Dividends paid	**–**	**(299)**	**(299)**	**–**	**(299)**
Interest paid on STICS	**–**	**–**	**–**	**(31)**	**(31)**
Appropriations of profit	**–**	**(299)**	**(299)**	**(31)**	**(330)**
Shares repurchased and cancelled	**(30)**	**–**	**(30)**	**–**	**(30)**
Tax relief on STICS interest(i)	**–**	**20**	**20**	**–**	**20**
Increase in own shares held by the Group	**(13)**	**–**	**(13)**	**–**	**(13)**
Share-based payments, net of settlements(ii)	**1**	**4**	**5**	**(1)**	**4**
At 31 December 2014	**4,181**	**615**	**4,796**	**319**	**5,115**

For the year ended 31 December 2013	Attributable to equity holders of the parent: Share capital £m	Other reserves £m	Total £m	Non-controlling interests £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(ii)	–	7	7	(1)	6
Other movements(iii)	–	4	4	–	4
At 31 December 2013	4,223	1,006	5,229	320	5,549

(i) Included within tax relief on STICS interest is £13 million (2013: £nil) relating to movements in deferred tax on the fair valuing of the STICS instruments on acquisition. These movements are attributable to previous years, however no prior year restatement has been recognised under IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors, on the grounds that there is no impact on previous years' profits and the immateriality of the amounts involved

(ii) The movement in other reserves arising from share-based payment schemes is £5 million for the year (31 December 2013: £7 million) and relates to the expense, net of settlement, of the Group's share-based incentive schemes.

(iii) For the year ended 31 December 2013, other movements comprise the consolidation of the Employee Benefit Trust ("EBT") (£2 million) and release of a share entitlement provision (£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 2014

For the year ended 31 December	2014 £m	2013 £m
Operating activities		
(Loss)/profit for the year	**(138)**	235
Adjusted for:		
– loss on remeasurement to fair value of discontinued operations	**14**	–
– recycling of cumulative translation differences on discontinued operations	**46**	–
– profit on disposal of investment in associate	**–**	(20)
– net realised and unrealised gains on assets at fair value	**(5,610)**	(5,507)
– finance costs	**131**	142
– amortisation and impairment of intangible assets	**390**	483
– depreciation of property and equipment	**2**	5
– movement in deferred acquisition costs	**(10)**	(59)
– total tax charge	**122**	134
– purchase of shares and other variable yield securities	**(27,477)**	(23,948)
– proceeds from sale of shares and other variable yield securities	**28,653**	25,363
– purchase of loans, debt securities and other fixed income securities	**(28,520)**	(26,911)
– proceeds from sale of loans, debt securities and other fixed income securities	**29,927**	28,257
– purchase of investment properties	**(53)**	(45)
– proceeds from sale of investment properties	**214**	265
– increase/(decrease) in insurance contract liabilities	**1,160**	(2,642)
– increase in investment contract liabilities	**957**	4,840
– increase/(decrease) in unallocated surplus	**65**	(29)
– decrease in provisions	**(46)**	(51)
– net movement in receivables and payables	**587**	216
Pre-tax cash inflow from operating activities	**414**	728
Tax paid	**(27)**	(48)
Net cash inflow from operating activities	**387**	680
Investing activities		
Disposal of held for sale assets, net of cash transferred	**(1,539)**	50
Additions to internally generated intangible assets	**(2)**	(4)
Net disposals/(additions) of property and equipment	**4**	(2)
Net cash (outflow)/inflow from investing activities	**(1,537)**	44
Financing activities		
Shares purchased and cancelled under buyback programme	**(30)**	–
Shares purchased in settlement of incentive schemes	**–**	(1)
Shares purchased by EBT	**(13)**	–
Finance costs	**(133)**	(143)
STICS interest	**(31)**	(31)
Net movement in other borrowings, net of expenses	**(19)**	(40)
Dividends paid to equity holders of the parent	**(299)**	(300)
Net cash outflow from financing activities	**(525)**	(515)
(Decrease)/increase in cash and cash equivalents	**(1,675)**	209
Balance at beginning of year	**9,690**	9,449
Exchange adjustments on the translation of foreign operations	**(91)**	32
Balance at end of year	**7,924**	9,690

Notes to the consolidated accounts

1. Accounting policies

1.1 Basis of preparation
The financial statements of the Company as at and for the year ended 31 December 2014 comprise the consolidated financial statements of the Company and its subsidiaries (together referred to as “the Group”) and the Group’s interests in its associates.

The consolidated financial statements as at and for the year ended 31 December 2014 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the European Union (“EU”).

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.

Following its classification as held for sale as at 30 June 2014 and subsequent disposal, the Lombard operating segment has been presented as a discontinued operation. A single amount is shown on the face of the consolidated income statement, comprising the post-tax result of the discontinued operation, the post-tax loss recognised on the remeasurement to fair value less costs to sell and associated corporate non-recurring costs of disposal. The consolidated income statement, consolidated statement of comprehensive income and consolidated statement of IFRS based operating profit comparatives have been restated.

The 2013 consolidated income statement includes the results of AmLife Insurance Berhad and AmFamily Berhad (collectively “AmLife”) up until the date of their disposal on 4 January 2013.

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 have been adopted in the Group financial statements with effect from 1 January 2014.

- 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*. Under IFRS 10, an investor controls an investee when it has exposure, or rights, to variable returns from involvement with the investee and has the ability to affect those returns through its power over the investee. The application of IFRS 10 has not had a material impact on the Group.
- IAS 28 (revised): *Investments in associates and joint ventures.* This standard supersedes IAS 28: *Investments in associates* and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The application of IAS 28 (revised) has no impact on the Group.
- IFRS 12: *Disclosure of interests in other entities.* This standard combines, enhances and replaces disclosure requirements for subsidiaries, joint arrangements, associates and structured entities. Relevant disclosures are included in note 8.

Amendments to IAS 32: *Financial instruments*: *Presentation* relating to offsetting financial assets and financial liabilities. These amendments clarify the meaning of ‘currently has a legally enforceable right to set-off’ and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting.

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 2015, unless otherwise stated, but where earlier adoption is permitted. They have been endorsed by the EU unless otherwise stated. They have not been considered for early adoption by the Group. These changes are not expected to materially impact the Group unless otherwise stated.

New standards:

- IFRS 9: *Financial instruments.* This standard reflects all phases of the IASB's work on the replacement of IAS 39: *Financial instruments: recognition and measurement.* The standard introduces new requirements for classification and measurement, impairment and hedge accounting. Classification is 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 may have a material impact on the classification and measurement of the Group's financial assets. This standard is effective for accounting periods beginning on or after 1 January 2018; it is yet to be endorsed by the EU; and
- IFRS 15: *Revenue from contracts with customers.* The objective of this standard is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. This standard is effective for accounting periods beginning on or after 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.

Amendments to existing standards:

- Amendment to IAS 16: *Property, plant and equipment* and IAS 38: *Intangible assets*: In these amendments the IASB has clarified that the use of revenue-based methods to calculate the depreciation of assets and amortisation of intangible assets is not appropriate. This amendment is effective for annual periods beginning on or after 1 January 2016 but has not yet been endorsed by the EU;
- Improvements to IFRSs 2012: These annual improvements address seven standards in the 2010-2012 reporting cycle. They include changes to IFRS 2: *Share-based payment*, IFRS 3: *Business combinations*, IFRS 8: *Operating segments*, IFRS 13: *Fair value measurement*, IAS 16: *Property, plant and equipment*, IAS 24: *Related party transactions* and IAS 38: *Intangible assets.* Consequential amendments are also made to IFRS 9: *Financial instruments*, IAS 37: *Provisions, contingent liabilities and contingent assets*, and IAS 39: *Financial instruments: recognition and measurement*. The amendments are effective for annual periods beginning on or after 1 July 2014;
- Improvements to IFRSs 2013: These annual improvements address four standards in the 2011-2013 reporting cycle. They include changes to IFRS 1: *First time adoption,* 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; and
- Improvements to IFRSs 2014: These annual improvements address four standards in the 2012-2014 reporting cycle. They include changes to IFRS 5: *Non-current assets held for sale and discontinued operations*, IFRS 7*: Financial instruments: disclosures*, IAS 19: *Employee benefits*, and IAS 34: *Interim financial reporting*. The amendments are effective for annual periods beginning on or after 1 January 2016 but have not yet been endorsed by the EU.

The impact of these amendments is currently being assessed by the Group.

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, the Overseas Life Assurance Business ("OLAB") within the UK life and pensions subsidiaries and Friends Life Investments ("FLI"), and

• FPI comprising Friends Provident International Limited ("FPIL").

Lombard has been classified as a discontinued operation with a single amount shown on the face of the consolidated income statement comprising the post-tax loss for the period, the post-tax loss recognised on the remeasurement of its net assets to fair value less costs to sell, loss on disposal, cumulative exchange difference arising on translation to Sterling, associated corporate non-recurring costs of disposal and any profit/loss on remeasurement of contingent consideration subsequent to disposal. Lombard's result has been excluded from IFRS based operating profit in 2013 and 2014, to better reflect the expected ongoing performance of the Group.

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, OLAB was managed and reported within the FPI segment. Following the decision to stop writing new business in 2013, OLAB was transferred to the Heritage segment in January 2014 and comparatives for the full year to 31 December 2013 have been restated.

b) Operating segment information

(i) IFRS based operating profit

For the year ended 31 December 2014	**UK £m**	**Heritage £m**	**FPI £m**	**Corporate £m**	**Total £m**
Life and pensions operating profit	**113**	**489**	**64**	**–**	**666**
Longer term shareholder investment return	**16**	**(61)**	**3**	**–**	**(42)**
Other (expense)/income	**(5)**	**7**	**–**	**(24)**	**(22)**
Development costs	**(19)**	**(14)**	**(13)**	**–**	**(46)**
IFRS based operating profit/(loss) before tax from continuing operations	**105**	**421**	**54**	**(24)**	**556**
Tax on operating profit					**(17)**
IFRS based operating profit after tax from continuing operations attributable to equity holders of the parent					**539**
Operating earnings per share from continuing operations (pence)					**38.14**

For the year ended 31 December 2013	UK £m	Restated Heritage £m	Restated FPI £m	Corporate £m	Restated Total £m
Life and pensions operating profit	76	422	73	–	571
Longer term shareholder investment return	13	(84)	(1)	3	(69)
Other (expense)/income	(19)	2	(2)	(34)	(53)
Development costs	(30)	(10)	(7)	–	(47)
IFRS based operating profit/(loss) before tax from continuing operations	40	330	63	(31)	402
Tax on operating profit					4
IFRS based operating profit after tax from continuing operations attributable to equity holders of the parent					406
Operating earnings per share (pence)					28.64

(ii) Reconciliation of IFRS based operating result before tax to profit or loss after tax

For the year ended 31 December 2014	**UK £m**	**Heritage £m**	**FPI £m**	**Corporate £m**	**Total £m**
IFRS based operating profit/(loss) before tax from continuing operations	**105**	**421**	**54**	**(24)**	**556**
Non-recurring items(i)(ii)(iii)(iv)	**(62)**	**(106)**	**(4)**	**(12)**	**(184)**
Amortisation and impairment of AVIF	**(48)**	**(185)**	**(69)**	**–**	**(302)**
Amortisation and impairment of other intangible assets	**(45)**	**–**	**(7)**	**–**	**(52)**
Interest payable on STICS	**–**	**31**	**–**	**–**	**31**
Short-term fluctuations in investment return(v)(vi)	**11**	**(190)**	**(16)**	**(12)**	**(207)**
Loss before policyholder and shareholder tax	**(39)**	**(29)**	**(42)**	**(48)**	**(158)**
Policyholder tax	**10**	**212**	**–**	**–**	**222**
(Loss)/profit before tax from continuing operations	**(29)**	**183**	**(42)**	**(48)**	**64**
Policyholder tax	**(10)**	**(212)**	**–**	**–**	**(222)**
Shareholder tax	**2**	**69**	**3**	**17**	**91**
(Loss)/profit after tax from continuing operations	**(37)**	**40**	**(39)**	**(31)**	**(67)**
Loss after tax from discontinued operations					**(71)**
Loss after tax for the year					**(138)**

(i) UK non-recurring items of £(62) million for the year ended 31 December 2014 include separation and integration costs of £(11) million, costs of £(19) million relating to service improvement elements of the outsourcing arrangement with Diligenta, £(3) million relating to finance transformation and Solvency II costs, £(10) million in respect of the Sesame strategic review and £(19) million relating to significant regulatory change. Non-recurring costs relating to significant regulatory change primarily relate to costs associated with the new retirement income product and platform development in response to the 2014 Budget announcement.

(ii) Heritage non-recurring items of £(106) million for the year ended 31 December 2014 include costs of £(52) million in respect of the Diligenta outsourcing agreement, costs of £(2) million relating to significant regulatory change, £(1) million of costs relating to the capital optimisation programme, £(29) million of financial transformation and Solvency II costs, and £(22) 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).

(iii) FPI non-recurring items of £(4) million for the year ended 31 December 2014 relate to finance transformation costs.

(iv) Corporate non-recurring items of £(12) million for the year ended 31 December 2014 include £22 million income from Heritage in respect of the funding relating to the Group's defined benefit pension scheme, £(11) million costs in relation to the proposed all-share acquisition of Friends Life Group Limited ("FLGL") by Aviva plc (the "Proposed Acquisition"), £(8) million relating to projects terminated as a consequence of the Proposed Acquisition, £(15) million relating to the Sesame strategic review.

(v) Includes investment variances on unit-linked sterling reserves and assets backing these reserves, which in previous periods were reported within operating profit. As this change in approach does not materially impact the 2013 comparative results, these have not been restated for this change.

(vi) 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.

For the year ended 31 December 2013	UK £m	Restated Heritage £m	Restated FPI £m	Corporate £m	Restated Total £m
IFRS based operating profit/(loss) before tax from continuing operations	40	330	63	(31)	402
Non-recurring items(i)(ii)(iii)	(35)	(226)	18	112	(131)
Amortisation and impairment of AVIF	(47)	(221)	(74)	–	(342)
Amortisation and impairment of other intangible assets	(42)	(14)	(7)	–	(63)
Interest payable on STICS	–	31	–	–	31
Short-term fluctuations in investment return(iv)	19	160	3	2	184
(Loss)/profit before policyholder and shareholder tax	(65)	60	3	83	81
Policyholder tax	9	325	–	–	334
(Loss)/profit before tax from continuing operations	(56)	385	3	83	415
Policyholder tax	(9)	(325)	–	–	(334)
Shareholder tax	27	174	1	(24)	178
(Loss)/profit after tax from continuing operations	(38)	234	4	59	259
Loss after tax from discontinued operations					(24)
Profit after tax for the year					235

(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 the 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), £(10) million separation and integration costs, £(53) million of costs in respect of the Diligenta outsourcing agreement, £(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 profits 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.

(iii) Revenue and expenses

For the year ended 31 December 2014	UK £m	Heritage £m	FPI £m	Corporate £m	Elimination of inter-segment amounts[i] £m	Total £m
Gross earned premiums on insurance and investment contracts	3,046	1,589	954	–	–	5,589
Investment contract premiums[ii]	(2,426)	(473)	(924)	–	–	(3,823)
Gross earned premiums	620	1,116	30	–	–	1,766
Premiums ceded to reinsurers[iii]	(109)	1,114	(5)	–	–	1,000
Net earned premiums	511	2,230	25	–	–	2,766
Fee and commission income	304	261	128	–	–	693
Investment return	1,694	5,591	306	79	(81)	7,589
Total revenue	2,509	8,082	459	79	(81)	11,048
Intersegment revenue	1	–	–	80	(81)	–
Total external revenue	2,508	8,082	459	(1)	–	11,048
Other income[iv]	–	–	–	22	(22)	–
Net claims and benefits paid	(153)	(3,226)	(14)	–	–	(3,393)
Change in insurance and investment contract liabilities	(1,662)	(3,649)	(287)	–	–	(5,598)
Transfer to unallocated surplus	–	(65)	–	–	–	(65)
Movement in net assets attributable to unit-holders	(25)	(35)	–	–	–	(60)
Acquisition expenses	(397)	(84)	(73)	–	–	(554)
Administrative and other expenses	(301)	(719)	(123)	(62)	22	(1,183)
Finance costs	–	(121)	(4)	(87)	81	(131)
Total claims, benefits and expenses	(2,538)	(7,899)	(501)	(149)	103	(10,984)
Intersegment expenses	–	(102)	–	(1)	103	–
Total external claims, benefits and expenses	(2,538)	(7,797)	(501)	(148)	–	(10,984)
(Loss)/profit before tax from continuing operations	(29)	183	(42)	(48)	–	64
Policyholder tax	(10)	(212)	–	–	–	(222)
Shareholder tax	2	69	3	17	–	91
(Loss)/profit after tax from continuing operations	(37)	40	(39)	(31)	–	(67)
Loss after tax from discontinued operations						(71)
Loss after tax for the year						(138)

(i) Eliminations include loan interest. Intersegment transactions are undertaken on an arm's length basis.
(ii) Accounted for as deposits under IFRS.
(iii) On 24 November 2014 an existing reinsurance treaty was amended such that investment risk transferred back to the Group whilst longevity risk continued to be reinsured. The amount due to reinsurers previously recognised under the agreement of £1,622 million at the amendment date was derecognised, with a corresponding credit recognised in premiums ceded to reinsurers.
(iv) Represents internal recharges on pension deficit reductions of £22 million.

