

6 August 2014

Friends Life Group Limited

Results for the half year ended 30 June 2014

Strong cash performance

- Sustainable free surplus £163 million, up 15% (30 June 2013: £142 million); on track to deliver £39 million uplift in expected return
- Continued good performance in Corporate Benefits, net fund inflows of £0.4 billion
- Value of new business down 24% to £65 million as predicted trends continue, with full impact of the Budget⁽ⁱ⁾ still to emerge
- IFRS based operating profit before tax of £159 million
- MCEV operating profit before tax of £193 million

Capital position robust, dividend secure

- Available shareholder assets £917 million
- IGCA⁽ⁱⁱ⁾ surplus £2.2 billion, coverage ratio 235%
- Economic capital surplus⁽ⁱⁱⁱ⁾ £4.0 billion, coverage ratio 193%
- Interim dividend of 7.05 pence per share (30 June 2013: 7.05 pence per share)

Business highlights and successful agreement of Lombard sale^(iv)

- Disposal of Lombard announced and share buy-back increased to £317 million
- Peak of auto-enrolment activity in the first half of 2014 delivers 648 schemes with 108,000 net members added to defined contribution pension schemes during the first half of 2014
- Strong growth in Protection, APE is up 21%
- Agreement to reallocate circa £800 million of annuities from with-profits funds, subject to regulatory non-objection, resulting in a SFS benefit of circa £7 million p.a. from 2015
- £200 million syndicated loans mandate further underpins expected return in 2015
- Re-platforming in International division remains on track for new business in the third quarter of 2014 and for all in-force in 2015; interim dividend passed and full year dividend to Group under review
- Excellent progress made towards preparing the launch of new retirement propositions:
 - Adding retail functionality to My Money Corporate Wrap platform
 - New flexible propositions being developed to offer alternative solutions for customers
 - Customer engagement model enhancements fully underway

Andy Briggs, Group Chief Executive said:

“It’s clear that our industry has seen a large amount of change in the first six months of 2014. Our cash generation is strong while our dividend coverage is improving. The scale of our business with over 2 million pension customers representing one in seven DC savers, as well as our focus on customer needs, means we are well placed to win in the retirement and savings market. I remain confident that we can fully benefit from the opportunities presented to us and that we have the right people to deliver our plans to drive growth throughout the business.”

(i) The Chancellor of the Exchequer’s Budget announcement on 19 March 2014.

(ii) Representing estimated Insurance Groups Capital Adequacy (“IGCA”) surplus as at 30 June 2014.

(iii) Estimated.

(iv) Lombard is treated as a discontinued operation within these half year results and is therefore excluded from the Group’s key operating performance measures. It however, remains within the Group’s capital measures.

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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.

Media

There will be a conference call today for wire services at 7.30 am (GMT) hosted by Andy Briggs, GCE. Dial in telephone number: +44(0)20 3427 1908, Participant code 8567399.

Analysts/Investors

A half year results presentation will take place at 08:30am (GMT) at the London Stock Exchange, 10 Paternoster Square, London EC4M 7LS. Dial in telephone number: 020 3059 8125 (UK) + 44 20 3059 8125 (all other locations), Participant password: Friends Life.

A webcast of the presentation and the presentation slides will be available on Friends Life's website, <http://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 half year results announcement later today.

Financial calendar

Third quarter 2014 interim management statement	11 November 2014
Full year 2014 results	10 March 2015
First quarter 2015 interim management statement	7 May 2015

2014 Interim dividend

Dividend amount	7.05 pence
Ex-dividend date	27 August 2014
Record date	29 August 2014
Final date for DRIP elections	15 September 2014
Dividend payment date	6 October 2014

Website: <http://www.friendslifegroup.com/>

Contents

Group Chief Executive's review	4
Key performance indicators	7
Chief Financial Officer's review	9
Business review	
Group results	12
Heritage division	16
UK division	21
International division	28
Discontinued operations	32
Corporate	34
Cash and capital	36
Principal risks and uncertainties	42
Going concern and Directors' responsibility statement	43
IFRS financial information	
IFRS consolidated financial statements	45
Notes to IFRS consolidated financial statements	55
Statement of Directors' responsibilities in respect of the MCEV basis	92
MCEV financial information	
MCEV consolidated financial statements	94
Notes to MCEV consolidated financial statements	99
Appendices	
New business information	132
IFRS new business strain and in-force surplus analysis	135
Non-core OLAB inter-divisional restatement	136
Lombard discontinued operations Group restatement	138
Heritage and Corporate Benefits pensions	139
Definitions	140
Abbreviations	143

Group Chief Executive's review

Introduction

The first half of 2014 has witnessed some of the most far reaching changes to the UK life sector for more than a generation. The regulatory changes announced in March present challenges and opportunities for all market participants, especially in the UK retirement savings market. The industry has been presented with the opportunity to develop innovative solutions to serve the needs of its customers. Implementing reforms to deliver better solutions for customers will take time – and the final outcomes are not entirely clear at this stage. However, this provides an opportunity to learn from the experiences of similar reforms in other countries, adopting the best practices, understanding where improvements can be made but, importantly, retaining the best features and experience built by UK insurance companies over the years.

The change in the industry has coincided with the turning point in the history of our Company. Earlier this year, we announced the completion of our transformational restructuring and our new financial framework for the future. To recognise the integrated structure and governance of the business, we unified the Group's brand, renaming the parent company Friends Life Group Limited in May. Recently we announced the agreement to sell Lombard, and the intention to return cash to the shareholders by way of a share buy-back.

Despite all this change, the fundamentals of how we run our business have not changed. Our strategy has remained clear and consistent, to focus on managing legacy life and pension products, and capturing value in the retirement provision market, which is still projected to more than triple over the next decade. My executive team has been delivering this strategy with the rigorous financial discipline that underpins everything we do. Our focus has remained on cash generation, both in the short term and in the longer term as we transition into the new world of retirement. The overview of our business performance is considered in this context, given that this is how we run our business and make our strategic choices.

Cash today

Focus on generating cash today is of paramount importance to us, as our dividend commitment rests on our ability to achieve 1.3 times sustainable free surplus to dividend coverage, at which point the Board will consider moving to a progressive dividend.

Last month we announced the disposal of our Lombard business to the Blackstone Group subject to anti-trust and regulatory approvals. There were very limited strategic and operational synergies between it and the rest of the Group, therefore the disposal creates more value for the shareholders, and will benefit the Lombard business. I am also delighted to announce that regulatory approval has been granted to increase the scale of the share buy-back announced on 11 July 2014 from £261 million to £317 million, with this to be commenced once the sale has completed and proceeds received. The increase of £56 million is equivalent to the amount of the vendor loan note issued as part of the Lombard sale. This demonstrates the strength of our balance sheet and the confidence of the Board in the financial strength of the business. Following the disposal, and assuming an immediate share buy-back at a 10 day rolling average share price of 332.1 pence as at 4 August 2014, equating to approximately 95 million shares, full year 2013 pro forma sustainable free surplus cover of the Group's dividend would be improved to 1.17 times from 1.10 times.

I am also very pleased with the strong cash generation performance delivered in the first half of 2014. Sustainable free surplus has risen by 15%, to £163 million. The key drivers of this growth are the successful closure to new business in non-core international markets and the reallocation of £2 billion of annuities from with-profits funds, actions taken in 2013 that are now starting to deliver tangible benefits. The free surplus generated from the profitable new business in the UK division written in 2013, particularly in Corporate Benefits, is also successfully contributing to the offsetting of the expected run-off of the Heritage book. I am also pleased to note that we are on track to deliver low double digit percentage growth in sustainable free surplus in 2014.

Cash tomorrow

Beyond our objective to achieve 1.3 times sustainable free surplus coverage of dividend, we have a strong ambition to continue cash generation growth to support a progressive dividend. There are a number of opportunities that give me confidence in the longer term cash generation growth.

Revenue optimisation in Heritage

Heritage remains the cash generation engine of the Group. Last year, Heritage executed its first in-house with-profits annuity transfer deal that is generating an additional circa £10 million sustainable free surplus benefit per annum from 2014. Plans in Heritage to transfer a further circa £800 million of annuities from with-profits funds are expected to be effective and completed in the second half of the year. There remains a further £1.5 billion of annuities in the with-profits funds for potential future transfers,

although because of the different profiles of each potential transaction, we would only consider proceeding with them if it is in the best interests of both our with-profits customers and our shareholders.

I'm pleased with the preparations for the transfers of the £14 billion of assets from F&C to Schroders and Friends Life Investments ("FLI"). Both are progressing well and I'm excited by the opportunities the new relationship with a partner of Schroders' standing will bring. The combined sustainable free surplus benefit of the proposed annuities transfer and the assets transfers is expected to generate circa £10 million of additional post tax cash benefit per annum from 2015 onwards. This is in addition to the £16 million per annum that previous initiatives have already been contributing from 2014.

Further revenue optimisation opportunities may present themselves as the £35 billion of discretionary assets currently managed by AXA come to the point, in late 2015, where we can seek to achieve the best possible outcome for our customers and shareholders.

Corporate Benefits and Heritage pension accumulation

It is also encouraging to see growing cash generation from the businesses that support customers during their accumulation stage. Last year our Corporate Benefits business turned cash positive on the underlying sustainable free surplus basis, as we maintained strict financial discipline of writing only profitable business and growing scale with no detriment to value. Compared to the first six months of 2013, the underlying sustainable free surplus generated by Corporate Benefits grew by £4 million to £14 million.

Combining Corporate Benefits and Heritage, our pensions accumulation businesses have over 2.3 million customers with over £48 billion of assets under administration. We believe this significant customer base is a considerable strategic asset as we move into the new world of retirement with over 80% of Corporate Benefits new business coming from our existing schemes. By continuing to provide excellent customer service, we believe that many of our customers will choose to de-cumulate on the same platform used for accumulation. Our scale position means we are well placed to support our customers over the long term.

Our Corporate Benefits business has delivered good performance in the first half of 2014 with positive net fund flows of £0.4 billion and regular premiums growing by 4% compared to the same period last year. The pace of auto-enrolment has peaked in the second quarter after a strong first quarter. 648 schemes auto-enrolled with Friends Life in the first six months of the year contributing to a 108,000 net increase in scheme members in this period. In addition, we have launched our new master trust proposition, and have developed a direct offer transfer proposition, to attract in new assets alongside our new scheme wins.

Retirement income

The retirement savings market is where we expect the most significant change, but this is also where we see significant opportunities for our business to add value to our customers. Customers are at the heart of our business and we have carried out extensive work to fully understand their specific needs. We will focus on our existing mass affluent customers, who do not have an active Independent Financial Adviser ("IFA") relationship and are unlikely to pay fees for IFA advice. Post Budget, these customers will have a much broader range of options and hence will have a greater need for guidance.

There is extensive customer research underway which will give us even greater insight into the needs of our core customer segments. Research we have undertaken, in conjunction with Ignition House Ltd, has so far revealed that about a quarter of retirees are struggling to understand the new freedoms they will soon enjoy and about two thirds are not aware of the potential tax implications of withdrawing cash as a lump sum at retirement. Research also shows that, the majority of mass affluent customers who do not have an advisor would not want to pay more than £500 for advice. Many of our customers remain uncertain about what products would suit them at retirement, for example three quarters of the surveyed retirees want the security of a fixed income and protection against inflation in retirement, but only a quarter intend to buy an annuity.

We have already made meaningful improvements in our customer engagement. Our customer relations teams make over 2,000 calls per month, covering over a half of the maturing pensions on our books. In the first half of this year we also contacted approximately 50,000 customers through direct mail, offering them support and guidance as they make their life defining choices in this period of uncertainty and change. By the end of the year we are also planning to contact a further 100,000 customers who are reaching a critical point in their retirement journey. We have also made some good progress in enhancing our online facility. New customer web pages were created to support customers post the Budget. Our new retirement planning "hub" went live in July on our customer website, providing a range of information to help customers at different stages of their retirement planning. Further, as part of our platform development, our extended customer interface will offer a single view of Friends Life holdings and tax guidance.

Most customers want simple, easily accessible products when they reach retirement. Features they would value most include a range of pre-selected funds, a facility to manage their income tax position, and a tool to assess current fund performance and impact of future fund performance on income. Alongside the proposed guidance regime, we will proactively engage with our customers to ensure they feel able to make an informed choice. By building on our already extensive knowledge of customer behaviour, we will deliver the right propositions to support our customers.

As far as these customer proposition choices are concerned, we believe that the biggest area of growth going forward will be in the 'flexible income' space. Those customers that decide not to buy an annuity will want much simpler propositions, so that they can

take a regular income from their accumulated pension and other assets. In particular, they will want to do this in the most tax efficient way, and hence a proposition offering both a pensions based vehicle alongside an ISA, and ensuring tax efficient switching between the two, will be key.

We are well placed to do this, with a market leading corporate wrap platform and planned developments to add retail platform functionality. We will offer our customers a new range of retirement income products and services giving them greater flexibility in how they choose to generate an income in retirement. For example, we will be launching an easy to use, online tool to help customers manage a prudent level of spend from a tax and longevity perspective. The first phase of development will go live by the time the new rules come into force and will enable our customers to manage their financial affairs and purchase a range of flexible savings and income generating solutions, such as New ISA, pension with a tax free cash facility, General Investments account and cash savings account.

In the meantime, we have lowered the minimum fund size on our existing drawdown product to £30,000 (before tax free lump sum is taken) from £50,000 (after tax free lump sum is taken). To ensure our existing customers have options and choices we have designed and launched a guided consolidation offering to allow more customers to use Friends Life as their preferred provider. We are also building on our strategic partnership with Schroders to develop new fund propositions such as income generating funds for customers in all distribution channels.

Our customer feedback indicates an increasing number of customers are considering delaying their retirement decision, and we expect this to increase further. When our customers delay, it is likely to be within their existing pensions product, and we will continue to provide them with the high levels of customer service and support they have come to expect. During this period of deferment we will continue to build even deeper relationships with these customers, ahead of them making their retirement income decision.

Outlook

Despite the magnitude of change in the first half of the year, the UK businesses have delivered resilient performance. Although the auto-enrolment activity has peaked, the outlook for the Corporate Benefits business remains positive, as the Budget is likely to encourage additional pension savings in the future. Retirement Income is well placed to reposition itself in light of recent regulatory changes to support our mass affluent customers' retirement needs. Progress has been made to enhance customer engagement and our product suite. Protection continues to be ideally positioned to provide a profitable underpinning to our transition to retirement strategy.

Our International business is continuing to operate in a challenging market and regulatory environment. We are however taking proactive measures to re-platform the business which will strengthen its competitive positioning and longer term prospects.

There is much to do across the businesses, but our business is strongly positioned with over two million pension customers representing around one in seven defined contribution ("DC") savers and around £48 billion of pension assets in our UK and Heritage divisions. Friends Life is fully able to meet the challenges and opportunities it faces and we are excited about the future.

Key performance indicators

Set out below are the Group's key performance indicators. These have been restated where necessary to reflect the classification of Lombard as a discontinued operation.