For the year ended 31 December 2013	UK £m	Restated Heritage £m	Restated FPI £m	Corporate £m	Elimination of inter-segment amounts[(i)] £m	Restated Total
Gross earned premiums on insurance and investment contracts	2,887	1,942	1,115	–	–	5,944
Investment contract premiums[(ii)]	(2,235)	(652)	(1,086)	–	–	(3,973)
Gross earned premiums	652	1,290	29	–	–	1,971
Premiums ceded to reinsurers	(96)	(496)	(3)	–	–	(595)
Net earned premiums	556	794	26	–	–	1,376
Fee and commission income	299	306	110	–	–	715
Investment return	1,800	5,917	232	94	(84)	7,959
Total revenue	2,655	7,017	368	94	(84)	10,050
Intersegment revenue	–	–	–	84	(84)	–
Total external revenue	2,655	7,017	368	10	–	10,050
Other income[(iii)]	–	–	20	116	(116)	20
Net claims and benefits paid	(141)	(3,652)	(13)	–	–	(3,806)
Change in insurance and investment contract liabilities	(1,851)	(1,825)	(163)	–	–	(3,839)
Transfer from unallocated surplus	–	29	–	–	–	29
Movement in net assets attributable to unit-holders	(35)	(54)	–	–	–	(89)
Acquisition expenses	(400)	(89)	(65)	–	–	(554)
Administrative and other expenses	(284)	(909)	(139)	(39)	116	(1,255)
Finance costs	–	(132)	(5)	(88)	84	(141)
Total claims, benefits and expenses	(2,711)	(6,632)	(385)	(127)	200	(9,655)
Intersegment expenses	–	(200)	–	–	200	–
Total external claims, benefits and expenses	(2,711)	(6,432)	(385)	(127)	–	(9,655)
(Loss)/profit before tax from continuing operations	(56)	385	3	83	–	415
Policyholder tax	(9)	(325)	–	–	–	(334)
Shareholder tax	27	174	1	(24)	–	178
(Loss)/profit after tax from continuing operations	(38)	234	4	59	–	259
Loss after tax from discontinued operations						(24)
Profit after tax for the year						235

(i) Eliminations include loan interest. Intersegment transactions are undertaken on an arm's length basis.
(ii) Accounted for as deposits under IFRS.
(iii) Includes internal recharges on pension deficit reduction contribution of £116 million and profit on the disposal of AmLife of £20 million.

(iv) Products and services

For the year ended 31 December 2014	**Gross earned premiums £m**	**Net earned premiums £m**	**Fee and commission income £m**	**Total external revenue[i] £m**
UK				
– Corporate benefits	**–**	**–**	**113**	**113**
– Protection	**341**	**232**	**–**	**232**
– Retirement income	**279**	**279**	**–**	**279**
– Other	**–**	**–**	**191**	**191**
Heritage				
– With-profits	**291**	**283**	**–**	**283**
– Pensions	**46**	**44**	**172**	**216**
– Investments	**183**	**175**	**69**	**244**
– Protection	**295**	**160**	**–**	**160**
– Annuities	**301**	**1,568**	**–**	**1,568**
– Other	**–**	**–**	**20**	**20**
FPI				
– Investments	**12**	**12**	**128**	**140**
– Protection	**18**	**13**	**–**	**13**
Total	**1,766**	**2,766**	**693**	**3,459**

(i) Total external revenue does not include investment return of £7,589 million.

For the year ended 31 December 2013	Gross earned premiums £m	Net earned premiums £m	Restated Fee and commission income £m	Restated 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 - restated	190	182	74	256
– Protection - restated	388	247	–	247
– Annuities	315	68	–	68
– Other	–	–	11	11
FPI				
– Investments - restated	14	14	110	124
– Protection - restated	15	12	–	12
Total	1,971	1,376	715	2,091

(i) Total external revenue does not include investment return of £7,959 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 2014	**UK £m**	**Heritage £m**	**FPI £m**	**Corporate £m**	**Elimination of inter-segment amounts[(i)] £m**	**Total £m**
Assets						
Intangible assets	**671**	**1,937**	**502**	**–**	**–**	**3,110**
Financial assets	**24,092**	**62,014**	**6,454**	**208**	**–**	**92,768**
Other assets	**1,871**	**9,632**	**1,447**	**2,020**	**(1,327)**	**13,643**
Total assets	**26,634**	**73,583**	**8,403**	**2,228**	**(1,327)**	**109,521**
Liabilities						
Insurance contracts	**3,442**	**32,138**	**170**	**–**	**–**	**35,750**
Investment contracts	**21,194**	**35,003**	**7,890**	**–**	**–**	**64,087**
Loans and borrowings	**17**	**868**	**–**	**1,311**	**(1,145)**	**1,051**
Other liabilities	**569**	**2,857**	**125**	**149**	**(182)**	**3,518**
Total liabilities	**25,222**	**70,866**	**8,185**	**1,460**	**(1,327)**	**104,406**

As at 31 December 2013	UK £m	Restated Heritage £m	Restated FPI £m	Lombard £m	Corporate £m	Elimination of inter-segment amounts[(i)] £m	Total £m
Assets							
Intangible assets	763	2,123	578	391	–	–	3,855
Financial assets	21,322	63,249	6,073	18,420	–	–	109,064
Other assets	1,798	11,186	1,434	1,985	2,264	(1,495)	17,172
Total assets	23,883	76,558	8,085	20,796	2,264	(1,495)	130,091
Liabilities							
Insurance contracts	3,110	31,354	126	–	–	–	34,590
Investment contracts	19,077	36,667	7,566	20,192	–	–	83,502
Loans and borrowings	13	1,178	11	2	1,031	(1,185)	1,050
Other liabilities	593	4,539	121	254	203	(310)	5,400
Total liabilities	22,793	73,738	7,824	20,448	1,234	(1,495)	124,542

(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 2014	**UK £m**	**Rest of the world £m**	**Total £m**
Gross earned premiums	**1,649**	**117**	**1,766**
Fee and commission income	**547**	**146**	**693**
Revenue from external customers	**2,196**	**263**	**2,459**
Investment return			**7,589**
Premiums ceded to reinsurers			**1,000**
Total revenue			**11,048**

For the year ended 31 December 2013	Restated UK £m	Restated Rest of the world £m	Restated Total £m
Gross earned premiums	1,836	135	1,971
Fee and commission income	593	122	715
Revenue from external customers	2,429	257	2,686
Investment return			7,959
Premiums ceded to reinsurers			(595)
Total revenue			10,050

d) Disposal of discontinued operations

Following receipt of the necessary regulatory approvals, the sale of the Lombard business to the Blackstone Group LP completed on 30 October 2014.

The initial consideration received of £316 million comprised £260 million cash and deferred payment in the form of a vendor loan note with a fair value of £56 million (€70 million). The vendor loan note is denominated in Euros, has an eight year term from the completion date and bears a coupon of 7% per annum. An additional contingent element could increase or decrease the value of the vendor loan note by up to €50 million, determined with reference to Lombard's assets under administration on 30 June 2017 in the upside scenario and with reference to the assets under administration and the achievement of certain new business thresholds at 30 June 2019 in the downside scenario. The sale agreement also contains customary representations, warranties and indemnities that would be expected in a transaction of this nature.

The results of discontinued operations include all associated costs.

(i) Results of discontinued operations

	2014 £m	2013 £m
Fee and commission income and income from service activities	**83**	112
Investment return	**1,300**	827
Total revenue	**1,383**	939
Movement in investment contract liabilities	**(1,215)**	(730)
Acquisition expenses	**(39)**	(49)
Administrative and other expenses	**(148)**	(205)
Finance costs	**–**	(1)
Total claims, benefits and expenses	**(1,402)**	(985)
Loss before shareholder tax	**(19)**	(46)
Shareholder tax	**8**	22
Loss after tax from discontinued operations	**(11)**	(24)
Loss on remeasurement to fair value	**(14)**	–
Recycling of cumulative translation differences	**(46)**	–
Loss from discontinued operations	**(71)**	(24)
Other comprehensive income, net of tax	**27**	10
Total comprehensive loss, net of tax	**(44)**	(14)

(ii) Cash flows of discontinued operations

	2014 £m	2013 £m
Operating cash flows	**98**	197
Investing cash flows	**(1)**	(4)
Financing cash flows	**(6)**	(23)
Total cash flows	**91**	170

(iii) Major classes of assets and liabilities at disposal date

	30 October 2014 £m
Intangible assets	**338**
Financial assets	**18,254**
Other assets	**164**
Cash and cash equivalents	**1,799**
Remeasurement to fair value	**(14)**
Assets	**20,541**
Investment contracts	**19,960**
Deferred tax liabilities	**79**
Other liabilities	**191**
Liabilities	**20,230**
Equity attributable to equity holders of the parent	**311**
Total equity	**311**
Total equity and liabilities	**20,541**

e) Disposal of investment in associate undertaking

On 4 January 2013 the Group 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 £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

	2014 £m	2013 £m
Ordinary dividends declared and charged to equity in the period		
Interim 2014 – 7.05 pence per share, paid on 6 October 2014	**100**	n/a
Final 2013 – 14.09 pence per share, paid on 16 May 2014	**199**	n/a
Interim 2013 – 7.05 pence per share, paid on 4 October 2013	**n/a**	100
Final 2012 – 14.09 pence per share, paid on 20 May 2013	**n/a**	200
Total dividends	**299**	300
Interest on 2003 STICS (coupon rate 6.875%)	**14**	14
Interest on 2005 STICS (coupon rate 6.292%)	**17**	17
Total appropriations of profit	**330**	331

a) Dividends paid on ordinary shares

An interim dividend of 7.05 pence per share was paid on 6 October 2014. If the Proposed Acquisition by Aviva completes, in addition to the 0.74 new Aviva shares that shareholders will receive for each share they own, a second interim dividend of 24.1 pence per share will be paid, which results in a full year dividend of 31.15 pence per share. The second interim dividend includes 10.01 pence per share enhancement to the 2013 final dividend. If the Proposed Acquisition does not complete, it is expected that the 2014 final dividend and therefore the 2014 full year dividend would be in line with the Company's 2013 final dividend and full year dividend respectively, subject to shareholders' approval.

b) STICS interest

Interest on the 2003 STICS is paid in equal instalments in May and November each year at a rate of 6.875%. Interest on the 2005 STICS is paid annually in either June or July at a rate of 6.292%.

4. Earnings per share

a) Basic and operating earnings per share

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	2014 Earnings £m	2014 Pence per share	Restated 2013 Earnings £m	Restated 2013 Pence per share
(Loss)/profit after tax from continuing operations attributable to equity holders of the parent	**(98)**	**(6.93)**	228	16.08
Add back:				
– short-term fluctuations in investment return	**207**	**14.64**	(184)	(12.98)
– non-recurring items	**184**	**13.02**	131	9.24
– amortisation and impairment of acquired intangible assets	**354**	**25.05**	405	28.57
– tax credit on items excluded from operating profit	**(108)**	**(7.64)**	(174)	(12.27)
Operating profit after tax from continuing operations attributable to equity holders of the parent	**539**	**38.14**	406	28.64

(Loss)/profit after tax from continuing operations attributable to equity holders of the parent	**(98)**	**(6.93)**	228	16.08
Loss after tax from discontinued operations attributable to equity holders of the parent	**(71)**	**(5.02)**	(24)	(1.69)
(Loss)/profit after tax attributable to equity holders of the parent	**(169)**	**(11.95)**	204	14.39

b) Diluted basic earnings per share from continuing operations

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

For the year ended 31 December 2014	Earnings £m	Weighted average number of shares	Pence per share
Loss after tax from continuing operations attributable to equity holders of the parent	**(98)**	**1,413,304,704**	**(6.93)**
Dilutive effect of share awards	**–**	**2,093,441**	**–**
Diluted basic earnings per share on loss after tax from continuing operations attributable to equity holders of the parent	**(98)**	**1,415,398,145**	**(6.93)**

For the year ended 31 December 2013	Restated Earnings £m	Weighted average number of shares	Restated Pence per share
Profit after tax from continuing operations attributable to equity holders of the parent	228	1,417,808,590	16.08
Dilutive effect of share awards	–	904,272	(0.01)
Diluted basic earnings per share on profit after tax from continuing operations attributable to equity holders of the parent	228	1,418,712,862	16.07

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

For the year ended 31 December 2014	**Earnings £m**	**Weighted average number of shares**	**Pence per share**
Operating profit after tax from continuing operations attributable to equity holders of the parent	**539**	**1,413,304,704**	**38.14**
Dilutive effect of share awards	**–**	**2,093,441**	**(0.06)**
Diluted basic earnings per share on operating profit after tax from continuing operations attributable to equity holders of the parent	**539**	**1,415,398,145**	**38.08**

For the year ended 31 December 2013	Restated Earnings £m	Weighted average number of shares	Restated Pence per share
Operating profit after tax from continuing operations attributable to equity holders of the parent	406	1,417,808,590	28.64
Dilutive effect of share awards	–	904,272	(0.02)
Diluted basic earnings per share on operating profit after tax from continuing operations attributable to equity holders of the parent	406	1,418,712,862	28.62

c) Diluted basic earnings per share from discontinued operations

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

For the year ended 31 December 2014	**Earnings £m**	**Weighted average number of shares**	**Pence per share**
Loss after tax from discontinued operations attributable to equity holders of the parent	**(71)**	**1,413,304,704**	**(5.02)**
Dilutive effect of share awards	**–**	**2,093,441**	**–**
Diluted basic earnings per share on loss after tax from discontinued operations attributable to equity holders of the parent	**(71)**	**1,415,398,145**	**(5.02)**

For the year ended 31 December 2013	Restated Earnings £m	Weighted average number of shares	Restated Pence per share
Loss after tax from discontinued operations attributable to equity holders of the parent	(24)	1,417,808,590	(1.69)
Dilutive effect of share awards	–	904,272	–
Diluted basic earnings per share on loss after tax from discontinued operations attributable to equity holders of the parent	(24)	1,418,712,862	(1.69)

d) Weighted average number of ordinary shares

For the year ended 31 December 2014	**Actual**	**Weighted**
Issued ordinary shares at beginning of period	**1,417,508,151**	**1,417,508,151**
Effect of:		
– purchase of own shares held	**(3,271,554)**	**(2,978,592)**
– shares repurchased and cancelled	**(9,057,000)**	**(1,224,855)**
Number of ordinary shares at end of period	**1,405,179,597**	**1,413,304,704**

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

5. Taxation

a) Tax recognised in the consolidated income statement

For the year ended 31 December	2014 £m	Restated 2013 £m
Current tax		
UK corporation tax at 21.5% (2013: 23.25%)	**56**	1
Adjustments in respect of prior periods	**(37)**	(6)
Overseas tax	**26**	15
Total current tax charge	**45**	10
Deferred tax		
Origination and reversal of temporary differences	**100**	266
Change in tax rates	**–**	(70)
Recognition of deferred tax assets previously unrecognised	**(5)**	(50)
Adjustments in respect of prior periods	**(9)**	–
Total deferred tax charge	**86**	146
Total tax charge	**131**	156
Analysis:		
Policyholder tax	**222**	334
Shareholder tax	**(91)**	(178)
Total tax charge	**131**	156

Legislation was enacted in 2013 to reduce the rate of corporation tax 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. In 2014, the average rate of corporation tax for the full calendar year is 21.5%.

b) Factors affecting tax charge for year

For the year ended 31 December	2014 £m	Restated 2013 £m
Profit before tax from continuing operations	**64**	415
Profit before tax from continuing operations determined with reference to the average rate of corporation tax in the UK of 21.5% (2013: 23.25%)	**14**	96
Effects of:		
– non-taxable income	**(85)**	(93)
– deductions not allowable for tax purposes	**11**	(9)
– overseas tax	**4**	(6)
– valuation of tax assets and liabilities	**(18)**	(49)
– adjustments in respect of prior periods	**(29)**	(21)
– impact of reduction in corporation tax rate to 20% on deferred tax asset/liability	**–**	(70)
– policyholder tax	**222**	334
– other	**12**	(26)
Total tax charge	**131**	156

6. Staff pension schemes

a) Introduction

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

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

FPIL and SBG also operate defined contribution arrangements.

b) Closed FPPS defined benefit scheme overview

On an IAS 19: *Employee benefits* (Revised 2011) basis, a gross surplus of £59 million has been recognised in respect of the FPPS at 31 December 2014 (2013: deficit of £4 million).