£m (unless otherwise stated)		2014 Half year	Restated 2013 Half year	Restated 2013 Full year
Cash today	Sustainable free surplus (“SFS”)	163	142	325
	SFS increased by £21 million to £163 million driven by initiatives undertaken within the Heritage division to improve cash generation. The increased cost of writing Retirement Income new business has been largely offset by the closure to new business in non-core International business.			
Cash tomorrow	Free surplus generation	167	74	377
	Free surplus generation of £167 million reflects the £163 million sustainable free surplus result with the benefit of positive economic variances partially offset by non-recurring items.			
Cash tomorrow	Value of new business (“VNB”)	65	85	179
	VNB decreased in the period reflecting the increased competitiveness in the Retirement Income business and the continuing challenging markets for the International division. The Protection and Corporate Benefits businesses have achieved value of new business in line with that delivered in the first half of 2013 in competitive markets.			
Capital strength	Group embedded value on an MCEV basis	5,724	5,980	6,065
	Group embedded value on an MCEV basis is down by £341 million compared to the 2013 year end. The strong operating profit of £193 million and £134 million of economic variances from market improvements have been offset by dividend payments, other non-operating items and the £268 million adverse impact from the expected disposal of Lombard.			
Capital strength	IGCA surplus coverage (%)	235	222	238
	IGCA coverage ratio of 235% is marginally lower than that at the end of 2013 as surplus emerging has been more than offset by payment of the external dividend and debt costs.			
Capital strength	Economic capital surplus coverage (%)	193	192	193
	Economic capital surplus coverage ratio is unchanged at 193%.			
Capital strength	Available shareholder assets (“ASA”)	917	839	917
	Available shareholder assets are unchanged at £917 million.			

	2014	Restated	Restated
	Half year	2013	2013
		Half year	Full year
IFRS based operating profit	159	171	402

IFRS based operating profit has fallen by 7% to £159 million reflecting adverse one-off items and lower in-force surplus following positive experience in 2013. This has been partially offset by higher returns on shareholder assets as long-term expected rates of return improve.

Returns

	2014	Restated	Restated
	Half year	2013	2013
		Half year	Full year
MCEV operating profit	193	203	535

MCEV operating profit decreased by 5% to £193 million reflecting the fall in Retirement Income VNB and a lower benefit from modelling improvements. Expected returns have increased following growth in the divisions open to new business and favourable economic movements in 2013.

Chief Financial Officer's review

Introduction

2014 marks the first year we report as Friends Life Group and the first year post the completion of the restructuring and transformation phase of the business. In March, I outlined the financial framework we would use to measure the progress of the business from 2014 onwards. Despite the magnitude of change we have seen in the industry in the first half of the year, I am pleased to announce a resilient set of financial results. In particular, sustainable free surplus, our primary measure of cash generation is up 15% to £163 million.

Of course, the retirement income market now looks very different to how it did six months ago. The Budget announcement has had limited impacts on our financial results to date but is expected to lead to lower levels of new business over time. However, our short term cash generation is secure so I reaffirm our previous guidance on the £39 million uplift in UK and Heritage expected free surplus returns for the full year, and I am also confident that we have the right skills to benefit from the exciting new opportunities in the retirement provision market place. We expect the Corporate Benefits business to be a beneficiary of the increased flexibility at retirement, which will encourage greater fund flows into pensions products. We also believe the new retirement income market place will play to our strengths, given our large existing customer base and strong focus on engagement with these customers.

We have also announced the expected disposal of Lombard for an initial consideration of £317 million. This disposal has sound strategic rationale: there were limited strategic or operational synergies with the rest of the Group and we believe the disposal realises more value for shareholders than continued ownership by the Group would create. I am also delighted to announce that regulatory approval has been granted to increase the scale of the share buy-back to £317 million from the £261 million announced on 11 July 2014, with this to be commenced once the sale has completed and proceeds received. The increase of £56 million is equivalent to the amount of the vendor loan note issued as part of the Lombard sale. This demonstrates the strength of the balance sheet and the confidence of the Board in the financial strength of the business. Once completed, the share buy-back will improve the coverage ratio of sustainable free surplus to dividend cost.

Financial performance

£m (unless otherwise stated)		2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Cash today	Sustainable free surplus	163	142	325
Cash tomorrow	Value of new business	65	85	179
	Open insurance business IRR	12.9%	22.8%	18.1%
	Net fund flows (£bn)	0.4	0.0	(0.2)
Returns	IFRS based operating profit	159	171	402
	MCEV operating profit	193	203	535
	Cash return ⁽ⁱⁱ⁾	21.1%	19.5%	23.8%
Capital strength	IGCA surplus coverage ratio	235%	222%	238%
	Economic capital surplus coverage ratio	193%	192%	193%
	Group available shareholder assets	917	839	917

(i) With exception of the capital strength measures, the 2013 half year and full year results have been restated to exclude the results of Lombard, which has been classified as discontinued during the period.

(ii) Sustainable free surplus/Shareholders Net Worth ("SNW"), where SNW is free surplus and required capital (net of external debt), i.e. MCEV excluding VIF. The SNW is adjusted to exclude Lombard and to reflect the in-period impact of dividend payments and other capital movements.

Cash today

Our consistent strategy and focus on growing cash today is evident in the results above. Sustainable free surplus has risen by 15% to £163 million (30 June 2013: £142 million). There is much more work to do, but these results represent further tangible progress on the journey we are taking. Following the 7% growth in sustainable free surplus achieved in 2013, from £304 million to £325 million, I am very pleased to confirm that we expect to achieve further low double digit percentage growth in sustainable free surplus for the full year 2014.

The growth in sustainable free surplus has been a product of our strategic focus on improving the cash generation of the Group. The key contributions to the growth in the first half of 2014 are the benefits from actions taken in the second half of 2013, notably the closure to new business in non-core international markets and the reallocation of £2 billion of annuities from with-profits funds. The

additional free surplus provided by the profitable new business written by UK divisions is also contributing successfully to the offsetting of the expected run-off of the Heritage book.

Looking forward, short term cash generation, after setting aside 150% of regulatory capital requirements, is not expected to be materially impacted by the Budget announcement, and actions continue across the Group to maintain the growth in sustainable free surplus. Good progress continues to be made on phase two of the with-profits annuity reallocation programme, and together with the agreement to transfer £14 billion of assets from F&C during 2014, these initiatives are expected to deliver circa £10 million per annum of additional sustainable free surplus from 2015 onwards.

It is also important to note that we have continued to deliver this increase in cash whilst increasing our investment in UK new business by £17 million, resulting from the improved competitiveness of the Retirement Income proposition.

In March I guided towards a circa £15 million increase in development costs for the full year 2014. Since then we have reduced our spend substantially and no longer expect anything like the previously guided increase. However, I am excluding here, and also from the full year 2014 sustainable free surplus guidance, the future costs associated with new retirement income product and platform development, which will be reported separately. Whilst it is difficult to predict the overall cost, we don't expect the expenditure to be more than £30 million in 2014.

Cash tomorrow

Value of new business in the first six months of the year has been impacted as expected by the increased competitiveness in the Retirement Income business and the continuing challenging markets for the International division. However, the Protection and Corporate Benefits businesses delivered resilient new business results in competitive markets.

The Protection business has performed well in the first half of the year, with value of new business of £31 million (30 June 2013: £32 million). Volumes have grown strongly, up by 21% from the first six months of 2013, enabling us to continue to deliver comparable value of new business despite the increasingly competitive market. As a result and as previously reported, we expect the full year 2014 value of new business to be lower than the £75 million achieved in 2013.

The performance of the Retirement Income business has been resilient with APE volumes of £30 million (30 June 2013: £32 million). The compression in Retirement Income margins is a continuation of that seen in the second half of 2013, as we moved to an increasingly competitive pricing position, resulting in value of new business of £28 million (30 June 2013: £44 million). Looking ahead, as expected, new annuity applications are now beginning to fall, albeit not yet to the level of long-term expectations. However, we expect applications in the second half of 2014 to fall further towards our long-term expectation of 20% lower than pre-Budget levels for Guaranteed Annuity Options ("GAO") business and 50% - 70% lower than pre-Budget levels for non-GAO business. GAO business currently comprises approximately half of new annuity applications in terms of premium, which will serve to partially insulate the Group against the larger expected market-wide falls in new annuity volumes. However, Retirement Income value of new business for 2014 will inevitably be materially lower than in 2013.