The Trustee and the Group consider the funding position of the FPPS on more than one basis. As part of the triennial review of the FPPS as at 30 September 2011, the Trustee and the Group recognised a deficit of £185 million on a Technical Provisions basis and on this funding basis agreed a deficit reduction plan as at 2 January 2013. The triennial review of the FPPS as at 30 September 2014 has commenced and in normal course the review would be completed within 15 months by 31 December 2015.

Under IFRIC 14, deficit reduction contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available after they are paid into the scheme, a liability is recognised when the obligation arises. In accordance with s207(4) Finance Act 2004, an additional liability of £66 million has been recognised at 31 December 2014 (2013: £48 million), reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £190 million (£151 million of deficit reduction contributions at a present value of £131 million plus the current surplus of £59 million). A deferred tax asset of £30 million (2013: £34 million) has also been recognised to reflect tax relief at a rate of 20% (2013: 20%) 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	2014 £m	2013 £m
IAS 19 surplus/(deficit) (excluding deficit reduction contribution)	**59**	(4)
Authorised payments surplus charge (penal tax) at 35% of available surplus following deficit reduction contribution, discounted to present value(i)	**(66)**	(48)
Net pension deficit (excluding deficit reduction contribution)	**(7)**	(52)

(i) Included in the charge for the year ended 31 December 2014 is a finance charge of £(2) million (2013: £(2) million) relating to penal tax on the present value of the pension deficit funding, which is recognised in the consolidated income statement.

Movement in IAS 19 pension surplus

For the year ended 31 December	2014 £m	2013 £m
Pension (deficit)/surplus at 1 January	**(4)**	62
Net interest on net defined benefit liability/asset(i)(ii)	**–**	3
Employer contributions	**23**	28
Remeasurement gains/(losses)	**41**	(96)
Administration costs(i)	**(1)**	(1)
Pension surplus/(deficit)	**59**	(4)
Present value of deficit reduction contributions	**131**	136
Available surplus subject to authorised payments surplus charge	**190**	132

(i) Recognised in the consolidated income statement.
(ii) The actual return on plan assets for the year ended 31 December 2014 is £252 million (31 December 2013: £81 million).

The total loss relating to the pension scheme recognised in the consolidated income statement for the year ended 31 December 2014 was £(3) million (2013: £nil). In addition to the amounts shown in the table above, a finance charge of £(2) million (2013: £(2)

million charge) relating to penal tax on the present value of pension deficit funding has also been recognised in the consolidated income statement.

Analysis of net pension surplus/(deficit) and related deferred tax

As at 31 December 2014	**Pension surplus/ (deficit) £m**	**Deferred tax £m**
Gross IAS 19 pension surplus and related deferred tax liability	**59**	**(12)**
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)(i)	**(66)**	**–**
Restriction of asset due to authorised payments surplus charge	**–**	**12**
Tax relief available on deficit reduction contributions	**–**	**30**
Net pension deficit and related deferred tax asset	**(7)**	**30**

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 liability 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

Remeasurement gains/(losses) of the defined benefit scheme

For the year ended 31 December	**2014 £m**	2013 £m
Remeasurement gains/(losses):		
– actuarial losses of the defined benefit scheme	**(149)**	(117)
– return on pension asset (excluding amounts included in net interest on net defined benefit liability/asset)	**190**	21
– irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus)(i)	**(15)**	(17)
Remeasurement gains/(losses) of the defined benefit scheme	**26**	(113)
Taxation	**–**	36
Remeasurement gains/(losses) of the defined benefit scheme after tax	**26**	(77)

(i) An additional finance charge of £(2) million (2013: £(2) million) is also recognised in the consolidated income statement relating to penal tax on the present value of pension deficit funding.

A tax credit of £30 million (2013: credit of £34 million) in respect of deficit reduction contributions and a further debit of £30 million (2013: credit of £2 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 2014	**AVIF £m**	**Other £m**	**Total £m**
Cost			
At 1 January 2014	**5,520**	**560**	**6,080**
Additions	**–**	**1**	**1**
Foreign exchange adjustments	**(23)**	**(6)**	**(29)**
Transferred to operations classified as held for sale	**(576)**	**(153)**	**(729)**
At 31 December 2014	**4,921**	**402**	**5,323**
Amortisation and impairment			
At 1 January 2014	**1,893**	**332**	**2,225**
Amortisation charge for the year(i)	**324**	**60**	**384**
Impairment charge for the year(i)(ii)	**–**	**6**	**6**
Foreign exchange adjustments	**(11)**	**(5)**	**(16)**
Transferred to operations classified as held for sale	**(271)**	**(115)**	**(386)**
At 31 December 2014	**1,935**	**278**	**2,213**
Carrying amounts at 31 December 2014	**2,986**	**124**	**3,110**

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

(i) Amortisation and impairment charges on continuing operations are included within administrative and other expenses in the consolidated income statement. Amortisation for the year of £(36) million relating to Lombard is included within loss after tax from discontinued operations in the consolidated income statement.

(ii) Impairment in 2014 of £(6) million related to intangible assets in SBG and reflects the ongoing strategic review of that business unit. AVIF impairment in 2013 of £(11) million has been recognised within OLAB as a result of worsening persistency.

(iii) Disposals in 2013 related to the sale of fully amortised software of £(8) million.

AVIF is shown gross of policyholder and shareholder tax of £544 million (2013: £693 million), with the offsetting balance included in deferred taxation.

i) AVIF

An analysis of AVIF by operating segment used for segmental reporting is set out below. The 2013 comparatives have been restated following the transfer of OLAB to Heritage in January 2014, as explained in note 2.

As at 31 December 2014	**Cost £m**	**Amortisation and impairment £m**	**Net book value £m**
UK	**896**	**(339)**	**557**
Heritage	**3,113**	**(1,176)**	**1,937**
FPI	**912**	**(420)**	**492**
Total	**4,921**	**(1,935)**	**2,986**

As at 31 December 2013	Cost £m	Amortisation and impairment £m	Net book value £m
UK	896	(291)	605
Heritage - restated	3,113	(991)	2,122
FPI - restated	912	(351)	561
Lombard	599	(260)	339
Total	5,520	(1,893)	3,627

ii) Other intangibles

Other intangibles are made up of the following:

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

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

As at 31 December 2013 other intangibles of £54 million (£41 million customer and distribution relationships; £4 million brand; £9 million software) related to Lombard.

iii) Impairment

During 2014 an impairment charge of £6 million was recognised (£5 million in respect of customer and distribution relationships and £1 million in respect of brand) relating to SBG. This impairment charge (which has reduced the value of the Sesame intangibles to £nil) reflects the outcomes identified to date from the ongoing strategic review of that business unit. Apart from this impairment charge, as at 31 December 2014, based on an impairment review of each of the CGUs, the directors are satisfied that none of the Group's intangible assets are impaired.

Following an impairment review at 31 December 2013, an impairment charge of £11 million was recognised in respect of the OLAB operation which was transferred from FPI to Heritage in January 2014. The impairment charge of £11 million was based on a recoverable amount of £25 million for OLAB AVIF. The calculation of the recoverable amount is based on value in use, determined from the current MCEV VIF balance for pre-acquisition business only, adjusted for differences between the IFRS and MCEV measurement basis for other net assets.

8. Financial assets

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

As at 31 December	2014 £m	2013 £m
Fair value through profit or loss (note 8(a)):		
Designated on initial recognition	**92,179**	108,791
Held for trading	**588**	265
Loans at amortised cost (note 8(b))	**1**	8
Total financial assets	**92,768**	109,064

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

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

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

Included within the unit-linked and with-profits assets are a total of £582 million (2013: £614 million) of financial assets relating to the non-controlling interests in the open-ended investment contracts ("OEICs") that have been consolidated as the Group is deemed to have control. These comprise £504 million of shares and other variable yield securities, £54 million of government securities and £24 million of corporate bonds (2013: £523 million of shares and other variable yield securities, £69 million of government securities and £22 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 £82,496 million (2013: £98,798 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 ("ABS") (excluding those held by the unit-linked funds) amount to £4,353 million (2013: £4,124 million) and 99% (2013: 98%) of these are at investment grade as set out in note 9e.

b) Loans at amortised cost

As at 31 December	2014 £m	2013 £m
Mortgage loans	**–**	4
Other loans	**1**	4
Total loans	**1**	8

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 these liabilities are included within the relevant balances in the Group's consolidated statement of financial position and are analysed as follows:

As at 31 December	2014 £m	2013 £m
Shares and other variable yield securities	**48,951**	63,145
Debt securities and other fixed income securities	**9,753**	12,647
Derivative financial instruments	**13**	66
Deposits with credit institutions	**9**	217
Total financial assets held at fair value	**58,726**	76,075
Investment properties	**1,374**	1,302
Insurance and other receivables	**191**	639
Cash and cash equivalents	**2,743**	4,783
Total assets	**63,034**	82,799
Net asset value attributable to unit-holders[(i)] and other payables	**(1,317)**	(1,655)
Total unit-linked net assets	**61,717**	81,144

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

d) Interests in unconsolidated structured entities

The following is a summary of the Group's interest in unconsolidated structured entities as included in the Group's consolidated statement of financial position at 31 December 2014 and classified as financial assets held at fair value through profit or loss.

As at 31 December	2014 £m
Shares and other variable yield securities:	
Unit trusts and other investment vehicles	**20,221**
Private equity	**258**
Debt securities and other fixed income securities:	
Loans	**248**
Asset-backed securities	**2,988**
Total	**23,715**

IFRS 12: *Disclosure of interests in other entities* is effective for the first time in 2014 and no comparative disclosure is required for interests in unconsolidated structured entities in the first year of application.

Outstanding commitments to private equity vehicles are £65 million.

There are no other contractual arrangements that could require a Group entity to provide financial support to these structured entities, the Group has not provided any support in the period and there is no current intention to provide support. The carrying amounts represent the Group's maximum exposure to loss from its interests in unconsolidated structured entities other than commitments to private equity vehicles.

The Group does not sponsor any unconsolidated structured entities.

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 investment contract liabilities, 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 6% (12% excluding unit-linked assets) of the Group's assets are based on valuation techniques where significant observable market data is not available (2013: 7% (11% excluding unit-linked assets)) 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. 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. Corporate bonds with single price feeds or limited trading activity are included in the level 3 category.

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

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' ("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.

The Group has financial liabilities which contain Discretionary Participation Features ("DPF") of £9,335 million (2013: £8,991 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

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

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

As at 31 December 2013	Including unit-linked Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Excluding unit-linked Level 1 £m	Level 2 £m	Level 3 £m	Total £m
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 asset-backed securities)	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.

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

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

b) Transfers between level 1 and level 2

As at 31 December 2014, £9,637 million (2013: £2,175 million) of corporate bonds, shares and other variable yield securities were transferred from level 1 to level 2 and £765 million (2013: £6,102 million) of corporate bonds, shares and other variable yield securities were transferred from level 2 to level 1. The transfers from level 1 to level 2 as at 31 December 2013 and 31 December 2014 include movements arising from refinements to the methodology under which shares and other variable yield securities are classified. Other movements between level 1 and level 2 reflect changes in market activity and in the availability of current quoted prices.

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

	Investment property £m	Owner-occupied properties £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

(i) Gains and their reversal on owner-occupied properties 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.

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

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 and loans at fair value include £346 million (2013: £331 million) of private loans; credit rating assumptions, ranging between AA and CC, have been used to derive discounted cash flow values.
- Shares and other variable yield securities include private equity investments, £194 million (2013: £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

	2014		2013	
As at 31 December	**Carrying amount £m**	**Effect of reasonably possible alternative assumptions £m**	Carrying amount £m	Effect of reasonably possible alternative assumptions £m
Unit-linked investments	**464**	**–**	2,847	–
Shares and other variable yield securities	**874**	**175**	1,134	227
Corporate bonds and loans at fair value (including ABS)	**1,951**	**195**	1,337	134
Total level 3 financial assets	**3,289**	**370**	5,318	361

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

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

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

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 2014	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**BB £m**	**B £m**	**Not rated £m**	**Total £m**
Corporate bonds and loans at fair value	**204**	**2,158**	**5,598**	**3,776**	**307**	**159**	**147**	**12,349**
Asset-backed securities	**1,350**	**828**	**1,568**	**564**	**29**	**10**	**4**	**4,353**
Derivative financial instruments	**–**	**–**	**419**	**114**	**–**	**–**	**42**	**575**
Reinsurance assets	**–**	**1,149**	**82**	**–**	**–**	**–**	**–**	**1,231**
Cash and cash equivalents	**3,932**	**397**	**567**	**268**	**–**	**–**	**17**	**5,181**
Insurance and other receivables	**32**	**129**	**120**	**66**	**5**	**–**	**330**	**682**
Total	**5,518**	**4,661**	**8,354**	**4,788**	**341**	**169**	**540**	**24,371**
%	**23%**	**19%**	**34%**	**20%**	**1%**	**1%**	**2%**	**100%**

As at 31 December 2013	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £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
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
%	20%	31%	30%	16%	1%	1%	1%	100%

10. Loans and borrowings

The Group's loans and borrowings are as follows:

		2014		2013	
	Coupon %	**Carrying Amount £m**	**Fair Value £m**	Carrying Amount £m	Fair Value £m
Subordinated liabilities:					
Friends Life Holdings plc £162 million LT2 subordinated debt due 2021	12.00	**176**	**228**	178	210
Friends Life Holdings plc £500 million LT2 subordinated debt due 2022	8.25	**497**	**613**	497	550
Friends Life Holdings plc US$575 million UT2 reset perpetual subordinated debt	7.875	**361**	**417**	339	378
Financial reinsurance:					
UK financial reinsurance treaties	Various	**5**	**5**	–	–
Heritage financial reinsurance treaties	Various	**9**	**9**	17	17
FPI financial reinsurance treaties	Various	**–**	**–**	11	11
Lombard financial reinsurance treaties	Various	**–**	**–**	3	3
Other:					
Amounts owed to credit institutions (overdrafts)		**3**	**3**	5	5
Total loans and borrowings		**1,051**	**1,275**	1,050	1,174

Subordinated liabilities

The FLH 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 FLH.

The FLH LT2 subordinated debt 2022 is irrevocably guaranteed on a subordinated basis by FLL. This debt is carried at amortised cost being £500 million principal less capitalised issue costs of £3 million (2013: £3 million).

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

Financial reinsurance

On 30 June 2014, FLPL entered into a financial reinsurance treaty with Munich Reinsurance Company UK Limited ("Munich Re") to finance new protection business written in the first half of 2014 in the UK division. The total amount owed to Munich Re under this financial reinsurance agreement as at 31 December 2014 was £5 million (31 December 2013: £nil).

FLL has three financial reinsurance contracts with Munich Re to finance German unit-linked pensions business (now reported within the Heritage division) written in the years ended 31 December 2010, 2011 and 2012. The total amount owed to Munich Re under these financial reinsurance arrangements as at 31 December 2014 was £9 million (31 December 2013: £17 million).

During 2013, FPI 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 2014 was £nil (31 December 2013: £11 million).

Other

Amounts owed to credit institutions (overdrafts) include £3 million (31 December 2013: £5 million) relating to credit balances held within OEICs that have been consolidated as the Group is deemed to have control. 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. If a third party who does not presently have control of the Group acquires such control, the Group must notify the agent immediately and 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 31 December 2014, the facility remains undrawn. Total interest-bearing loans and borrowings are repayable as follows:

As at 31 December	**2014 £m**	2013 £m
Within one year or on demand	**15**	31
Between one and two years	**3**	9
Between two and three years	**3**	2
Between three and four years	**4**	2
Between four and five years	**3**	2
In more than five years	**1,023**	1,004
Total loans and borrowings	**1,051**	1,050

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

Total interest expense for financial liabilities not measured at fair value through profit or loss, which arises solely from interest-bearing loans and borrowings, is £95 million (2013: £94 million)

11. Share capital

	2014		2013	
Issued and fully paid	**Number of shares (million)**	**£m**	Number of shares (million)	£m
Shares of no par value fully paid	**1,405.2**	**4,181**	1,417.5	4,223
Total at 31 December	**1,405.2**	**4,181**	1,417.5	4,223

Changes to share capital during the year

	31 December 2014	
Issued and fully paid	**Number of shares (million)**	**Share capital £m**
Opening share capital at 1 January	**1,417.5**	**4,223**
Net increase in own shares held by the Group	**(3.2)**	**(12)**
Shares repurchased and cancelled	**(9.1)**	**(30)**
Closing share capital	**1,405.2**	**4,181**

Issued and fully paid	31 December 2013 Number of shares (million)	Share capital £m
Opening share capital at 1 January	1,418.1	4,225
Net increase in own shares held by the Group	(0.6)	(2)
Closing share capital	1,417.5	4,223

All ordinary shares in issue in the Company rank pari passu and carry the same voting rights and rights to receive dividends and other distributions declared or paid by the Company.