Difficult trading conditions in the International division have led to a disappointing new business performance in the first half of the year. Value of new business has fallen to £5 million (30 June 2013: £9 million). Challenging market conditions for regular premium insurance business throughout the regions have impacted new business performance in the first half of 2014. As announced in March, we are investing in a new International IT platform, which will support future growth and product development. The project is progressing well and we expect to re-platform new business by the end of the third quarter of the year, with in-force business expected to be re-platformed during 2015. This is an important development for the FPI business, one which creates a foundation for growth in future new business.

Our asset-based business, Corporate Benefits, has performed well in the first six months of the year, with a net fund inflow of £0.4 billion (30 June 2013: £0.0 billion). 648 new schemes have auto-enrolled in the first half of the year, leading to a net increase in members of 108,000 to over 1.25 million. Regular premiums received have also increased by 4% from 12 months ago due to the large numbers of new members. This significant increase in new members and in-force regular premiums provides a strong platform for further growth in assets under administration. This growth in the business has contributed to an increase in underlying free surplus generation from £11 million in the full year 2013 to £14 million in the first half of 2014, demonstrating the improved operational leverage in the business. Value of new business in the first six months of the year at £12 million (30 June 2013: £13 million), is slightly lower than the same period in 2013 due to the higher proportion of lower margin auto-enrolment business. Overall, however, the momentum in the Corporate Benefits business is very pleasing and with a strong proposition and growing assets under management, we are excellently placed for the expected future growth in this market, now more attractive than ever to savers post the Budget announcement.

Returns

IFRS based operating profit has fallen by 7% to £159 million (30 June 2013: £171 million), largely reflecting adverse one-off items in the period and lower in-force surplus. This has been partially offset by higher returns on shareholder assets as long-term expected rates of return improve. The result also reflects the increased new business strain within the UK Retirement Income business,

arising from the increased competitiveness of the proposition as seen in the latter half of 2013, and marginally lower sales volumes. This is partially offset by a reduction in new business strain on non-core Overseas Life Assurance Business ("OLAB") business, following the closure to new business in the second half of 2013.

MCEV operating profit has also been affected by the increased competitiveness in Retirement Income, with a fall of 5%, to £193 million (30 June 2013: £203 million). This is a resilient result, and illustrates the benefit on the MCEV basis of management actions undertaken to increase future cash generation. A reduction in expected future investment management costs has contributed £25 million to MCEV operating profit, of which the strategic investment partnership with Schroders announced in March 2014 played a principal part.

The cash return ratio has increased in the first half of 2014 to 21.1% (30 June 2013: 19.5%). This largely reflects the increase in sustainable free surplus on a stable shareholder net worth position.

Capital strength

Our continued financial discipline across all areas of the business has maintained the strong balance sheet and robust capital position of the Group. Our coverage ratios on both an IGCA and economic capital basis remain stable at 235% and 193% respectively.

Group available shareholder assets are unchanged at £917 million. This includes the new syndicated loans mandate worth £200 million announced in May. This mandate offers the Group the potential for higher returns on shareholder funds, alongside the increased diversification from investing in a new asset class. £139 million has already been invested, with the remainder expected to be invested in the third quarter of 2014.

Free surplus emergence

In March, we announced an expectation of a £39 million increase in the full year 2014 free surplus expected return in the UK and Heritage divisions compared to the prior year equivalent. Today we report half year results that are in line with this guidance and that we are currently on track for the full year expectation.

There is no material change to the profile of expected free surplus emergence as a result of the regulatory announcements in the first half of the year. In the shorter term, we expect the run-off of the Heritage book to be more than offset by the additional contributions from UK new business and the continuation of Heritage initiatives. With the development of broadened retirement income propositions in the medium term, combined with contributions from the other new business propositions, we are confident in offsetting the longer term run-off.

Following the transfer of the OLAB business from the International division into Heritage, the estimated expected returns for the UK and Heritage businesses in 2014 have been revised as follows:

£m	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
2013 actual free surplus (excl. OLAB)	541										
2013 actual free surplus (incl. OLAB)	561										
Estimated free surplus run-off (excl. OLAB)		580	550	520	480	450	420	410	400	390	370
Estimated free surplus run-off (incl. OLAB)		600	565	530	485	450	420	410	400	390	370

Dividends

The interim dividend per share is confirmed as 7.05 pence, in line with 2013.

In light of recent trading performance, adverse foreign exchange movements and a potential change in the biting capital constraint, the International division will not pay an interim dividend to Group in 2014, and the full year dividend to Group remains under review. This does not impact the Group's full year ordinary dividend expectations.

Outlook

The continued growth in sustainable free surplus highlights our consistent focus on the generation of cash for shareholders and our progression towards meeting our criteria for triggering a review of the move to a progressive dividend. However notwithstanding this progress, there remain uncertainties as to when this will be achieved, with the impact of the share buy-back and expected return growth dependent on the average price of shares acquired and cancelled in the share buy-back programme, and economic factors respectively, neither of which can be predicted.

Given the impact on new annuity volumes created by the Budget announcement, and as communicated in May, the ambition to grow the Group value of new business by 10% per annum will not be achievable in 2014. Our short term cash generation is secure, even after the Budget announcement, with a steady run-off from the Heritage book expected to be more than offset by disciplined growth in profitable new business and cash optimisation initiatives undertaken within the Heritage division. The disposal of Lombard, alongside the strategic rationale for the transaction, is an example of our rigorous financial discipline and focus on cash generation.

Business review

Group operating results

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

£m

Group IFRS based operating results	UK	Heritage	Int'l	Corp	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
New business strain	(17)	(15)	(9)	-	(41)	(39)	(66)
In-force surplus	41	188	46	-	275	282	473
Long-term investment return	8	(28)	-	1	(19)	(31)	(69)
Principal reserving changes and one-off items	(6)	(7)	-	-	(13)	2	164
Development costs	(12)	(10)	(4)	-	(26)	(25)	(47)
Other income and charges	(4)	3	(1)	(15)	(17)	(18)	(53)
IFRS based operating profit/(loss) before tax⁽ⁱⁱ⁾	10	131	32	(14)	159	171	402

Group operating free surplus generation

Expected return from in-force business	56	252	28	-	336	329	638
Investment in new business	(55)	(19)	(14)	-	(88)	(98)	(189)
Underlying free surplus generation	1	233	14	-	248	231	449
Development costs	(12)	(8)	(1)	-	(21)	(19)	(39)
Coupon on external debt	-	-	-	(47)	(47)	(45)	(92)
	(11)	225	13	(47)	180	167	318
Operating experience variances	(15)	2	(4)	-	(17)	(14)	34
Other operating variances	(2)	6	-	-	4	(1)	5
Other income and charges	(2)	-	-	(2)	(4)	(10)	(32)
Sustainable free surplus	(30)	233	9	(49)	163	142	325
Operating assumption changes	-	-	-	-	-	(11)	52
Operating free surplus generation	(30)	233	9	(49)	163	131	377

Group MCEV operating results

Value of new business	71	(11)	5	-	65	85	179
Expected existing business contribution	38	107	11	(32)	124	108	215
Operating experience variances	(14)	16	(2)	-	-	(13)	(32)
Operating assumption changes	14	29	-	-	43	34	101
Other operating variances	(5)	8	-	-	3	30	172
Development costs	(12)	(9)	(1)	-	(22)	(25)	(47)
Other income and charges	(4)	-	(1)	(15)	(20)	(16)	(53)
MCEV operating profit/(loss) before tax	88	140	12	(47)	193	203	535

(i) 2013 half year and full year results have been restated to exclude the operating results of Lombard, which has been classified as discontinued during the period.

(ii) 2014 IFRS based operating profit excludes investment variances on unit-linked sterling reserves and the assets backing these reserves. The change has not had a material impact on the results of the Group.