The increase in own shares held by the Group relates to shares held in the EBT.

On 11 July 2014, the Company announced an intention to return cash to shareholders via a share buyback programme. The Company entered into an arrangement with its corporate brokers to repurchase £317 million worth of ordinary shares of nil par value of the Company, representing 6.7% of the Company's issued share capital at that time. The share buyback commenced on 31 October 2014 following the completion of the Lombard sale.

On 21 November 2014, following the announcement that the boards of Aviva and the Group had reached agreement on the key financial terms of a possible all share combination of Aviva and Friends Life, the buyback programme was suspended and no further shares were repurchased from that date. In the period between 31 October and 21 November 2014, 9,057,000 ordinary shares were purchased for an aggregate consideration of £30 million.

12. 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. In addition, the sale agreement for the disposal of the Lombard business includes representations, warranties and indemnifications that would be expected in a transaction of this nature. Whilst 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.

In February 2013 the Group commenced a strategic review of the businesses of SBG, including Sesame Limited. This strategic review is still ongoing with a number of potential options and outcomes for the Sesame business being considered. Due to potential liabilities from future advice related claims, Sesame is reliant on the continued financial support of the Group to be able to continue to trade. Any costs associated with future complaints 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:

	2014			2013		
	Land and buildings £m	**Other £m**	**Total £m**	Land and buildings £m	Other £m	Total £m
Within one year	**12**	**–**	**12**	15	1	16
Between one and five years	**43**	**–**	**43**	55	1	56
In more than five years	**71**	**–**	**71**	81	1	82
Total operating lease payables	**126**	**–**	**126**	151	3	154

At 31 December 2013, £17 million of lease commitments related to the Lombard business that was sold in 2014 (£14 million land and buildings; £3 million other).

Other commitments

The Group has investment property commitments of £24 million (2013: £16 million) relating to ongoing construction, renovation costs and costs of acquiring existing properties.

13. 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

The key management personnel of FLGL are 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 of the key management personnel in respect of the year ending 31 December 2014 is as set out below:

	2014 Number	**2014 £m**	2013 Number	2013 £m
Salary and short-term employee benefits(i)	**21**	**10**	30	10
Post-employment benefits (excluding defined benefit scheme)	**1**	**–**	1	–
Share-based payments	**1**	**1**	7	2
Total key management personnel compensation charged to the income statement		**11**		12
Post-employment benefits: defined benefit schemes	**–**	**–**	–	–
Total key management personnel compensation		**11**		12

(i) Including Messrs Cowdery and Tiner who stepped down from the board on 8 May 2014.

There were no balances outstanding at the year end with key management (2013: £nil).

Salary and short term employment benefits include £nil payments for loss of office (2013: £0.9 million).

b) Other related parties

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 which owns FLG Holdings Limited, the holding company for the Friends Life Group. The limited partner in RHN1 is RCAP UK LP ("RCAP"). RCAP is an entity established by current and former partners and employees of Resolution Operations LLP ("ROL") including Messrs Cowdery and Tiner who served as directors of the Company during the year as set out in the Governance report. RCAP is entitled to share in the value created by RHN1.

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 in March 2013.

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 £1,676 million of capital returned to the Company to date) is approximately £3,065 million as shown below.

	Gross equity deployed		
Transaction	**The Company £m**	**RCAP £m**	**Total £m**
Friends Provident(i)	**1,916.0**	**0.2**	**1,916.2**
AXA UK Life Business(ii)	**2,139.8**	**0.2**	**2,140.0**
Total	**4,055.8**	**0.4**	**4,056.2**

(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.

Accumulated value of net equity deployed	**2014 £m**	2013 £m
At 1 January	**3,543**	3,752
Distributions from RHN1	**(610)**	(350)
Accumulations in the year	**132**	141
At 31 December	**3,065**	3,543

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 (refer to note 14).

If the Company 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.

c) Related party transactions

There were no related party transactions entered into by FLGL or any member of the Friends Life Group during the year ended 31 December 2014, save for transactions with Clive Cowdery, or entities with which he is associated, which are related party transactions under Listing Rule 11 by virtue of him being a director of Friends Life Group Limited until 8 May 2014.

Property lease

On 12 March 2014, Friends Life entered into a deed of variation and settlement with ROL and Resolution Capital Limited (entities controlled by Clive Cowdery) under which the Company paid £875,000 to discharge certain obligations which arose from the business sale agreement entered into between the Company and ROL in December 2012. The value of the transactions amounted to £875,000 and did not require shareholder or any other approval.

Resolution (Brands) Limited

The Company was party to an amended and restated trademark licensing agreement (the "Trademark Licence Agreement") with Resolution (Brands) Limited, (a company wholly owned by Clive Cowdery), under which the Company had been granted a licence to use the "Resolution" trademark. There were no fees payable under the agreement in 2014 (2013: £nil). The Trademark Licence Agreement was terminated following the change of name to Friends Life Group Limited, approved by shareholders at the Company's Annual General Meeting held on 8 May 2014.

14. Post balance sheet events

On 19 January 2015, the Group published a Scheme of Arrangement ("the Scheme") document in relation to the Proposed Acquisition by Aviva plc of Friends Life Group Limited. An Aviva Prospectus was issued by Aviva plc on the same day.

Under the terms of the Proposed Acquisition, Friends Life shareholders will receive 0.74 Aviva shares for each Friends Life share owned. In addition, a second interim dividend of 24.1 pence per share will be paid to Friends Life shareholders after the Scheme is approved. In the event that the transaction does not complete, the second interim dividend will not be paid, and it would be expected that the 2014 full year dividend would be in line with the 2013 full year dividend. At completion of the Proposed Acquisition the Group is required to settle the RCAP value share arrangement (see note 13) in cash. The cash consideration payable to RCAP is expected to be approximately £220 million. However, under the terms of the Limited Partnership Agreement, RCAP can elect to receive the consideration in shares.

The Proposed Acquisition must be approved by the Company's shareholders, Aviva's shareholders and the Guernsey Court. Subject to approval, the Proposed Acquisition will be completed by way of a Scheme of Arrangement in accordance with Guernsey company law. The Scheme will require shareholder approval at a meeting convened by order of the Guernsey Court ("the Court Meeting") and at an extraordinary general meeting of the Company ("the General Meeting"). The Court Meeting and General Meeting will be held on 26 March 2015. If the Proposed Acquisition is approved by shareholders and the Court, the Scheme will become effective on 10 April 2015, Aviva shares will be issued to Friends Life shareholders, and the second interim dividend will be paid by 24 April 2015.

MCEV FINANCIAL INFORMATION

Consolidated income statement – MCEV basis

For the year ended 31 December 2014

	Notes	2014 £m	Restated 2013 £m
Covered business			
Value of new business	6	**132**	179
Expected existing business contribution		**241**	215
Operating experience variances		**(65)**	(32)
Operating assumption changes		**29**	101
Other operating variances		**219**	172
Development costs	10	**(35)**	(47)
Covered business operating profit before tax	3	**521**	588
Other income and charges		**(23)**	(53)
Operating profit before tax		**498**	535
Economic variances	3	**(143)**	401
Non-recurring items and non-operating variances	3	**(277)**	(143)
Profit from continuing operations before tax		**78**	793
Tax on operating profit		**(91)**	(127)
Tax on other activities		**88**	(59)
Profit from continuing operations after tax		**75**	607
Profit/(loss) from discontinued operations after tax		**14**	(28)
Profit for the year[(i)]		**89**	579

(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 2014 includes the results of Lombard International Assurance S.A. and Insurance Development Holdings AG (collectively "Lombard") as a discontinued operation. The Lombard result after tax up until the date of disposal on 30 October 2014 is shown as a single amount in the consolidated income statement. The 2013 comparative results have been restated to reflect Lombard as a discontinued operation.

Earnings per share – MCEV basis

For the year ended 31 December 2014

Basic earnings per share	Note	**2014 Pence**	Restated 2013 Pence
Basic earnings per share on MCEV basis after tax from continuing operations, attributable to equity holders of the parent	4	**5.31**	42.81
Basic earnings per share on MCEV basis after tax from discontinued operations, attributable to equity holders of the parent	4	**0.99**	(1.97)
Total basic earnings per share		**6.30**	40.84

Diluted earnings per share	Note	**2014 Pence**	Restated 2013 Pence
Diluted earnings per share on MCEV basis after tax from continuing operations, attributable to equity holders of the parent	4	**5.30**	42.79
Diluted earnings per share on MCEV basis after tax from discontinued operations, attributable to equity holders of the parent	4	**0.99**	(1.97)
Total diluted earnings per share		**6.29**	40.82

Consolidated statement of comprehensive income – MCEV basis

For the year ended 31 December 2014

	2014 £m	Restated 2013 £m
Profit from continuing operations after tax	**75**	607
Profit/(loss) from discontinued operations after tax	**14**	(28)
Profit for the year	**89**	579
Remeasurement gains/(losses) on defined benefit pension schemes, net of tax	**26**	(77)
Other comprehensive income/(loss) for the year from continuing operations	**26**	(77)
Foreign exchange adjustments	**(31)**	16
Other comprehensive (loss)/income for the year from discontinued operations	**(31)**	16
Total other comprehensive loss for the year, net of tax	**(5)**	(61)
Total comprehensive income for the year from continuing operations	**101**	530
Total comprehensive loss for the year from discontinued operations	**(17)**	(12)
Total comprehensive income for the year[(i)]	**84**	518

(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 2014

	2014 £m	2013 £m
Opening ordinary shareholders' equity	**6,065**	5,831
Disposal of AmLife on 4 January 2013	**–**	7
Total comprehensive income for the year	**84**	518
Increase in own shares held by the Group	**(13)**	(2)
Dividends paid	**(299)**	(300)
Share-based payments, net of settlements	**5**	7
Disposal of Lombard on 30 October 2014[(i)]	**(283)**	–
Shares repurchased and cancelled	**(30)**	–
Other movements[(ii)]	**–**	4
(Decrease)/increase in MCEV reserves for the year	**(536)**	234
Closing ordinary shareholders' equity	**5,529**	6,065

(i) Lombard was sold on 30 October 2014 for a consideration of £316 million. The disposal value of Lombard of £(283) million reflects the £316 million sale value less the £594 million MCEV value of Lombard as at the date of sale, less the impact of liabilities assumed as a result of the transaction.

(ii) For 31 December 2013, other movements comprise the consolidation of the Group's Employee Benefit Trust (£2 million) and release of a share entitlement provision (£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 financial position – MCEV basis

For the year ended 31 December 2014

	2014 £m	2013 £m
Assets		
VIF of covered business	**3,739**	4,369
Intangible assets	**–**	7
Property and equipment	**44**	50
Investment properties	**2,690**	2,561
Financial assets	**92,709**	109,064
Deferred acquisition costs	**–**	76
Reinsurance assets	**1,231**	2,837
Current tax assets	**24**	33
Insurance and other receivables	**900**	1,134
Cash and cash equivalents	**7,924**	9,690
Total assets	**109,261**	129,821
Liabilities		
Insurance contracts	**35,822**	34,647
Unallocated surplus	**692**	627
Financial liabilities		
– Investment contracts	**63,229**	82,574
– Loans and borrowings	**1,770**	1,633
– Amounts due to reinsurers	**–**	1,580
Net asset value attributable to unit-holders	**589**	621
Provisions	**176**	230
Pension scheme deficit	**7**	52
Deferred tax liabilities	**419**	544
Current tax liabilities	**–**	1
Insurance payables, other payables and deferred income	**1,027**	1,245
Total liabilities	**103,731**	123,754
Equity attributable to:		
– Equity holders of the parent	**5,529**	6,065
– Non-controlling interests	**1**	2
Total equity	**5,530**	6,067
Total equity and liabilities	**109,261**	129,821

Group MCEV analysis of earnings

For the year ended 31 December 2014

	2014			Restated 2013
	Covered business £m	Non-covered business £m	Total business £m	Total business £m
Opening Group MCEV	**5,054**	**1,011**	**6,065**	5,831
Opening adjustments:				
– disposal of AmLife	**–**	**–**	**–**	7
Adjusted opening Group MCEV	**5,054**	**1,011**	**6,065**	5,838
Operating MCEV earnings	**415**	**(8)**	**407**	408
Non-operating MCEV earnings	**(306)**	**(26)**	**(332)**	199
Total MCEV earnings from continuing operations	**109**	**(34)**	**75**	607
Earnings from discontinued operations	**21**	**(7)**	**14**	(28)
Other movements in IFRS net equity	**–**	**26**	**26**	(77)
Closing adjustments:				
– capital and dividend flows	**(416)**	**79**	**(337)**	(291)
– foreign exchange variances	**(31)**	**–**	**(31)**	16
– disposal of Lombard	**(269)**	**(14)**	**(283)**	–
Closing Group MCEV	**4,468**	**1,061**	**5,529**	6,065

Notes to the MCEV results

1. Basis of preparation

Introduction

Friends Life Group Limited is presenting the results and financial position for its life and pensions business on the MCEV basis and for its other businesses on the IFRS basis. The MCEV basis is in compliance with the European Insurance CFO Forum MCEV Principles[(i)] ("the MCEV Principles"), issued in June 2008, and re-issued in amended form in October 2009. In accordance with guidance issued by the CFO Forum in September 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 4 March 2015.

MCEV methodology

Overview

The MCEV basis of reporting is designed to recognise profit as it is earned over the term of a life insurance policy. The total profit recognised over the lifetime of the policy is the same as that recognised under the IFRS basis of reporting, but the timing of recognition is different.

Covered business

Covered business comprises all life and pensions business written by the 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 Group holding company level and certain holding company costs 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; and
- FPI.

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.

In previous reporting periods, OLAB was managed and reported within the FPI segment. Following the decision to stop writing new business in 2013, OLAB was transferred to the Heritage segment in January 2014 and the segmental comparatives for 31 December 2013 have been restated.

On 30 October 2014, the Company disposed of its entire holding of Lombard for a total consideration of £316 million, comprising £260 million upfront cash consideration and £56 million deferred consideration in the form of a vendor loan note. The results of Lombard for the period to disposal have been shown under discontinued operations, and comparatives for the year ended 31 December 2013 have been restated as appropriate.