Non-operating results

£m

	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Group IFRS results			
IFRS based operating profit before tax	159	171	402
Short-term fluctuations in investment return ²	25	133	184
Gain on sale of associates (AmLife)	-	20	20
Other non-recurring items	(55)	(57)	(151)
STICS interest adjustment to reflect IFRS accounting for STICS as equity	16	16	31
IFRS profit before acquisition accounting adjustments and shareholder tax	145	283	486
Amortisation and impairment of acquired in-force business	(153)	(167)	(342)
Amortisation and impairment of other intangible assets	(23)	(26)	(63)
IFRS (loss)/profit before shareholder tax from continuing operations	(31)	90	81
Shareholder tax	15	(20)	178
IFRS (loss)/profit after tax from continuing operations	(16)	70	259
Loss after tax from discontinued operations	(27)	(9)	(24)
IFRS (loss)/profit after tax	(43)	61	235
Group free surplus generation			
Operating free surplus generation	163	131	377
Economic variances	56	61	265
Other non-operating items	(38)	(114)	(249)
FLH free surplus generated	181	78	393
FLGL income and charges	(9)	(10)	(21)
Total free surplus generated from continuing operations	172	68	372
Free surplus generated from discontinued operations	(5)	6	5
Total free surplus generated	167	74	377
Group MCEV profit after tax			
MCEV operating profit before tax	193	203	535
Economic variances	134	226	401
Non-recurring costs	(48)	(70)	(181)
Other non-recurring items and non-operating variances	(60)	37	38
MCEV profit from continuing operations before tax	219	396	793
Tax	(52)	(85)	(186)
MCEV profit from continuing operations after tax	167	311	607
(Loss)/profit from discontinued operations	(5)	10	(28)
MCEV profit after tax	162	321	579
Operating ROEV (%)	6.4%	6.5%	8.8%

(i) 2013 half year and full year results have been restated to exclude the results of Lombard, which has been classified as discontinued during the period.

(ii) 2014 short-term fluctuations in investment return include investment variances on unit-linked sterling reserves and the assets backing these reserves. The change has not had a material impact on the results of the Group.

Group IFRS: non-operating results

Short-term fluctuations in investment returns amounted to a favourable £25 million. This principally reflects the release of credit default reserves and annuity portfolio mismatch variances, where the liabilities are matched on a realistic basis as opposed to the reported regulatory basis.

Other non-recurring items of £(55) million include:

- outsourcing implementation costs, net of provisions, of £(26) million;
- finance transformation costs, net of provisions, of £(20) million, largely in relation to Solvency II;
- separation and integration programme costs of £(5) million; and
- other non-recurring costs of £(4) million.

A shareholder tax credit of £15 million is recognised for the period and includes a £31 million tax credit in relation to the amortisation and impairment of AVIF and other intangibles.

Group free surplus generation: non-operating results

Economic variances combine the impact of changes to economic assumptions with the investment return variances over the period. Total economic variances in the first half of 2014 had a £56 million positive impact on free surplus. The largest component of this is due to gains on equities and bonds over the period, which have allowed historic taxable losses to be valued. In addition, a positive impact arose on annuity business, primarily as a result of the unwind of credit default allowances, in addition to an assumption change to reduce future credit default allowances due to the narrowing of corporate bond spreads in the first half of 2014.

Other non-operating items of £(38) million include £(55) million of non-recurring items, consistent with those reported within the IFRS result. In addition, there is a net impact of £17 million from items specific to free surplus, including £9 million in respect of capital releases due to the de-authorisation of Friends Life Company ("FLC") and Friends Life Winterthur Life ("FLWL") following the completion of the 2013 phase of the capital optimisation programme.

FLGL other income and charges of £(9) million relate to investor related corporate costs incurred within the Friends Life Group holding company, and are in line with those reported in the first half of 2013.

Group MCEV: non-operating results

Economic variances combine the impact of changes to economic assumptions with the investment return variances over the period. Total economic variances in the first half of 2014 had a £134 million positive impact on MCEV profit before tax. This was due to the narrowing of corporate bond spreads on assets backing annuity business and increases in the value of fixed interest assets in unit-linked business partially offset by a negative economic variance from an increase in the market value of the Group's external debt.

Non-recurring costs, other non-recurring items and non-operating variances total £108 million and include costs of £55 million, consistent with those reported within the IFRS result, in addition to net costs of £53 million specific to MCEV. The £53 million specific to MCEV includes a £50 million provision (split £15 million in Heritage and £35 million in UK division) 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 £10 million provision established to cover the anticipated impact on future profits from the removal of Active Member Discounts ("AMD") on existing schemes. Furthermore, we have today also set out our approach to paying initial commission, with commission on new entrants replaced with a 2% level rate from 1 September 2014. The Group believes that alongside our commitment to paying other commission types until April 2016, provided the scheme's default fund charge is already within the cap, that this is a sustainable solution that smoothes the transition for advisers and employers to fee-based remuneration.

Group net assets and shares in issue

£m (unless otherwise stated)	2014 Half year	2013 Full year
Total Group IFRS net assets	5,260	5,549
Net Group MCEV	5,724	6,065
Shares in issue⁽ⁱ⁾	1,414,137,006	1,417,508,151

(i) Adjusted to exclude 3,972,022 FLGL shares held by the Employee Benefit Trust ("EBT") at 30 June 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.

At 30 June 2014, IFRS total equity was £5,260 million (31 December 2013: £5,549 million), with equity attributable to equity holders of the parent of £4,949 million (31 December 2013: £5,229 million). IFRS net assets per share attributable to shareholders were £3.50 (31 December 2013: £3.69) based on shares in issue (excluding shares held in the EBT) at the balance sheet date.

Net Group MCEV was £5,724 million (31 December 2013: £6,065 million) giving MCEV per share of £4.05 (31 December 2013: £4.28). The decrease in net Group MCEV reflects the remeasurement of Lombard at the lower of its carrying amount and fair value less costs to sell. Lombard MCEV of £578 million has been adjusted down by £268 million to the £310 million held for sale carrying value.

Heritage division

Half year 2014 highlights

- **Sustainable free surplus generation** up to £233 million (30 June 2013: £181 million) reflecting reduced levels of free surplus invested in new business from the non-core OLAB business and £16 million higher expected return from in-force business.
- **Regulatory change:** Significant levels of regulatory change have been announced during the first half of 2014. The Heritage division is in a strong position to respond positively to these changes, many of which focus on the fair treatment of customers which is central to the Heritage strategy.
- **Reallocation of with-profits annuities (phase 2):** Agreement has been reached, subject to regulatory non-objection, to reallocate circa £800 million of annuities from a with-profits fund into a shareholder owned non-profit fund, with this expected to be effective and completed in the second half of the year. This transaction is currently expected to require a 2014 free surplus investment of around £(15) million and result in a sustainable free surplus benefit of circa £7 million per annum from 2015.
- **Strategic investment partnership with Schroders:** Preparations for the asset transfers to Schroders continue to progress well with £12 billion of equity and multi-asset funds to be transferred from F&C in the fourth quarter of 2014. As part of this transaction a further £2 billion of fixed interest assets will be transferred to Friends Life Investments ("FLI").
- **IFRS based operating profit** increased to £131 million (30 June 2013: £116 million) with benefits from reduced new business strain and improved long-term investment return.
- **MCEV operating profit** is in line with prior year at £140 million (30 June 2013: £141 million).

Heritage division's 2013 full year and half year results have been restated to reflect the transfer of OLAB from the International division.

Strategy

The Heritage division has £69 billion of assets under administration and serves circa 4 million customers across a range of products. These products are no longer actively marketed and are largely administered on legacy systems.

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

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

- Operational excellence: dedicated customer service within an efficient cost base in line with business scale;
- Capital efficiency: optimisation of capital required for the business;
- Cash generation: safe generation with focused opportunities for enhancing future cash generation;
- Strong risk focus: robust financial risk and balance sheet volatility management; and
- Focus on investments: utilising the Group's internal asset management capability to maximise returns and lower costs.