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, 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 includes certain corporate benefit schemes that have been transferred within Friends Life on to the new 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 the 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 by fitting statistical distributions to each material risk that the with-profits funds are exposed to, randomly sampling from these distributions over the lifespan of the funds. Monte Carlo simulation has been used, and any simulation where adverse risk events exceed the total fund assets represents a cost to the shareholder. TVOG is the average of these costs over all simulations. Allowance has been made under the different scenarios for management actions, such as reductions in the enhancements made to asset shares. 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 mitigate the risk fully. 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. 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 2014

	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	**664**	**21**	**4,369**	**5,054**	**1,011**	**6,065**
Value of new business	**(169)**	**76**	**199**	**106**	**–**	**106**
Expected existing business contribution:						
– reference rate	**16**	**(9)**	**29**	**36**	**–**	**36**
– in excess of reference rate	**7**	**(41)**	**191**	**157**	**–**	**157**
Transfers from VIF and required capital to free surplus	**535**	**(2)**	**(533)**	**–**	**–**	**–**
Operating experience variances and development costs	**(59)**	**8**	**(30)**	**(81)**	**–**	**(81)**
Operating assumption changes	**113**	**(9)**	**(80)**	**24**	**–**	**24**
Other operating items	**35**	**133**	**5**	**173**	**(8)**	**165**
Operating Group MCEV earnings	**478**	**156**	**(219)**	**415**	**(8)**	**407**
Economic variances	**(142)**	**(45)**	**77**	**(110)**	**(3)**	**(113)**
Other non-operating items	**(139)**	**(29)**	**(28)**	**(196)**	**(23)**	**(219)**
Total Group MCEV earnings from continuing operations	**197**	**82**	**(170)**	**109**	**(34)**	**75**
Earnings from discontinued operations	**4**	**2**	**15**	**21**	**(7)**	**14**
Total Group MCEV earnings	**201**	**84**	**(155)**	**130**	**(41)**	**89**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**26**	**26**
Closing adjustments:						
– capital and dividend flows	**(416)**	**–**	**–**	**(416)**	**79**	**(337)**
– foreign exchange variances	**–**	**(4)**	**(27)**	**(31)**	**–**	**(31)**
– acquired/divested businesses	**260**	**(81)**	**(448)**	**(269)**	**(14)**	**(283)**
Closing Group MCEV	**709**	**20**	**3,739**	**4,468**	**1,061**	**5,529**

For the year ended 31 December 2013

Net of tax	Restated Covered business Free surplus £m	Required capital £m	VIF £m	Total £m	Restated Non-covered business £m	Restated 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	(189)	82	249	142	–	142
Expected existing business contribution:						
– reference rate	13	(8)	28	33	–	33
– in excess of reference rate	7	(49)	179	137	–	137
Transfers from VIF and required capital to free surplus	526	(13)	(513)	–	–	–
Operating experience variances and development costs	(5)	(34)	(30)	(69)	–	(69)
Operating assumption changes	52	5	26	83	–	83
Other operating items	5	93	34	132	(50)	82
Operating Group MCEV earnings	409	76	(27)	458	(50)	408
Economic variances	265	(81)	127	311	–	311
Other non-operating items	(231)	(21)	63	(189)	77	(112)
Total Group MCEV earnings from continuing operations	443	(26)	163	580	27	607
Earnings from discontinued operations	5	3	(36)	(28)	–	(28)
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

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 2014

	Covered business						
Gross of tax	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Non-covered business £m**	**Total £m**
Value of new business	**141**	**(21)**	**12**	**–**	**–**	**–**	**132**
Expected existing business contribution	**73**	**211**	**21**	**–**	**(64)**	**–**	**241**
Operating experience variances	**(35)**	**(17)**	**(13)**	**–**	**–**	**–**	**(65)**
Operating assumption changes	**14**	**13**	**2**	**–**	**–**	**–**	**29**
Other operating variances	**(15)**	**228**	**6**	**–**	**–**	**–**	**219**
Development costs	**(19)**	**(12)**	**(4)**	**–**	**–**	**–**	**(35)**
Covered business operating profit/(loss) before tax	**159**	**402**	**24**	**–**	**(64)**	**–**	**521**
Other income and charges	**–**	**–**	**–**	**–**	**–**	**(23)**	**(23)**
Operating profit/(loss) before tax	**159**	**402**	**24**	**–**	**(64)**	**(23)**	**498**
Economic variances	**64**	**(24)**	**2**	**–**	**(180)**	**(5)**	**(143)**
Other non-operating items	**(127)**	**(117)**	**(4)**	**–**	**–**	**(29)**	**(277)**
Profit/(loss) from continuing operations before tax	**96**	**261**	**22**	**–**	**(244)**	**(57)**	**78**
Attributed tax on operating result	**(34)**	**(86)**	**–**	**–**	**14**	**15**	**(91)**
Attributed tax on other activities	**14**	**35**	**–**	**–**	**31**	**8**	**88**
Profit/(loss) from continuing operations after tax	**76**	**210**	**22**	**–**	**(199)**	**(34)**	**75**
Profit/(loss) from discontinued operations after tax	**–**	**–**	**–**	**21**	**–**	**(7)**	**14**
Profit/(loss) after tax	**76**	**210**	**22**	**21**	**(199)**	**(41)**	**89**

For the year ended 31 December 2013

Gross of tax	Covered business UK £m	Restated Heritage[i] £m	Restated FPI[i] £m	Restated Lombard[ii] £m	Corporate £m	Restated Non-covered business[ii] £m	Restated Total[ii] £m
Value of new business	184	(26)	21	–	–	–	179
Expected existing business contribution	60	214	16	–	(75)	–	215
Operating experience variances	(33)	(2)	3	–	–	–	(32)
Operating assumption changes	(6)	96	11	–	–	–	101
Other operating variances	36	138	(2)	–	–	–	172
Development costs	(30)	(10)	(7)	–	–	–	(47)
Covered business operating profit/(loss) before tax	211	410	42	–	(75)	–	588
Other income and charges	–	–	–	–	–	(53)	(53)
Operating profit/(loss) before tax	211	410	42	–	(75)	(53)	535
Economic variances	60	417	(5)	–	(71)	–	401
Other non-operating items	(5)	(240)	(2)	–	–	104	(143)
Profit/(loss) from continuing operations before tax	266	587	35	–	(146)	51	793
Attributed tax on operating result	(49)	(99)	–	–	18	3	(127)
Attributed tax on other activities	(18)	(30)	–	–	16	(27)	(59)
Profit/(loss) from continuing operations after tax	199	458	35	–	(112)	27	607
Loss from discontinued operations after tax	–	–	–	(28)	–	–	(28)
Profit/(loss) after tax	199	458	35	(28)	(112)	27	579

(i) Heritage and FPI 31 December 2013 segmental analysis have been restated following the transfer of OLAB business from FPI to Heritage in January 2014.
(ii) Lombard has been treated as discontinued operations as at 31 December 2014 and consequently the 31 December 2013 comparatives have been restated.

Continuing operations

UK covered business

The life and pensions covered business operating profit before tax for the UK segment was £159 million (2013: £211 million).

VNB

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

Expected existing business contribution

The total expected contribution of £73 million (2013: £60 million) comprises £67 million from applying expected rates of return to the value of in-force of £1,033 million at the start of the period, and £6 million of expected return on shareholders' net assets. The UK expected contribution on shareholders' net assets of £6 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 £(35) million (2013: £(33) million) and comprise the following elements:

- £(19) million charge from worse than expected persistency experience, in particular on the Corporate Benefits and Group Protection businesses. As at 31 December 2013 a provision of £50 million was held to cover adverse persistency on existing corporate pensions schemes. £13 million of this provision has been used to meet the adverse experience during 2014;
- £(8) million charge from worse than assumed mortality experience, in particular in the Group Protection business;
- £(6) million charge from expenses, primarily due to a short-term expense overrun on the Corporate Benefits platform as the volume of business gets up to scale; and
- £(2) million net charge from other sources.

Operating assumption changes

Operating assumption changes of £14 million in the year (2013: £(6) million) comprise:

- £27 million benefit from updating the long-term expense assumptions including a reduction in Corporate Benefits investment expenses, of which the strategic investment partnership with Schroders had a significant contribution;
- £17 million benefit from adopting longevity assumptions for annuities that assume a shorter expectation of life in line with the updated mortality projections released by the Continuous Mortality Investigation ("CMI");
- £(23) million charge from strengthening the morbidity assumptions primarily on critical illness and income protection business; and
- £(7) million net charge for persistency which includes a £(13) million charge from the increase in the provision to cover renegotiation of terms on existing schemes and the impact of updating the lapse assumptions on Corporate Benefits business following experience, partially offset by the benefit from updating persistency assumptions on Protection business.

Other operating variances

Other operating variances of £(15) million in the year (2013: £36 million) is primarily driven by modelling improvements within the Protection business.

Development costs

Development costs of £(19) million (2013: £(30) 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 Benefits platform; 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 £402 million (2013: £410 million).

VNB

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 (2013: £214 million) comprises £194 million from applying expected rates of return to the value of in-force of £2,397 million at the start of the period, and £17 million of expected return on shareholders' net assets. The Heritage expected contribution on shareholders' net assets of £17 million primarily reflects the return based on the reference rate.

Operating experience variances

Operating experience variances totalled £(17) million (2013: £(2) million) and comprise the following elements:

- £(21) million charge from changes in provisions in respect of legacy business;
- £(14) 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;
- £20 million benefit from persistency experience being better than anticipated primarily on unit-linked bonds;
- £6 million benefit from better than assumed mortality experience, in particular on the life protection business; and
- £(8) million net charges from other sources.

Operating assumption changes

Operating assumption changes of £13 million in the year (2013: £96 million) comprise:

- £34 million benefit from updating persistency assumptions primarily from investment bond business;
- £27 million benefit from adopting longevity assumptions for annuities that assume a shorter expectation of life in line with the updated mortality projections released by the CMI;
- £18 million benefit from an increase in deferred tax assets following the removal of restrictions on the valuation of deferred acquisition expenses;
- £6 million net benefit from a revision on inception and recovery rates on income protection and critical illness business, partially offset by an update to mortality rates for investment bonds;
- £(50) million charge from establishing a provision to cover anticipated adverse persistency on pensions business following the UK Chancellor's Budget announcement in March 2014; and
- £(22) million net charge from updating the long-term expense assumptions and partially offset by the benefit of savings on future investment expenses, of which the strategic investment partnership with Schroders had a significant contribution.

Other operating variances

Other operating variances of £228 million (2013: £138 million) comprise:

- £97 million as a result of a project to recapture £1.6 billion of assets backing annuities;
- £68 million benefit reflecting the impact of the with-profits annuity reallocation activity;
- £94 million from a change to the modelling used in the Time Value of Options and Guarantees, to align with the Group's Economic Capital model; and
- £(31) million net charge from various other modelling changes.

Development costs

Development costs of £(12) million (2013: £(10) 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 £24 million (2013: £42 million).

VNB

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

Expected existing business contribution

The expected contribution of £21 million (2013: £16 million) comprises £20 million which reflects the expected return on the opening value of in-force of £424 million at 1 January 2014, and £1 million from the expected return on shareholders' net assets.

Operating experience variances

Operating experience variances of £(13) million (2013: £3 million) comprise:

- £(8) million charge from worse than expected persistency experience, primarily on regular savings plans;
- £(2) 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; and
- £(3) million net charge from other operational elements and other minor variances.

Operating assumption changes

Operating assumption changes of £2 million in the year (2013: £11 million) comprise:

- £14 million benefit from updating mortality assumptions;
- £(21) million charge from increasing the long-term expense assumptions;
- £(5) million charge from updating persistency assumptions principally from an increase in partial withdrawal assumptions; and
- £14 million net benefit from other assumption changes, primarily relating to deferral of maturity dates on regular savings plans.

Other operating variances

Other operating variances, amounting to £6 million in the year (2013: £(2) million) principally reflect enhancements to models following internal review and movements in the cost of non-hedgeable risk.

Development costs

Development costs of £(4) million (2013: £(7) million) primarily relate to a small number of product and systems driven projects.

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 £(64) million (2013: £(75) million) represents the expected interest costs arising on the debt held within the life and pensions covered business with the decrease being driven principally by a reduction in spread on the Group's external debt.

Non-covered business

The non-covered business generated an operating loss of £(23) million (2013: £(53) million) which comprises:

- £(19) million of corporate costs;
- £(5) million operating result of Sesame Bankhall; and
- £1 million operating result of fpb AG, the Group's distributor of German business.

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 £(143) million (2013: £401 million) and these comprise:

- £(185) million from an increase in the market value of debt;
- £(119) million principally reflects the incomplete trading of gilt assets into higher yielding assets as part of the recapture of £1.6 billion of assets backing annuities. This variance is expected to reverse as the assets are reinvested in 2015;

- £(70) million as a result of worse than expected investment returns on equities which reduced the value of future charges, and hence PVFP, on unit-linked business;
- £(64) million due to the widening of credit spreads on corporate bonds;
- £(17) million reflecting adverse currency movements;
- £98 million benefit due to an increase in the illiquidity premium assumption;
- £82 million reflecting falling reference rates;
- £73 million from a decrease in inflation assumptions;
- £56 million tax benefit primarily due to losses brought into value by equity realisations and gilt bond gains during the year; and
- £3 million of other economic variances.

Other non-operating items

Total other non-operating items of £(277) million (2013: £(143) million) comprise:

- £(65) 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);
- £(50) million from establishing a provision to cover the anticipated impact of the imposition of a charge cap of 0.75% on default funds for qualifying auto-enrolment schemes;
- £(45) million from establishing a provision to cover the anticipated costs associated with new Retirement Income product and platform development;
- £(25) million of costs relating to the Sesame strategic review;
- £(21) million from costs relating to significant regulatory change;
- £(19) million from project costs primarily in relation to the Aviva transaction;
- £(15) million from non-recurring costs in respect of Solvency II, partially offset by utilisation of the provision established against these costs;
- £(13) million from Finance Transformation project costs;
- £(10) million due to the establishment of provisions to cover the anticipated impact on future profits from the removal of Active Member Discounts on existing schemes;
- £(5) million net charge from tax related non-operating items; and
- £(9) million of other non-recurring items.

Discontinued operations

Lombard business

The profit from discontinued operations after tax of £14 million (2013: £(28) million loss) is the net of tax earnings from the Lombard business. This result reflects the non-recurrence of negative assumption changes, positive economic variances and offset by a lower contribution from new business, materially adverse operational experience variances and adverse other non-operating items primarily from the costs related to the sale of Lombard.

4. Earnings per share

a) Basic and operating earnings per share

For the year ended 31 December	2014 Earnings £m	2014 Pence per share	Restated 2013 Earnings £m	Restated 2013 Pence per share
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	**75**	**5.31**	607	42.81
Add back:				
– Economic variances	**143**	**10.12**	(401)	(28.28)
– Non-recurring items and non-operating variances	**277**	**19.60**	143	10.09
– Tax credit on items excluded from operating profit	**(88)**	**(6.23)**	59	4.16
Operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	**407**	**28.80**	408	28.78

Profit after tax from continuing operations attributable to ordinary equity holders of the parent	**75**	**5.31**	607	42.81
Profit/(loss) after tax from discontinued operations attributable to ordinary equity holders of the parent	**14**	**0.99**	(28)	(1.97)
Profit after tax attributable to ordinary equity holders of the parent	**89**	**6.30**	579	40.84

b) 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 2014	Earnings £m	Weighted average number of shares	Pence per share
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	**75**	**1,413,304,704**	**5.31**
Dilutive effect of share awards	**–**	**2,093,441**	**(0.01)**
Diluted earnings per share on profit after tax from continuing operations attributable to ordinary equity holders of the parent	**75**	**1,415,398,145**	**5.30**

For the year ended 31 December 2013	Restated Earnings £m	Weighted average number of shares	Restated Pence per share
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	607	1,417,808,590	42.81
Dilutive effect of share awards	–	904,272	(0.02)
Diluted earnings per share on profit after tax from continuing operations attributable to ordinary equity holders of the parent	607	1,418,712,862	42.79

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

For the year ended 31 December 2014	Earnings £m	Weighted average number of shares	Pence per share
Operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	**407**	**1,413,304,704**	**28.80**
Dilutive effect of share awards	**–**	**2,093,441**	**(0.04)**
Diluted earnings per share on operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	**407**	**1,415,398,145**	**28.76**

For the year ended 31 December 2013	Restated Earnings £m	Weighted average number of shares	Restated Pence per share
Operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	408	1,417,808,590	28.78
Dilutive effect of share awards	–	904,272	(0.02)
Diluted earnings per share on operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	408	1,418,712,862	28.76

c) Diluted earnings per share from discontinued operations

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

For the year ended 31 December 2014	Earnings £m	Weighted average number of shares	Pence per share
Profit after tax from discontinued operations attributable to ordinary equity holders of the parent	**14**	**1,413,304,704**	**0.99**
Dilutive effect of share awards	**–**	**2,093,441**	**–**
Diluted earnings per share on profit after tax from discontinued operations attributable to ordinary equity holders of the parent	**14**	**1,415,398,145**	**0.99**

For the year ended 31 December 2013	Restated Earnings £m	Weighted average number of shares	Restated Pence per share
Loss after tax from discontinued operations attributable to ordinary equity holders of the parent	(28)	1,417,808,590	(1.97)
Dilutive effect of share awards	–	904,272	–
Diluted earnings per share on loss after tax from discontinued operations attributable to ordinary equity holders of the parent	(28)	1,418,712,862	(1.97)

d) Weighted average number of ordinary shares

For the year ended 31 December 2014	**Actual**	**Weighted**
Issued ordinary shares at beginning of period	**1,417,508,151**	**1,417,508,151**
Effect of:		
– shares repurchased and cancelled	**(9,057,000)**	**(1,224,855)**
– purchase of own shares held	**(3,271,554)**	**(2,978,592)**
Number of ordinary shares at end of period	**1,405,179,597**	**1,413,304,704**

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

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:

	2014 £m	2013 £m
Equity attributable to ordinary shareholders on an IFRS basis	**4,796**	5,229
Less items only included on an IFRS basis (net of tax):		
– IFRS reserving and other IFRS adjustments	**632**	540
– Deferred front end fees	**59**	58
– Deferred acquisition costs	**(824)**	(795)
– Acquired present value of in-force	**(2,442)**	(2,933)
– Other intangible assets	**(107)**	(186)
Add items only included on a MCEV basis (net of tax):		
– Adjustment for long-term debt to market value	**(324)**	(217)
Net worth on a MCEV basis	**1,790**	1,696
Value of in-force covered business	**3,739**	4,369
Equity attributable to ordinary shareholders on a MCEV basis	**5,529**	6,065

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 86bps to 106bps.