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

The division continues to provide good customer service supported by its outsourced suppliers. Following the first major migration from two legacy administration systems onto the Diligenta BaNCS IT platform at the end of 2013, initial issues have been successfully resolved and learning points have been factored into plans for future migrations.

A multi-year programme to implement a uniform capital management framework for the six with-profits funds continues. As part of that initiative and the ongoing objective to ensure that with-profits funds remain appropriately invested for customers and shareholders, the with-profits annuity reallocation programme continues. Phase 2 of this has seen an agreement being reached, subject to regulatory non-objection, to reallocate circa £800 million of annuities from a with-profits fund into a shareholder owned non-profit fund, with this expected to be effective and completed in the second half of the year. This transaction is currently expected to require a 2014 free surplus investment of around £(15) million and result in a benefit of circa £7 million per annum from 2015.

FLI now manages £17.4 billion of fixed interest assets. A further £2 billion of assets will be re-captured from the transfer of fixed interest assets currently managed by F&C later in 2014, alongside the move of circa £12 billion of assets from F&C to Schroders. A benefit to MCEV across the UK and Heritage divisions has been recognised in respect of the anticipated investment expense savings.

Investments have also been made in a number of different asset classes to drive increased yield within the annuity portfolio and shareholder funds across the Group. These include a £500 million commercial real estate mandate awarded to Pramerica (£60

million invested), a £500 million infrastructure loan mandate awarded to MetLife Investment Management (£60 million invested), and a £200 million syndicated loans mandate awarded to Ares Management (£139 million invested, full capital deployment anticipated by end of the third quarter of 2014).

Regulatory changes

During the first half of 2013, the FCA announced plans to incorporate a legacy product review within its 2014 Business Plan, which has added a level of uncertainty to the industry as a whole. The Group is confident that the Heritage division is in a strong position to respond to the FCA.

The FCA's 2014 outlook identified a number of potential emerging risks relating to the fair treatment of long-standing customers by life insurers. The Thematic Review now underway on this topic will assess a number of areas connected to the operation of legacy business, including back book strategy and governance, how products have performed and the quality of customer communications.

The Group is part of a highly regulated industry which has undergone a series of independent reviews to ensure transparency and fair treatment of customers over a number of years. Friends Life's customers are at the heart of the business and it is firmly believed that by doing right by the customers this will in turn create a strong and successful business that will support the Group's future success. The Heritage division is specifically focused on meeting the ongoing needs of Friends Life's legacy customers to ensure fair customer outcomes. As part of this there is significant ongoing investment across a number of change programmes (such as the Service Improvement Programme in partnership with Diligenta) that will deliver improved customer service and provide customers with a more consistent and reliable customer experience.

The business is working with the FCA, responding to their requests and is looking forward with confidence to the next steps of the review.

Financial performance

IFRS based operating profit

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
New business strain	(15)	(21)	(41)
In-force surplus	188	177	304
Long-term investment return	(28)	(37)	(84)
Principal reserving changes and one-off items	(7)	-	159
Development costs	(10)	(3)	(10)
Other income and charges	3	-	2
IFRS based operating profit before tax	131	116	330

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

The 2014 half year Heritage IFRS based operating profit of £131 million is £15 million higher than the prior period. This improvement has been driven by higher in-force surplus, improved long-term investment return and lower new business strain. In-force surplus is favourable compared to the first half of 2013 with the run-off of the closed book of business being more than offset by a £5 million benefit from the first phase of the with-profits annuity reallocation programme and higher management charges, due to improved economic conditions. Improved long-term investment return is primarily due to improved long-term interest rates whilst lower new business strain reflects the cessation of new business sales within the transferred OLAB business.

Development spend of £(10) million is higher than 2013 reflecting the interim cost of completing the transfer of equity and multi-asset funds to Schrodgers and FLI, the reallocation of with-profits annuities, the ongoing cost of implementing regulatory change together with improvements to existing products and systems to support the in-force business.

Operating expenses

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Acquisition	16	19	37
Maintenance	104	113	254
	120	132	291
Development costs	10	3	10
Total	130	135	301

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

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

Maintenance costs of £104 million are lower than the first half of 2013 due to contractual savings in customer service and IT achieved through the Diligenta partnership and a reduction in costs following the successful completion of the AHM programme to move all IT infrastructure and business applications hosted by AXA to Friends Life in 2013.

Sustainable free surplus generation

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Expected return from in-force business:			
Free surplus emergence	245	229	448
Return on shareholder assets	7	7	14
Investment in new business	(19)	(36)	(52)
Underlying free surplus generation	233	200	410
Development costs	(8)	(2)	(9)
Operating experience variances	2	(17)	45
Other operating variances	6	-	(1)
Sustainable free surplus generation	233	181	445

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

The 2014 half year sustainable free surplus generation of £233 million is £52 million higher than the first half of 2013, with lower investment in new business and higher expected return from in-force business.

Expected return from in-force business at £252 million is £16 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 FLAS with-profits fund, improved economic conditions and tax benefits.

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

MCEV operating profit

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Value of new business	(11)	(13)	(26)
Expected existing business contribution	107	107	214
Operating experience variances	16	(15)	(2)
Operating assumption changes	29	34	96
Other operating variances	8	31	138
Development costs	(9)	(3)	(10)
MCEV operating profit before tax	140	141	410

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

The Heritage MCEV operating profit of £140 million is in line with the equivalent period in 2013.

Expected existing business contribution is in line with the first half of 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.

The £29 million operating assumption changes includes an £11 million benefit reflecting revised assumptions in respect of lower future investment expenses after the transfer of assets to Schroders and FLI from F&C, and an increased recognition of deferred tax assets of £18 million.

Value of in-force business

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

£bn	30 June 2014	Restated ⁽ⁱ⁾ 31 December 2013
Pensions	0.6	0.6
Investments	0.7	0.7
Annuities	0.3	0.3
Protection	0.4	0.4
With-profits	0.4	0.4
Total Heritage VIF	2.4	2.4

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

Total Heritage value of in-force business remains unchanged from 2013. This reflects the positive economic conditions in 2014 which have offset the run-off of the in-force book.

Heritage assets under administration

£bn	2014 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Unit-linked pensions	19.1	19.3
Unit-linked investment	15.9	16.1
Annuities and protection	10.2	9.5
With-profits	23.5	23.7
Total	68.7	68.6

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

The increase in assets under administration reflects favourable investment returns over 2013 offsetting the run-off of the business.

New business

£m (unless otherwise stated)	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Value of new business	(11)	(13)	(26)
Investment in new business	(19)	(36)	(52)
IRR	(2.8)%	(0.5)%	(1.0)%
APE	23	36	68

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

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

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

Outlook

During the second half of 2014, further progress is expected to be made on the multi-year programmes to migrate customers to new platforms, involving the Group's two largest outsource partners (Capita and Diligenta), with migrations targeted during 2015. These migrations continue to support the drive for operational efficiency and simplification to improve customer service.

The transfer of assets from F&C to Schroders and FLI is expected to complete in the fourth quarter of 2014, these transfers support the drive for generating good returns for policyholders and shareholders, and cost efficiency.

Phase two of the reallocation of with-profits annuities is also expected to complete in the second half of the year, delivering significant de-risking of future returns for policyholders and generating circa £7 million SFS per annum for the shareholder, with an upfront investment of circa £(15) million. In addition, further reallocations are being considered.

Throughout the remainder of 2014 and beyond, Heritage will focus on responding to the regulatory changes within the industry and ensuring the division works together with the UK division to provide solutions for Friends Life's customers in an ever changing regulatory environment.