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 the expenses within the value of new business reflect:

- the level of acquisition 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 2014, this short-term overrun was £8 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

	New business premiums							
Year ended 31 December 2014	**Single £m**	**Regular £m**	**APE £m**	**Average annual premium multiplier(i)**	**PVNBP £m**	**Post-tax VNB £m**	**Pre-tax VNB £m**	**New business margin %**
UK Corporate Benefits	**578**	**556**	**614**	**4.0**	**2,817**	**16**	**21**	**0.7**
UK Protection	**–**	**89**	**89**	**7.2**	**638**	**54**	**69**	**10.8**
UK Retirement Income(ii)	**559**	**–**	**56**	**–**	**559**	**40**	**51**	**9.1**
UK total	**1,137**	**645**	**759**	**4.5**	**4,014**	**110**	**141**	**3.5**
Heritage	**167**	**26**	**43**	**3.5**	**258**	**(16)**	**(21)**	**(8.1)**
FPI	**507**	**60**	**110**	**4.9**	**801**	**12**	**12**	**1.5**
Total	**1,811**	**731**	**912**	**4.5**	**5,073**	**106**	**132**	**2.6**

Year ended 31 December 2013	New business premiums Single £m	Regular £m	APE £m	Average annual premium multiplier(i) £m	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(ii)	664	–	66	–	664	63	83	12.5
UK total	1,206	604	724	4.8	4,086	140	184	4.5
Heritage(iii)	201	48	68	4.8	431	(19)	(26)	(6.0)
FPI(iii)	595	67	127	5.0	927	21	21	2.3
Total	2,002	719	919	4.8	5,444	142	179	3.3

(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 as this business only has single premium business therefore PVNBP is the same as the premiums received in the year.
(ii) The value of new business for annuities shown in the table above has been valued assuming an illiquidity premium ranging from 86bps to 106bps during 2014 and from 65bps to 85bps during 2013.
(iii) OLAB was transferred from the FPI segment to the Heritage segment in January 2014 and the segmental comparatives for 31 December 2013 have been restated.

UK

The VNB from the UK segment was £141 million (2013: £184 million), comprising:

- UK Corporate Benefits VNB of £21 million (2013: £26 million), with the reduction reflecting an increase in acquisition costs and reduced margins;
- UK Protection VNB of £69 million (2013: £75 million), with the decrease being driven by an adverse movement in the opening interest rate and mix of new business written, partially offset by an increase in Individual Protection volumes; and
- UK Retirement Income VNB of £51 million (2013: £83 million), with the lower VNB reflecting reduced margins as a result of improvements in the competitive pricing of annuities and reduced volumes following the Budget announcement in March 2014.

Heritage

Heritage VNB of £(21) million (2013: £(26) million), with the increase primarily reflecting reduced expenses following the closure of business in OLAB in 2013. The negative VNB reflects the fact that Heritage now only writes increments to products no longer actively marketed.

FPI

FPI VNB was £12 million (2013: £21 million), with the reduction reflecting lower volumes for regular premium unit-linked insurance business throughout the regions.

New business performance metrics

New business written requires an initial capital investment to meet the set-up costs and capital requirements.

The IRR provides a measure of the return to shareholders on this initial capital investment. It is equivalent to the discount rate at which the present value of the after-tax cash flows expected to be earned over the lifetime of the business written is equal to the initial capital invested, including setting aside the required capital, to support the writing of the business.

The cash payback on new business is the time elapsed until the total of expected (undiscounted) cash flows is sufficient to recoup the initial capital invested, including the release of the required capital, to support the writing of new business.

New business key performance metrics

	2014			Restated 2013[i]		
	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
UK Corporate Benefits	**21**	**8.3**	**11**	26	8.4	11
UK Protection	**69**	**19.2**	**5**	75	13.8	7
UK Retirement Income	**51**	**14.6**	**7**	83	>25.0	2
UK total	**141**	**13.0**	**8**	184	15.3	7
Heritage	**(21)**	**(2.7)**	**n/a**	(26)	(1.0)	n/a
FPI	**12**	**9.4**	**8**	21	11.0	7
Total	**132**	**10.5**	**9**	179	11.0	9

(i) Heritage and FPI year ended 31 December 2013 new business metrics have been restated following the transfer of OLAB business from FPI to Heritage in January 2014. Total year ended 31 December 2013 new business metrics have been restated following the sale of Lombard in October 2014.

The Group new business IRR was 10.5% (2013: 11.0%) and the payback period on new business was 9 years (2013: 9 years). The new business IRR on open insurance businesses (UK Protection, UK Retirement Income and FPI) was 15.1% (2013: 18.1%).

The decrease in UK IRR is impacted by reduced margins from Retirement Income, partially offset by changes to reinsurance terms on Protection business.

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.

The FPI IRR has reduced reflecting the impact of reduced volumes pushing up unit acquisition costs.

The Group new business IRR does not include the impact of the with-profits annuity fund reallocation activity or the recapture of assets backing annuities. If these activities, which represent a discretionary use of capital for the purposes of generating returns, were to be included within the IRR, then the Group IRR would increase to 16.7%.

7. Segmental analysis of Group MCEV

	2014									Restated 2013[iv]
	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	**228**	**431**	**659**	**1,208**	**–**	**(24)**	**(63)**	**1,121**	**1,780**	1,418
Heritage	**457**	**1,298**	**1,755**	**2,374**	**(36)**	**(82)**	**(102)**	**2,154**	**3,909**	4,161
FPI	**24**	**28**	**52**	**492**	**–**	**(1)**	**(27)**	**464**	**516**	508
Lombard	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	598
Corporate[i]										
– IFA and distribution	**59**	**–**	**59**	**–**	**–**	**–**	**–**	**–**	**59**	41
– Pension deficit of FPPS	**23**	**–**	**23**	**–**	**–**	**–**	**–**	**–**	**23**	(18)
– Other	**979**	**10**	**989**	**–**	**–**	**–**	**–**	**–**	**989**	980
Gross Group MCEV[ii]	**1,770**	**1,767**	**3,537**	**4,074**	**(36)**	**(107)**	**(192)**	**3,739**	**7,276**	7,688
Corporate – external STICS	**–**	**(499)**	**(499)**	**–**	**–**	**–**	**–**	**–**	**(499)**	(478)
Corporate – external debt[iii]	**–**	**(1,248)**	**(1,248)**	**–**	**–**	**–**	**–**	**–**	**(1,248)**	(1,145)
Net Group MCEV	**1,770**	**20**	**1,790**	**4,074**	**(36)**	**(107)**	**(192)**	**3,739**	**5,529**	6,065

(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. Corporate includes non-covered business of £(8) million relating to UK (2013: £2 million), £67 million relating to Heritage (2013: £40 million) and £nil relating to discontinued operations (2013: £5 million)

(ii) 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.

(iii) 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.

(iv) OLAB was transferred from the FPI segment to the Heritage segment in January 2014 and the comparatives for 31 December 2013 have been restated.

7.1 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 minimum 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.

7.2 PVFP

The PVFP at 31 December 2014 includes a £140 million net of tax (2013: £46 million) deduction in respect of anticipated adverse experience on pensions business comprising of £70 million within the UK segment (2013: £27 million) and £70 million within the Heritage segment (2013: £19 million). Further details on these provisions are provided in note 10.

7.3 TVOG

The TVOG at 31 December 2014 of £36 million (2013: £114 million), is split between £19 million (2013: £79 million) market risk and £17 million (2013: £35 million) non-market risk. The significant fall in the level of TVOG for market risk is primarily due to a change in the modelling used in the TVOG, to align with the Group's Economic Capital model. The non-market risks include lapses, annuitant longevity, and operational risk within the with-profits fund. The allowance for non-market risks is made by consideration of the impact of extreme scenarios from the Group's Economic Capital model.

7.4 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 ("ICG").

Additionally, the Group capital management policy in respect of FLGL is to hold 150% of Group CRR excluding WPICC (2013: 150%). The cost of holding any additional capital is shown in the FLGL covered business segment. At 31 December 2014, no additional capital was required to meet the Group capital management policy and hence no additional cost was required.

7.5 CNHR

The cost of residual non-hedgeable risk of £192 million (2013: £203 million) is presented as an equivalent annual cost of capital charge of 1.0% (2013: 1.2%) on projected risk-based Group required capital for all non-hedgeable risks. 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					Non-covered business	
Year ended 31 December 2014	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Non-covered business £m**	**Total £m**
Opening Group MCEV	**1,418**	**4,161**	**508**	**598**	**(1,631)**	**1,011**	**6,065**
Operating MCEV earnings	**125**	**316**	**24**	**–**	**(50)**	**(8)**	**407**
Non-operating MCEV earnings	**(49)**	**(106)**	**(2)**	**–**	**(149)**	**(26)**	**(332)**
Group MCEV earnings from continuing operations	**76**	**210**	**22**	**–**	**(199)**	**(34)**	**75**
Earnings from discontinued operations	**–**	**–**	**–**	**21**	**–**	**(7)**	**14**
Total Group MCEV earnings	**76**	**210**	**22**	**21**	**(199)**	**(41)**	**89**
Other movements in IFRS net equity	**–**	**–**	**–**	**–**	**–**	**26**	**26**
Closing adjustments:							
– capital and dividend flows	**(25)**	**(462)**	**(14)**	**(8)**	**93**	**79**	**(337)**
– foreign exchange variances	**–**	**–**	**–**	**(31)**	**–**	**–**	**(31)**
– disposal of Lombard	**311**	**–**	**–**	**(580)**	**–**	**(14)**	**(283)**
Closing Group MCEV	**1,780**	**3,909**	**516**	**–**	**(1,737)**	**1,061**	**5,529**

	Covered business					Restated Non-covered business	
Year ended 31 December 2013	UK £m	Restated Heritage £m	Restated FPI £m	Restated Lombard £m	Corporate £m	Restated Non-covered business £m	Restated Total £m
Opening Group MCEV	1,227	4,181	511	615	(1,611)	908	5,831
Opening adjustments:							
– disposal of AmLife	–	–	(43)	–	–	50	7
Adjusted opening Group MCEV	1,227	4,181	468	615	(1,611)	958	5,838
Operating MCEV earnings	162	311	42	–	(57)	(50)	408
Non-operating MCEV earnings	37	147	(7)	–	(55)	77	199
Group MCEV earnings from continuing operations	199	458	35	–	(112)	27	607
Earnings from discontinued operations	–	–	–	(28)	–	–	(28)
Total Group MCEV earnings	199	458	35	(28)	(112)	27	579
Other movements in IFRS net equity	–	–	–	–	–	(77)	(77)
Closing adjustments:							
– capital and dividend flows	(8)	(478)	5	(5)	92	103	(291)
– foreign exchange variances	–	–	–	16	–	–	16
Closing Group MCEV	1,418	4,161	508	598	(1,631)	1,011	6,065

9. Maturity profile of value of in-force business by proposition

At 31 December 2014	Total £m	Years 1–5 £m	6–10 £m	11–15 £m	16–20 £m	21–25 £m	26–30 £m	31–35 £m	36–40 £m	41+ £m
UK Corporate Benefits	**692**	**276**	**190**	**120**	**63**	**29**	**11**	**3**	**–**	**–**
UK Protection	**278**	**108**	**61**	**44**	**31**	**18**	**9**	**5**	**2**	**–**
UK Retirement Income	**95**	**9**	**10**	**13**	**17**	**17**	**14**	**9**	**4**	**2**
Vendor Loan Note	**56**	**16**	**40**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
UK Total	**1,121**	**409**	**301**	**177**	**111**	**64**	**34**	**17**	**6**	**2**
Heritage	**2,154**	**1,087**	**446**	**304**	**157**	**80**	**46**	**19**	**9**	**6**
FPI	**464**	**215**	**128**	**69**	**32**	**12**	**5**	**2**	**1**	**–**
Total VIF	**3,739**	**1,711**	**875**	**550**	**300**	**156**	**85**	**38**	**16**	**8**

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 2014 %	2013 %
UK and Heritage		
Long-term rate	**1.90**	3.10
Swap yield curve		
– Term 1 year	**0.74**	0.71
– Term 5 years	**1.46**	2.18
– Term 10 years	**1.88**	3.11
– Term 15 years	**2.12**	3.48
– Term 20 years	**2.26**	3.58
FPI long-term rate	**1.90**	3.10

Reference rate – Illiquidity premium adjustment

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

In this regard, the methodology adopted for the valuation of immediate annuities in the UK 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 premiums 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	
	2014	2013	**2014**	2013
UK and Heritage immediate annuities	**70bps**	60bps	**86-106bps**	65-85bps

Expected existing business contribution

The expected existing business contribution is the sum of two components:

- the expected earnings over the period assuming the opening assets earn the beginning of period reference rate; and
- the additional expected earnings (in excess of the beginning of period reference rate) consistent with management’s expectation for the business.

The reference rate is based on the one-year swap return plus, for UK immediate annuity business only, an illiquidity premium equivalent to 60bps (2013: 75bps) at the beginning of the period. The reference rate at 31 December 2014 will form the basis for the expected existing business contribution during 2015.

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.

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 IRR and 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 (2013: 3%) and 2% for property (2013: 2%).

For cash and government bonds no excess over the one-year risk free reference rate has been assumed. For corporate bonds, the return is based on the excess of actual corporate bond spreads on the reporting date, less an allowance for defaults, over the one-year risk free reference rate.

For annuity business the excess return reflects the excess of the bond portfolio over the reference rate including the illiquidity premium adjustment.

Expense inflation

Maintenance expenses for UK, Heritage and FPI business are assumed to increase in the future at a rate of 1% (2013: 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.

	Expense inflation	
	2014 %	2013 %
UK	**3.80**	4.30
Heritage	**3.80**	4.30
FPI	**3.80**	4.30

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	
	2014	2013
Closing exchange rate	**0.789**	0.832
Average exchange rate	**0.808**	0.847

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 WPF, the shareholder receives the management charges in the non-profit fund for these.

The requirement to retain the FLC reattributed inherited estate (“RIE”) to support FLC Old WPF and FLC New WPF, together with the other with-profit fund support arrangements are governed by the 2013 FLL Scheme.

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 from 31 December 2014 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 Moody’s economic scenario generator and are calculated using 2,000 simulations. The with-profits model is consistent with the model used for the Economic Capital Balance Sheet and is calibrated to market conditions at the valuation date using the EIOPA swap 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

	2014 Swap term				2013 Swap term			
Option term	**10 yrs %**	**15 yrs %**	**20 yrs %**	**25 yrs %**	10 yrs %	15 yrs %	20 yrs %	25 yrs %
UK Sterling								
10 years	**27**	**26**	**25**	**24**	18	17	16	15
15 years	**27**	**27**	**26**	**25**	19	18	17	16
20 years	**26**	**25**	**24**	**23**	17	16	15	14
25 years	**27**	**26**	**24**	**22**	16	15	14	13

Swaption implied volatilities – OLAB return of premium guarantee

	2014 Swap term				2013 Swap term			
Option term	**10 yrs %**	**15 yrs %**	**20 yrs %**	**25 yrs %**	10 yrs %	15 yrs %	20 yrs %	25 yrs %
Euro								
10 years	**35**	**34**	**32**	**31**	23	22	21	20
15 years	**35**	**34**	**32**	**30**	25	23	22	20
20 years	**32**	**30**	**28**	**26**	22	20	19	18
25 years	**28**	**26**	**24**	**23**	21	19	18	16

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 13.1% (2013: 15%) and a running yield of 4.3% (2013: 4.3%). Sample implied volatilities are shown in the table below.

	2014		2013	
Option term	**Equity %**	**Property %**	Equity %	Property %
5 years	**21**	**13**	19	15
10 years	**22**	**13**	22	15
15 years	**23**	**13**	24	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.

	2014	2013
Option term	**Equity %**	Equity %
5 years	**21**	20
10 years	**21**	21
15 years	**21**	21

10.3 Other assumptions

Required capital

Required capital under MCEV amounted to £20 million (2013: £21 million). The required capital is shown net of £1,737 million (2013: £1,631 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 2013.

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 and Isle of Man. 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 and Heritage 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 2014 reflects the reduction in corporation tax that took effect from April 2014.

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

	Tax rates	
	2014 %	2013 %
UK	**21.50**	23.25
Heritage	**21.50**	23.25
FPI	**0.00**	0.00

The PVFP for UK and Heritage 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 21% to 20% over the period to 2015 (2013: 23% to 21% over the period to 2014) and for an ultimate rate of 20% from April 2015 (2013: 20% from April 2015).

VAT in the UK of 20.0% (2013: 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.

In 2014, a provision of £50 million gross of tax has been established to cover the anticipated impact of the imposition of a charge cap of 0.75% p.a. on default funds for qualifying auto-enrolment schemes and a provision of £10 million gross of tax has been established to cover the anticipated impact on future profits from the removal of Active Member Discounts on existing schemes. Note that the establishment of these provisions has been included as non-operating within the analysis of MCEV earnings as they relate to regulatory changes.

Provisions are also held to cover adverse persistency experience on corporate pensions business in the UK covering the impact of renegotiation of terms on existing schemes, anticipated short-term persistency following the implementation of auto-enrolment and the impact of the new pension freedoms announced in the 2014 Budget. At 31 December 2014 these totalled £123 million, gross of tax (2013: £60 million).

Future improvements in annuitant mortality have been assumed to be in accordance with the projections published by the CMI in 2013, with a long-term rate of 1.5% per annum for males, 1.25% females (2013: CMI 2011 mortality projections, with a long-term rate 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 reflects the anticipated acquisition 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.

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. A provision of £7 million was held at 31 December 2014 (31 December 2013: £39 million). During 2014 development expenditure of £(97) million has been incurred in relation to the Diligenta arrangement which have been partially offset by a £32 million utilisation of the remaining provision. The net cost of £(65) million is shown in the consolidated income statement within other non-operating items.

In March 2014, the UK Chancellor announced major changes to the pension system in his Budget and the costs associated with responding to these significant regulatory changes have been reported within other non-recurring items. At 31 December 2014, £21 million costs associated with the new retirement income product and platform development together with a £45 million impact from establishing a provision for future costs in response to significant regulatory changes have been reported within non-recurring items for the year.

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;
- Significant regulatory change; 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.

Development costs

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 £35 million (2013: £47 million) have been excluded from the calculation of unit costs and have been recognised in operating profits. Development costs relate to investment in activities expected to create value in the future, but where that expected value cannot be anticipated within the current year's financial results until the value is realised.

	Development costs	
	2014 £m	Restated 2013 £m
UK	**19**	30
Heritage	**12**	10
FPI	**4**	7
Total	**35**	47

Non-hedgeable risks

A charge equivalent to 1.0% (2013: 1.2%) has been applied to the projected risk-based group required capital for all non-hedgeable risks over the remaining lifetime of in-force business.

In line with management's view of the business, allowance has been made for diversification benefits within the non-hedgeable risks of the covered business.

Other assumptions

The external STICS, external 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 2014	**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**	**227**	**2**	**(5)**	**224**
STICS 2005	**268**	**272**	**8**	**(3)**	**277**
LT2 subordinated debt 2021	**162**	**228**	**12**	**(12)**	**228**
LT2 subordinated debt 2022	**500**	**613**	**29**	**(32)**	**610**
UT2 subordinated debt[(ii)]	**356**	**417**	**4**	**(15)**	**406**
Currency swap	**–**	**(10)**	**–**	**2**	**(8)**
Total	**1,496**	**1,747**	**55**	**(65)**	**1,737**

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

(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.

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 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.

	FLGL covered business				
Change in MCEV (net of tax) in 2014	**UK £m**	**Heritage £m**	**FPI £m**	**Corporate £m**	**Total £m**
Base MCEV	**1,780**	**3,909**	**516**	**(1,737)**	**4,468**
Market risk					
100bps increase in reference rates	**(45)**	**(67)**	**3**	**70**	**(39)**
100bps decrease in reference rates	**51**	**53**	**(5)**	**(74)**	**25**
Removal of illiquidity premium for immediate annuities	**(174)**	**(563)**	**–**	**–**	**(737)**
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield	**(52)**	**(156)**	**(26)**	**–**	**(234)**
25% increase in equity/property volatility at the valuation date	**–**	**(31)**	**–**	**–**	**(31)**
25% increase in swaption implied volatility at the valuation date	**–**	**(1)**	**–**	**–**	**(1)**
100bp increase in corporate bond spreads(i)	**(90)**	**(279)**	**–**	**70**	**(299)**
100bp decrease in corporate bond spreads(i)	**116**	**344**	**–**	**(74)**	**386**
10% adverse movement in Sterling/overseas exchange rate(ii)	**(7)**	**(31)**	**(20)**	**–**	**(58)**
10% fall in value of unit-linked funds	**(67)**	**(233)**	**(31)**	**–**	**(331)**
100bp increase in expense inflation	**(33)**	**(91)**	**(10)**	**–**	**(134)**
100bp decrease in expense inflation	**30**	**76**	**9**	**–**	**115**
Insurance and other risk					
Reduction to EU minimum capital or equivalent(iii)	**8**	**43**	**–**	**–**	**51**
10% decrease in maintenance expenses	**38**	**71**	**23**	**–**	**132**
10% proportionate decrease in lapse rates	**44**	**55**	**8**	**–**	**107**
10% proportionate decrease in PUP rates	**10**	**1**	**2**	**–**	**13**
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	**38**	**52**	**6**	**–**	**96**
– After reinsurance	**17**	**24**	**2**	**–**	**43**
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	**(20)**	**(172)**	**–**	**–**	**(192)**
– After reinsurance	**(20)**	**(59)**	**–**	**–**	**(79)**

(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 (2013: 40bps) for in-force business and 40bps (2013: 40bps) 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 £835 million (2013: £812 million). This sensitivity shows the impact on embedded value and value of new business of using the lower regulatory capital requirement.

	FLGL covered business					
Change in MCEV (net of tax) in 2013	UK £m	Restated Heritage(i) £m	Restated FPI(i) £m	Lombard £m	Corporate £m	Total £m
Base MCEV	1,418	4,161	508	598	(1,631)	5,054
Market risk						
100bps increase in reference rates	(21)	(64)	1	(2)	109	23
100bps decrease in reference rates	20	89	(3)	–	(124)	(18)
Removal of illiquidity premium for immediate annuities	(118)	(399)	–	–	–	(517)
10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend/rental yield	(48)	(149)	(26)	(36)	–	(259)
25% increase in equity/property volatility at the valuation date	–	(30)	–	–	–	(30)
25% increase in swaption implied volatility at the valuation date	–	(4)	–	–	–	(4)
100bp increase in corporate bond spreads(ii)	(72)	(286)	–	(9)	109	(258)
100bp decrease in corporate bond spreads(ii)	77	274	–	9	(124)	236
10% adverse movement in Sterling/overseas exchange rate(iii)	(7)	(32)	(19)	(52)	–	(110)
10% fall in value of unit-linked funds	(62)	(212)	(31)	(63)	–	(368)
100bp increase in expense inflation	(30)	(94)	(9)	(9)	–	(142)
100bp decrease in expense inflation	26	81	7	7	–	121
Insurance and other risk						
Reduction to EU minimum capital or equivalent(iv)	9	42	–	–	–	51
10% decrease in maintenance expenses	30	69	19	16	–	134
10% proportionate decrease in lapse rates	36	57	9	37	–	139
10% proportionate decrease in PUP rates	9	2	3	–	–	14
5% decrease in mortality/morbidity – life assurance						–
– Before reinsurance	27	50	6	3	–	86
– After reinsurance	12	19	3	2	–	36
5% decrease in mortality/morbidity – annuity business						–
– Before reinsurance	(17)	(129)	–	–	–	(146)
– After reinsurance	(17)	(51)	–	–	–	(68)

(i) Heritage and FPI 31 December 2013 sensitivities have been restated following the transfer of OLAB business from FPI to Heritage in January 2014.
(ii) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 40bps (2013: 40bps) for in-force business and 40bps (2013: 40bps) for the value of new business.
(iii) Currency risk is expressed in terms of total overseas exposure; the Group's principal currency exposures other than sterling are the Euro and US Dollar.
(iv) Required capital is set at the greater of regulatory capital and requirements arising from internal capital management policies. In aggregate, the required capital is higher than the regulatory requirement by £835 million (2013: £812 million). This sensitivity shows the impact on embedded value and value of new business of using the lower regulatory capital requirement.

Change in value of new business (gross of tax) in 2014	FLGL covered business UK £m	Heritage £m	FPI £m	Total £m
Base value of new business	**141**	**(21)**	**12**	**132**
Market risk				
100bps increase in reference rates	**(12)**	**-**	**(1)**	**(13)**
100bps decrease in reference rates	**13**	**-**	**1**	**14**
Removal of illiquidity premium for immediate annuities	**(42)**	**-**	**-**	**(42)**
100bps increase in corporate bond spreads(i)	**(19)**	**-**	**-**	**(19)**
100bps decrease in corporate bond spreads(i)	**24**	**-**	**-**	**24**
100bps increase in expense inflation	**(8)**	**-**	**-**	**(8)**
100bps decrease in expense inflation	**7**	**-**	**-**	**7**
Insurance and other risk				
Reduction to EU minimum capital or equivalent	**2**	**-**	**-**	**2**
10% decrease in maintenance expenses	**5**	**-**	**2**	**7**
10% proportionate decrease in lapse rates	**15**	**-**	**1**	**16**
10% proportionate decrease in PUP rates	**5**	**-**	**-**	**5**
5% decrease in mortality/morbidity – life assurance				
– Before reinsurance	**10**	**-**	**-**	**10**
– After reinsurance	**1**	**-**	**-**	**1**
5% decrease in mortality/morbidity – annuity business				
– Before reinsurance	**(3)**	**-**	**-**	**(3)**
– After reinsurance	**(5)**	**-**	**-**	**(5)**
Impact of end of period assumptions on VNB	**7**	**-**	**-**	**7**

(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 (2013: 40bps) for in-force business and 40bps (2013: 40bps) for the value of new business.

Change in value of new business (gross of tax) in 2013	FLGL covered business UK £m	Restated Heritage[(i)] £m	Restated FPI[(i)] £m	Lombard £m	Total £m
Base value of new business	184	(26)	21	25	204
Market risk					
100bps increase in reference rates	(3)	–	–	–	(3)
100bps decrease in reference rates	1	–	2	–	3
Removal of illiquidity premium for immediate annuities	(44)	–	–	–	(44)
100bps increase in corporate bond spreads[(ii)]	(18)	–	–	–	(18)
100bps decrease in corporate bond spreads[(ii)]	19	–	–	–	19
100bps increase in expense inflation	(7)	–	–	–	(7)
100bps decrease in expense inflation	5	–	–	–	5
Insurance and other risk					
Reduction to EU minimum capital or equivalent	2	–	–	–	2
10% decrease in maintenance expenses	8	–	2	2	12
10% proportionate decrease in lapse rates	14	–	1	4	19
10% proportionate decrease in PUP rates	5	–	1	–	6
5% decrease in mortality/morbidity – life assurance					
– Before reinsurance	8	–	–	–	8
– After reinsurance	3	–	–	–	3
5% decrease in mortality/morbidity – annuity business					
– Before reinsurance	(3)	–	–	–	(3)
– After reinsurance	(5)	–	–	–	(5)
Impact of end of period assumptions on VNB	(11)	–	(2)	(1)	(14)

(i) Heritage and FPI 31 December 2013 sensitivities have been restated following the transfer of OLAB business from FPI to Heritage in January 2014.
(ii) The corporate bond spread sensitivities of an increase/(decrease) of 100bps assume an increase/(decrease) in the illiquidity premium for immediate annuities of 40bps (2013: 40bps) for in-force business and 40bps (2013: 40bps) for the value of new business.

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:

	MCEV classification						
At 31 December 2014	**UK £m**	**Heritage £m**	**FPI £m**	**Lombard £m**	**Corporate £m**	**Non-covered business(i) £m**	**Total MCEV by IFRS segments £m**
IFRS segment							
UK	**1,780**	**–**	**–**	**–**	**–**	**(8)**	**1,772**
Heritage	**–**	**3,909**	**–**	**–**	**–**	**67**	**3,976**
FPI	**–**	**–**	**516**	**–**	**–**	**–**	**516**
Corporate	**–**	**–**	**–**	**–**	**(1,737)**	**1,002**	**(735)**
Total MCEV (by MCEV segments)	**1,780**	**3,909**	**516**	**–**	**(1,737)**	**1,061**	**5,529**

(i) The non-covered business includes £422 million within Corporate representing the MCEV of the Friends Life Group holding companies above FLH.

	MCEV classification						
At 31 December 2013	UK £m	Restated Heritage £m	Restated FPI £m	Lombard £m	Corporate £m	Restated Non-covered business(i) £m	Total MCEV by IFRS segments £m
IFRS segment							
UK	1,418	–	–	–	–	2	1,420
Heritage – restated	–	4,161	–	–	–	40	4,201
FPI – restated	–	–	508	–	–	(1)	507
Lombard	–	–	–	598	–	5	603
Corporate	–	–	–	–	(1,631)	965	(666)
Total MCEV (by MCEV segments)	1,418	4,161	508	598	(1,631)	1,011	6,065

(i) The non-covered business includes £164 million within Corporate representing the MCEV of the Friends Life Group holding companies above FLH.

13. FLH return on embedded value

	2014		Restated 2013	
	£m	**% p.a.**	£m	% p.a.
Value of new business	**132**	**2.0**	179	2.8
Expected existing business contribution(i)	**305**	**4.5**	290	4.4
Operating experience variances	**(65)**	**(1.0)**	(32)	(0.6)
Operating assumption changes	**29**	**0.4**	101	1.6
Other operating variance	**219**	**3.3**	172	2.7
Development costs	**(35)**	**(0.5)**	(47)	(0.7)
Other income and charges	**1**	**–**	(26)	(0.4)
FLH MCEV operating profit before tax and financing	**586**	**8.7**	637	9.8
Impact of financing(i)	**(64)**	**1.5**	(75)	1.7
Attributed tax charge on MCEV operating profit	**(96)**	**(1.8)**	(132)	(2.7)
FLH MCEV operating profit after tax	**426**	**8.4**	430	8.8
Economic variances	**(143)**	**(2.8)**	401	8.2
Other non-operating items	**(277)**	**(5.5)**	(143)	(2.9)
Attributed tax on other activities	**88**	**1.7**	(59)	(1.2)
FLH MCEV profit from continuing operations after tax	**94**	**1.8**	629	12.9
Profit/(loss) from discontinued operations(ii)	**14**	**0.1**	(28)	(2.0)
FLH MCEV profit	**108**	**1.9**	601	10.9
Remeasurement losses on defined benefit pension schemes	**26**	**0.5**	(77)	(1.4)
Foreign exchange adjustments	**(31)**	**(0.6)**	16	0.3
Total return on FLH MCEV over the year	**103**	**1.8**	540	9.8

(i) Impact of financing comprises the expected impact of financing of covered debt of £64 million for 2014 (2013: £75 million). These amounts have been deducted from the expected existing business contribution.
(ii) The profit/(loss) from discontinued operations allows for inclusion of embedded value from discontinued operations.

The table above provides an analysis of the return on FLH embedded value, excluding the Friends Life Group Limited holding companies above FLH, consistent with previous years. The starting FLH embedded value for continuing operations for 2014 is £5,298 million, net of the market-consistent value of debt instruments of £1,623 million and having excluded £603 million in respect of discontinued operations and £164 million in respect of the Friends Life Group holding companies above FLH. The 2014 embedded value has been adjusted to allow for the timing of dividend payments.

The starting embedded value for 2013 is £5,078 million, net of the market-consistent value of debt instruments of £1,596 million and having excluded £620 million in respect of discontinued operations and £133 million in respect of the Friends Life Group holding companies above FLH. The 2013 embedded value has been adjusted to allow for the timing of dividend payments.

The FLH MCEV operating return before tax and financing is based on the gross FLH 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 FLH 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 2014 £m	Restated[(i)] FY 2013 £m	Change %	**FY 2014 £m**	Restated[(i)] FY 2013 £m	Change %
UK division						
– Protection	**89**	84	6	**–**	–	–
– Retirement Income	**–**	–	–	**559**	664	(16)
– Corporate Benefits	**556**	520	7	**578**	542	7
Total UK division	**645**	604	7	**1,137**	1,206	(6)
Heritage division	**26**	48	(46)	**167**	201	(17)
International division	**60**	67	(10)	**507**	595	(15)
Total Group – Continuing	**731**	719	2	**1,811**	2,002	(10)
Discontinued – Lombard[(ii)]	**–**	–	–	**1,150**	1,983	(42)
Total Group	**731**	719	2	**2,961**	3,985	(26)

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.
(ii) Lombard 2014 figures are up to and including 30 October 2014.

	Regular premiums			Single premiums		
	Q4 2014 £m	Restated(i) Q4 2013 £m	Change %	**Q4 2014 £m**	Restated(i) Q4 2013 £m	Change %
UK division						
– Protection	**19**	21	(10)	**–**	–	–
– Retirement Income	**–**	–	–	**119**	164	(27)
– Corporate Benefits	**135**	145	(7)	**136**	209	(35)
Total UK division	**154**	166	(7)	**255**	373	(32)
Heritage division	**6**	11	(45)	**45**	47	(4)
International division	**21**	14	50	**120**	164	(27)
Total Group – Continuing	**181**	191	(5)	**420**	584	(28)
Discontinued – Lombard(ii)	**–**	–	–	**83**	829	(90)
Total Group	**181**	191	(5)	**503**	1,413	(64)

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.
(ii) Lombard 2014 figures are up to and including 30 October 2014.