UK division

Half year 2014 highlights

- **UK free surplus expected return** up £7 million to £56 million, driven by profitable new business written in 2013. The division is on target to deliver the expected increase in the full year.
- **New business APE** up 25% from strong sales in Corporate Benefits and Protection with Retirement Income volumes down less than 10% despite the Budget announcement in March. However, VNB and investment in new business ("INB") were impacted by margin changes in Retirement Income following improvements to the competitiveness of annuity pricing, which has also exerted pressure on IRRs.
- **Net fund flows in Corporate Benefits** of £0.4 billion, from a neutral position in the same period last year, taking assets under administration to £20.8 billion.
- **Sustainable free surplus** down to £(30) million from £(4) million in the first six months of 2013 driven primarily by the improvements to the competitiveness of annuity pricing and some adverse experience variances. IFRS based operating profit and MCEV operating profit of £10 million and £88 million, respectively, are lower than in the first half of 2013.
- **The Embassy transition programme** to move clients' assets onto the division's strategic platform has successfully delivered six tranches of assets with the remaining four planned to complete this year.

Strategy

The UK division continues to focus on helping customers enjoy a financially secure and prosperous retirement, protect their loved ones should they fall ill or die and make their money work hard for them. The UK division's two insurance businesses, Protection and Retirement Income, remain focused on leveraging successful management of risk to provide valuable products to customers at suitable returns for shareholders. Despite the Budget, the Group still expects three fold growth in the funds available at retirement over the next decade. The asset-based business, Corporate Benefits, focuses on cash delivery driven by growth in assets under administration and as the number two player in the market by assets managed is expected to leverage opportunities from the fast growing retirement savings market, which will triple in size over the next decade.

The Protection business delivers profitable growth driven by the provision of highly regarded products. The business participates at the premium end of the market offering high quality, innovative products centred on providing value to customers in their time of need.

With an estimated one in nine of all UK retiring DC pension customers, Friends Life is well placed to capitalise on the opportunities afforded by the recent Budget announcement and is developing new simple, flexible propositions and enhanced customer engagement to offer solutions for those customers seeking an alternative to the traditional annuity. However, the Retirement Income business strongly believes that annuities will continue to play a vital role for those customers who value a guaranteed income in retirement and utilises its longevity and fixed interest asset management expertise to offer products that deliver a stable income.

The Corporate Benefits business continues to pursue an asset gathering strategy of growing assets under administration and improving net fund flows, by writing profitable new business and focusing on customer retention. It continues to invest in its core propositions and migration of the book to more cost efficient platforms is progressing in line with expectations.

The business is pleased to announce the appointment of Andy Curran as the new interim UK CEO, subject to regulatory approval. Andy brings with him extensive experience of the UK insurance industry and his experience will be invaluable as the division works to deliver the major programmes and drive forward the business' growth aspirations.

Financial performance

£m (unless otherwise stated)	2014 Half year	2013 Half year	2013 Full year
VNB			
Protection	31	32	75
Retirement Income	28	44	83
<i>Insurance business total</i>	59	76	158
Corporate Benefits	12	13	26
Total UK VNB	71	89	184
Investment in new business			
Protection	(22)	(21)	(44)
Retirement Income	(12)	3	(6)
<i>Insurance business total</i>	(34)	(18)	(50)
Corporate Benefits	(21)	(20)	(48)
Total investment in new business	(55)	(38)	(98)
IRR			
Protection	13.3%	15.0%	13.8%
Retirement Income	15.0%	25%+	25%+
<i>Insurance business total</i>	14.0%	30.9%	21.3%
Corporate Benefits	9.4%	7.6%	8.4%
Total IRR	12.1%	16.7%	15.3%
APE			
Protection	47	39	84
Retirement Income	30	32	66
<i>Insurance business total</i>	77	71	150
Corporate Benefits	328	253	574
Total APE	405	324	724

UK division

The UK division delivered strong growth in volumes in the first half of 2014 with APE up 25% to £405 million. Growth has been delivered by the Corporate Benefits and Protection business units which are up 30% and 21% respectively. Retirement Income volumes are only slightly down on the first half of 2013 demonstrating the excellent engagement the business has had with its customers, especially as the impact from the Budget announcement begins to emerge.

VNB is down 20% on the same period of 2013 mainly as a result of improvements in the competitiveness of annuity pricing which has impacted margins, whereas Protection VNB is marginally lower than the same period in 2013 driven by a higher proportion of lower margin group life schemes and reduced margins in individual protection.

Corporate Benefits has delivered positive net fund flows of £0.4 billion with assets under administration increasing to £20.8 billion. A higher proportion of auto-enrolment business resulted in VNB falling £1 million compared to the first half of 2013.

Protection

Protection sales volumes have increased by 21% compared to the first half of 2013, driven by growth in the individual protection proposition. Although volumes in the first quarter of 2013 were depressed due to gender neutral pricing rule changes, there has been continued strong volume growth in this business. In the second quarter of 2014, individual protection sales were up 31% on the second quarter of 2013.

Much of this volume increase has been through individual critical illness. In May, Friends Life strengthened its highly regarded Critical Illness Protect+ products. These enhancements focus on the core illnesses which generate most claims and hence matter the most to the business' customers. These changes ensure the Protect+ range continues to deliver high-quality protection products to customers, and were very well received in the market. Further enhancements are planned across the Protection range in the second half of 2014 to ensure that these products continue to support customers in their time of need.

Overall, Protection VNB is marginally behind the first half of 2013 due to changes in new business mix and margin pressures offsetting the growth in volumes. In addition, an increase in long-term interest rates meaning future emerging profits are worth less in today's terms has also reduced VNB when compared to the first six months of 2013. At a proposition level the contribution from group protection has reduced, reflecting a shift in mix towards lower margin group life business. This reduction is only partially offset by the individual protection proposition where higher volumes, albeit at lower margin as a result of increased competitive market pressure, have resulted in an increased contribution.

Through disciplined use of a modest amount of financial reinsurance and a focus on the cost of writing new business the Group has been able to limit the increase in INB to 5% whilst increasing volumes by 21%.

Retirement Income

The Retirement Income business has delivered strong volumes of new business in the first half of the year, with total volumes less than 10% down on the same period in 2013 despite the changes announced in the Budget. Indeed volumes written in the second quarter, post Budget, are in-line with those written in the first quarter of this year. The business believes that some new business was delayed from the first quarter into the second quarter as customers considered but then re-affirmed their annuity purchase. The business is writing steady volumes of annuities originating from policies with GAOs, which continue to represent strong value for money for customers. Though applications on non-GAO annuities have fallen since the budget, APE has held up as those customers wishing to defer retirement are typically those with a smaller pot, wishing to take advantage of increased commutation limits. While the Retirement Income business is observing an increasing number of customers choosing to defer retirement decisions, the business's improved ability to support its customers in their decision making has helped to address the uncertainties created by the recent Budget and as a consequence resulted in only a moderate fall in new business levels.

The year-on-year reduction in VNB was expected and reflects the improvements made to the competitiveness of the business' annuity proposition through the latter part of 2013.

The business continues to consider entry into the bulk annuity and longevity swap markets; leveraging the Group's expertise in longevity modelling and fixed interest asset management. Any business written will be subject to the strict financial discipline that is applied to the rest of the Group.

Retirement Income remains focused on the mass affluent customer base existing in Heritage and Corporate Benefits. In the lead up to April 2015 when the new rules announced in the Budget come into force, the business' customer service staff will continue to support customers by explaining the effect of the rule changes and customers' range of options. In parallel, the business is developing a new range of services and propositions to ensure customers can enjoy a fully flexible approach to retirement in the post Budget landscape.