Group new business - APE

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

	FY 2014 £m	Restated(i) FY 2013 £m	Change %	**Q4 2014 £m**	Restated(i) Q4 2013 £m	Change %
UK division						
– Protection	**89**	84	6	**19**	21	(10)
– Retirement Income	**56**	66	(15)	**12**	16	(25)
– Corporate Benefits	**614**	574	7	**149**	166	(10)
Total UK division	**759**	724	5	**180**	203	(11)
Heritage division	**43**	68	(37)	**11**	15	(27)
International division	**110**	127	(13)	**31**	31	–
Total Group – Continuing	**912**	919	(1)	**222**	249	(11)
Discontinued – Lombard(ii)	**115**	198	(42)	**8**	83	(90)
Total Group	**1,027**	1,117	(8)	**230**	332	(31)

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.
(ii) Q4 Lombard results only include 30 days trading due to the disposal of the business on 30 October 2014.

Quarterly APE Progression	**Q4 2014 £m**	Q3 2014 £m	Q2 2014 £m	Q1 2014 £m
UK division				
– Protection	**19**	23	23	24
– Retirement Income	**12**	14	15	15
– Corporate Benefits	**149**	137	166	162
Total UK division	**180**	174	204	201
Heritage division	**11**	9	12	11
International division	**31**	32	24	23
Total Group – Continuing	**222**	215	240	235
Discontinued – Lombard(i)	**8**	34	45	28
Total Group	**230**	249	285	263

(i) Q4 Lombard results only include 30 days trading due to the disposal of the business on 30 October 2014.

International division

APE by region (actual exchange rates)	**FY 2014 £m**	Restated(i) FY 2013 £m	Change %
North Asia	**27**	30	(10)
South Asia	**15**	19	(21)
Middle East	**40**	35	14
UK & Rest of World	**28**	43	(35)
Total	**110**	127	(13)

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.

Discontinued operations – Lombard

APE by region (actual exchange rates)	**FY 2014 £m**	FY 2013 £m	Change %
UK and Nordic	**37**	68	(46)
Northern Europe	**4**	12	(67)
Southern Europe	**69**	110	(37)
Rest of World	**5**	8	(38)
Total including large cases	**115**	198	(42)
Of which: Large cases (greater than €10m)	**34**	87	(61)
Total excluding large cases	**81**	111	(27)

(i) Lombard 2014 figures are up to and including 30 October 2014.

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 2014 £m	Restated(i) FY 2013 £m	Change %	**Q4 2014 £m**	Restated(i) Q4 2013 £m	Change %
International division	**110**	127	(13)	**31**	31	–
Discontinued – Lombard(ii)	**121**	198	(39)	**9**	83	(89)

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.
(ii) Lombard 2014 figures are up to and including 30 October 2014.

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 2014 £m	Restated(i) FY 2013 £m	Change %	**Q4 2014 £m**	Q3 2014 £m	Q2 2014 £m	Q1 2014 £m
UK division							
– Protection	**638**	623	2	**141**	161	163	173
– Retirement Income	**559**	664	(16)	**119**	141	152	147
– Corporate Benefits	**2,817**	2,799	1	**671**	617	788	741
Total UK division	**4,014**	4,086	(2)	**931**	919	1,103	1,061
Heritage division	**258**	431	(40)	**65**	55	75	63
International division	**801**	927	(14)	**221**	237	176	167
Total Group – Continuing	**5,073**	5,444	(7)	**1,217**	1,211	1,354	1,291
Discontinued – Lombard(ii)	**1,150**	1,983	(42)	**83**	340	448	279
Total Group	**6,223**	7,427	(16)	**1,300**	1,551	1,802	1,570

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.
(ii) Lombard 2014 figures are up to and including 30 October 2014.

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. 2013 full year results have been restated to exclude the results of Lombard, which was classified as a discontinued operation during 2014.

£m	UK	Heritage	Int'l	FY 2014	Restated FY 2013
Investment in new business	(105)	(35)	(29)	(169)	(189)
Movement in required capital, tax and other items	68	2	1	71	71
New business cash strain	(37)	(33)	(28)	(98)	(118)
DAC/DFF	9	6	86	101	129
Other IFRS adjustments	–	3	(79)	(76)	(77)
IFRS new business strain	(28)	(24)	(21)	(73)	(66)

Analysis of 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	Int'l	FY 2014	Restated FY 2013
Expected return from in-force business	119	481	52	652	638
Movement in required capital, tax and other items	(39)	(154)	3	(190)	(181)
In-force cash surplus	80	327	55	462	457
DAC/DFF	(12)	(36)	(54)	(102)	(86)
Other IFRS adjustments	24	32	88	144	102
IFRS in-force surplus	92	323	89	504	473

Analysis of non-core OLAB business sustainable free surplus contribution

£m	FY 2014	FY 2013
Expected return from in-force business	15	20
Investment in new business	(2)	(22)
Underlying free surplus	13	(2)

Appendix 3: Assets under administration

£bn	2014 Full year	Restated(i) 2013 Full year
Heritage:		
Unit-linked pensions	**18.3**	19.3
Unit-linked investment	**15.3**	16.1
Annuities and protection	**11.7**	9.5
With-profits	**23.0**	23.7
UK:		
Corporate Benefits	**22.0**	20.1
Retirement Income	**2.4**	2.1
International	**7.0**	6.6
Total	**99.7**	97.4

(i) 2013 results have been restated to reflect the transfer of OLAB from the International to Heritage division.

Appendix 4: Expense reconciliation

FY 2014, £m	Acquisition expenses	Admin and other expenses	Total
Acquisition costs	(164)	–	**(164)**
Maintenance costs	–	(313)	**(313)**
Development costs	(46)	–	**(46)**
Corporate	–	(26)	**(26)**
Total operating costs	(210)	(339)	**(549)**
Non-recurring(i)	–	(201)	**(201)**
Commissions	(187)	(54)	**(241)**
Sesame	(148)	(49)	**(197)**
Enhanced allocation of units	(15)	–	**(15)**
DAC (net of deferral and amortisation)	11	–	**11**
Development costs (WP)	(5)	–	**(5)**
Intangible impairment & amortisation	–	(354)	**(354)**
Investment management expenses	–	(174)	**(174)**
Investment property expenses	–	(7)	**(7)**
Other	–	(5)	**(5)**
Total expenses	(554)	(1,183)	**(1,737)**

(i) Non-recurring costs of £(201) million are presented before actuarial provision releases of £17 million which are presented within changes in insurance contract liabilities.

Appendix 5: Non-core OLAB inter-divisional restatement

£m	Reported Int'l	Reported Heritage	OLAB	**Restated Int'l**	**Restated Heritage**
Q1 2013					
VNB	2	(4)	(3)	**5**	**(7)**
APE	40	13	5	**35**	**18**
HY 2013					
VNB	4	(8)	(5)	**9**	**(13)**
APE	79	27	9	**70**	**36**
Q3 2013 (YTD)					
VNB	3	(13)	(9)	**12**	**(22)**
APE	108	41	12	**96**	**53**
FY 2013					
VNB	14	(19)	(7)	**21**	**(26)**
APE	141	54	14	**127**	**68**

FY 2013, £m

IFRS operating profit	Reported Int'l	Reported Heritage	OLAB	**Restated Int'l**	**Restated Heritage**
New business strain	(40)	(25)	(16)	**(24)**	**(41)**
In-force surplus	140	264	40	**100**	**304**
Long-term investment return	(1)	(84)	–	**(1)**	**(84)**
Principal reserving changes and one-off items	15	141	18	**(3)**	**159**
Development costs	(10)	(7)	(3)	**(7)**	**(10)**
Other income and charges	(2)	2	–	**(2)**	**2**
IFRS based operating profit before tax	102	291	39	**63**	**330**

FY 2013, £m

MCEV operating profit	Reported Int'l	Reported Heritage	OLAB	**Restated Int'l**	**Restated Heritage**
Value of new business	14	(19)	(7)	**21**	**(26)**
Expected existing business contribution	19	211	3	**16**	**214**
Operating experience variances	13	(12)	10	**3**	**(2)**
Operating assumption changes	14	93	3	**11**	**96**
Other operating variances	9	127	11	**(2)**	**138**
Development costs	(10)	(7)	(3)	**(7)**	**(10)**
Other income and charges	(2)	–	–	**(2)**	**–**
Operating profit before tax	57	393	17	**40**	**410**

FY 2013, £m

Sustainable free surplus	Reported Int'l	Reported Heritage	OLAB	**Restated Int'l**	**Restated Heritage**
Expected return from in-force business	97	442	20	**77**	**462**
Investment in new business	(61)	(30)	(22)	**(39)**	**(52)**
Underlying free surplus generation	36	412	(2)	**38**	**410**
Development costs	(9)	(7)	(2)	**(7)**	**(9)**
Operating experience variances	18	27	18	**–**	**45**
Other operating items	(9)	(1)	–	**(9)**	**(1)**
Other income and charges	(2)	–	–	**(2)**	**–**
Sustainable free surplus generation	34	431	14	**20**	**445**

Appendix 6: Lombard discontinued operations Group restatement

FY 2013, £m

IFRS operating profit	Reported Group	Lombard	**Restated Group**
New business strain	(97)	(31)	**(66)**
In-force surplus	541	68	**473**
Long-term investment return	(69)	–	**(69)**
Principal reserving changes and one-off items	164	–	**164**
Development costs	(50)	(3)	**(47)**
Other income and charges	(53)	–	**(53)**
IFRS based operating profit before tax	436	34	**402**

FY 2013, £m

MCEV operating profit	Reported Group	Lombard	**Restated Group**
Value of new business	204	25	**179**
Expected existing business contribution	248	33	**215**
Operating experience variances	(57)	(25)	**(32)**
Operating assumption changes	19	(82)	**101**
Other operating variances	178	6	**172**
Development costs	(50)	(3)	**(47)**
Other income and charges	(53)	–	**(53)**
Operating profit/(loss) before tax	489	(46)	**535**

FY 2013, £m

Sustainable free surplus	Reported Group	Lombard	**Restated Group**
Expected return from in-force business	682	44	**638**
Investment in new business	(213)	(24)	**(189)**
Underlying free surplus generation	469	20	**449**
Development costs	(41)	(2)	**(39)**
Coupon on debt	(92)	–	**(92)**
Operating experience variances	25	(9)	**34**
Other operating items	2	(3)	**5**
Other income and charges	(32)	–	**(32)**
Sustainable free surplus generation	331	6	**325**

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 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") represent assets and other financial instruments available to cover corporate costs, to service debt issued by Friends Life holding companies and, subject to shareholder approval, to pay dividends or return to shareholders. ASA reflects the deduction of working capital from free surplus.

Aviva – Aviva plc, a company incorporated under the laws of England and Wales with registered number 2468686, whose registered office is St Helen's, 1 Undershaft, London, EC3P 3DQ.

Aviva General Meeting – The meeting of the Aviva shareholders convened for the purpose of approving the Proposed Acquisition.

Aviva Prospectus – The document that Aviva will produce and make available that tells shareholders about the new Aviva shares that will be issued if the Proposed Acquisition completes.

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 Friends Life Group 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 Friends Life Group Limited.

Computershare – Computershare Investor Services PLC, which acts as the Registrar for Aviva **or** Computershare Investor Services (Jersey) Ltd which acts as Registrar for Friends Life (as applicable).

Court – The Royal Court of Guernsey.

Court Hearing – This is the hearing by the Guernsey Court to approve the Scheme under Part VIII of the Companies (Guernsey) Law, 2008.

CREST – CREST is the system for the paperless settlement of trades in securities and the holding of uncertificated securities.

DRIP – The Friends Life Dividend Reinvestment Plan allows shareholders to purchase additional shares on the dividend payment date from the proceeds of their cash dividend. It will not be applicable for the second interim dividend.

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 ("FLGL") means Friends Life Group Limited (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 Court Meeting – The meeting of the Friends Life shareholders convened by the Court to consider, and if thought fit, approve the Scheme.

Friends Life General Meeting – The meeting of the Friends Life shareholders convened for the purposes of implementing the Proposed Acquisition.

Friends Life holding companies means RHN1, FLG Holdings Limited, Friends Life Group Limited, Friends Life Holdings plc, Friends Life FPG Limited, Friends Life FPL Limited and London and Manchester Group Limited.

Friends Life Share Account – The corporate sponsored nominee account service of Friends Life operated by Computershare Investor Services PLC. If you hold your shares in the Friends Life Share Account, you will not be in possession of a share certificate, because the shares are held by Computershare Company Nominees Limited on your behalf. A similar service is operated by Computershare on behalf of Aviva, known as the Aviva Share Account.

Friends Life Share Incentive Plans - The Friends Provident Holdings (UK) plc Share Incentive Plan 2010 and the Friends Provident Group plc Share Incentive Plan 2009.

Group means Friends Life Group 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. In previous reporting periods, OLAB was managed and reported within the FPI segment. Following the decision to stop writing new business in 2013, OLAB was transferred to the Heritage segment in January 2014 and the segmental comparatives for 31 December 2013 have been restated.

IFRS based operating profit/(loss) is the profit (or loss) based on longer-term investment return excluding: (i) profit (or loss) from discontinued operations, (ii) investment variances on unit-linked sterling reserves and the assets backing these reserves, which in previous periods were included within operating profit, (iii) investment return variances from expected investment return for non-linked business which is calculated on a long-term rate of return, (iv) returns attributable to non-controlling interests in policyholder funds, (v) policyholder tax, (vi) significant non-recurring items, (vii) 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.

Proposed Acquisition – The Proposed Acquisition of Friends Life by Aviva to be implemented by way of the Scheme.

Required capital of the Group is based on the most onerous capital management policy for the Group, currently IGCA.

Resolution Operations LLP ("ROL") is a privately owned advisory and operating firm which provided services to the Company 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.

Scheme of Arrangement ("the Scheme") – The Scheme is the method by which Friends Life shares will be exchanged for new Aviva shares.

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 FLGL 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 policy holders 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 FLH 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 13 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
AMD	Active Member Discount
APE	Annual Premium Equivalent
ASA	Available Shareholder Assets
AUA	Assets Under Administration
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
CIIA	Chartered Institute of Internal Auditors
CMI	Continuous Mortality Investigation
CMIR	Continuous Mortality Investigation Report
CMPs	Capital Management Policies
CNHR	Cost of Non-Hedgeable Risk
COP	Capital Optimisation Programme
CRO	Chief Risk Officer
CRR	Capital Resource Requirements
CSA	Control Self -Assessment
DAC	Deferred Acquisition Costs
DFF	Deferred Front End Fees
DPF	Discretionary Participation Features
DSAP	Deferred Share Award Plan
EBC	Employee Benefit Consultant
EBR	Equity Backing Ratio
EBT	Employee Benefit Trust
ECJ	European Court of Justice
EEA	European Economic Area
ERC	Executive Risk Committee
EU	European Union
EV	Embedded Value
FAL	Friends Annuities Limited
FCA	Financial Conduct Authority
FLAS	Friends Life Assurance Society Limited

FLC	Friends Life Company Limited
FLDL	Friends Life Distribution Limited
FLGL	Friends Life Group Limited (formerly known as Resolution Limited)
FLG LTIP	Friends Life Group plc Long Term Incentive Plan
FLH	Friends Life Holdings plc (formerly known as 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 AG	Financial Business Partners AG
FPI	A segment within the International division comprising FPIL (Friends Provident International Limited)
FPPS	Friends Provident Pension Scheme
FRA	Flexible Retirement Account
FRS	Financial Reporting Standards
FSG	Free Surplus Generation
FSMA	Financial Services and Markets Act 2000
FTE	Full Time Equivalent
GAO	Guaranteed Annuity Options
GCE	Group Chief Executive
GEC	Group Executive Committee
GMP	Guaranteed Minimum Pension
HMRC	Her Majesty's Revenue and Customs
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
LPA	Limited Partnership Agreement
LT2	Lower Tier 2
MCEV	Market Consistent Embedded Value
MVR	Market Value Reduction
NBS	New Business Strain

NGP	New Generation Pension
NIC	National Insurance Contribution
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
ORSA	Own Risk and Solvency Assessment
PBSE	Post-Balance Sheet Event
PPFM	Principles and Practices of Financial Management
PRA	Prudential Regulation Authority
PSP	Performance Share Plan
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
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
SBG	Sesame Bankhall Group
SFS	Sustainable Free Surplus
SID	Senior Independent Director
SIP	Share Incentive Plan
SSF	Segregated Sub Fund
STICS	Step-up Tier one Insurance Capital Securities
TSR	Total Shareholder Return
TVOG	Time Value of financial Options and Guarantees
UKLA	UK Listing Authority
UT2	Upper Tier 2
VIF	Value of In-Force
VLN	Vendor Loan Note
VNB	Value of New Business
WPF	With-Profits Fund
WPICC	With-Profits Insurance Capital Component