Corporate Benefits

Assets under administration

£ bn	2014 Half year	2013 Half year	2013 Full year
1 January	20.1	17.8	17.8
Inflows	1.3	1.1	2.0
Outflows	(0.9)	(1.1)	(2.2)
Net fund flows	0.4	-	(0.2)
Net investment return	0.3	1.9	2.5
Total 30 June/31 December	20.8	19.7	20.1

£m	2014 Half year	2013 Half year	2013 Full year
Total regular premiums received	920	885	1,760

Corporate Benefits has returned to positive net fund flows of £0.4 billion continuing the trend seen in the first quarter of 2014 compared with a flat performance in the first half of 2013. This has contributed to assets under administration increasing to £20.8 billion including market growth of £0.3 billion. Notwithstanding this very pleasing performance, Corporate Benefits has been notified of the potential loss of a large scheme (circa £0.35 billion) which is expected to disinvest in the second half of 2014 to pursue an unbundled proposition.

Regular premiums on existing schemes have shown strong growth principally driven by auto-enrolment with strong new business volumes written in the second half of 2013 and the first half of 2014. In the first half of 2014, 542 employers have auto-enrolled 648 schemes, leading to a net increase in new members of 108,000 to over 1.25 million. This rate of auto-enrolment trajectory is expected to slow materially in the second half of the year as the majority of the business' target customer schemes have now completed their transition.

Income from annual management charges is higher than the first half of 2013 owing to market growth seen in 2013. Expenses have been held at a broadly constant level with only variable expenses, such as investment fees, showing a small increase with volume growth. The growth in income on a largely fixed expense base has led to an increase in underlying free surplus generation from £11 million in the full year 2013 to £14 million in the first half of 2014. This has also resulted in improved positive operational leverage from 9 bps in the first half of 2013 to 13 bps in the first half of 2014.

Corporate Benefits continues to focus on providing value to the customer and has previously communicated that it will be offering all 169 of its schemes with AMDs the chance to move to a single annual management charge ("AMC") in the foreseeable future. This AMC is likely to be the current active member rate, subject to a minimum. So far new terms have been offered to schemes representing around 70% of the total assets under administration of schemes with AMDs.

The Corporate Benefits business has shown strong growth in APE in the first half of 2014, up 30% on the first six months of 2013 with strong growth in sales of new schemes and the client management team renewing their focus on growing the back book through increasing contributions from existing schemes.

The Embassy transition programme which is moving client's assets from the Embassy platform to NGP is showing good progress and is on track to complete in 2014, releasing the cost burden of running a legacy platform. Corporate Benefits has now successfully moved six out of the planned 10 tranches. The remaining four tranches are planned at monthly intervals with the final one expected to transition before the end of 2014.

Since the launch of the Master Trust solution in early 2014, there has been increased interest from key sales partners. In addition, there are growing levels of enquiries to utilise the Master Trust as an alternative buyout vehicle to traditional transfer policies, offering the potential to increase fund flows and assets under administration.

IFRS based operating profit

£m	2014 Half year	2013 Half year	2013 Full year
New business strain	(17)	(7)	(1)
In-force surplus	41	50	69
Long-term investment return	8	5	13
Principal reserving changes and one-off items	(6)	2	8
Development costs	(12)	(19)	(30)
Other income and charges	(4)	(5)	(19)
IFRS based operating profit before tax	10	26	40

IFRS based operating profit of £10 million is down by £16 million compared with the first half of 2013. New business strain has increased by £10 million relative to the first half of 2013 principally driven by adverse impacts in the Retirement Income business. This business still generates a positive new business strain, however due to the more competitive positioning of the Retirement Income proposition and lower volumes, the positive new business strain created by the business is below the 2013 level.

In-force surplus has reduced by £9 million, principally driven by a £4 million adverse claims experience in Protection and a £4 million one-off positive adjustment for investment expenses in 2013 that has not been repeated in 2014.

Operating expenses

£m	2014 Half year	2013 Half year	2013 Full year
Acquisition	53	52	99
Maintenance	25	25	48
	78	77	147
Development costs	12	19	30
Total	90	96	177

With the growth in APE of 25%, strong cost control has been exercised and as a result acquisition costs have only increased by £1 million on the same period in 2013. Maintenance expenses are in line with the prior year.

Development costs have reduced as the business has neared the end of a large number of significant investments including auto-enrolment, the launch of Open Market Annuities and Protection proposition enhancements. The business continues to exercise financial discipline in selecting development projects to ensure that value for money is maintained.

Sustainable free surplus generation

£m	2014 Half year	2013 Half year	2013 Full year
Expected return from in-force business			
Free surplus emergence	54	47	93
Return on shareholder assets	2	2	6
Investment in new business	(55)	(38)	(98)
Underlying free surplus generation	1	11	1
Development costs	(12)	(14)	(23)
Operating experience variances	(15)	3	(11)
Other operating variances	(2)	2	15
Sustainable free surplus before Sesame	(28)	2	(18)
Sesame	(2)	(6)	(22)
Sustainable free surplus generation	(30)	(4)	(40)

SFS is £26 million lower than the first half of 2013 as a result of a higher investment in new business due to the improvements to the competitiveness of annuity pricing and some adverse operating experience variances. Expected returns have increased by £7 million from the first half of 2013 as a result of the profitable new business written in 2013.

	2014 Half year			2013 Half year			2013 Full year		
£m	Protection	Retirement Income	Corporate Benefits	Protection	Retirement Income	Corporate Benefits	Protection	Retirement Income	Corporate Benefits
Expected return from in-force business	15	6	35	14	5	30	30	10	59
Investment in new business	(22)	(12)	(21)	(21)	3	(20)	(44)	(6)	(48)
Underlying free surplus generation	(7)	(6)	14	(7)	8	10	(14)	4	11

The Protection business has delivered a £(7) million underlying free surplus loss, in line with the first six months of 2013, with expected returns up £1 million driven by profitable new business written in 2013. This is offset by higher costs of writing new business as a result of increased volumes and sales mix, despite a £5 million benefit from financial reinsurance.

In Retirement Income underlying free surplus has fallen to £(6) million from a profit in the first half of 2013. Whilst expected return is up by £1 million, this is more than offset by the reduction in new business margins leading to a higher investment in new business, with this primarily driven by the more competitive pricing.

Corporate Benefits, the Group's asset based business, has shown strong cash generation growth with underlying free surplus increasing to £14 million. The table below shows how underlying free surplus is analysed between income and outgoings with the growth in income driven by increasing assets under administration. Income levels are now at 60bps and show growing operating leverage against a stable cost base (outgoings 47bps).

£m (unless otherwise stated)	2014 Half year	2014 Half year	2013 Half year	2013 Half year	2013 Full year	2013 Full year
Income	60	60bps	55	62bps	110	62bps
Outgoings	(47)	(47)bps	(47)	(53)bps	(94)	(53)bps
Other	1		2		(5)	
Underlying free surplus	14		10		11	

MCEV operating profit

£m	2014 Half year	2013 Half year	2013 Full year
Value of new business	71	89	184
Expected existing business contribution	38	30	60
Operating experience variances	(14)	-	(33)
Operating assumption changes	14	-	(6)
Other operating variances	(5)	-	36
Development costs	(12)	(19)	(30)
Life and pensions covered business operating profit before tax	92	100	211
Other income and charges	(4)	(5)	(19)
MCEV operating profit before tax	88	95	192

MCEV operating profit before tax is down £7 million compared with the first half of 2013, mainly due to the fall in VNB, partially offset by a £8 million increase in the expected existing business contribution arising from the growth in the business and favourable economics.

Operating experience variances are adverse compared to the first half of 2013 by £14 million. The principal experience items are £4 million as a result of an increase in protection claims and £4 million adverse persistency experience primarily as a result of the impact of scheme re-writes in the Corporate Benefits business.

Operating assumption changes of £14 million reflect a reduction in expected future investment management expenses after the transfer of assets to Schroders and FLI from F&C.

Outlook

The significant changes to the UK retirement savings market resulting from the Budget announcement are far reaching and the UK division is excited by the new opportunities to add value for customers. The division's focus will be on increasing the already strong engagement with its large existing customer base, most of whom do not have an active IFA relationship, and so will be in greater need of support and guidance in order to make an informed choice from the broader range of options now available to them. Utilising the Group's extensive knowledge of customer behaviour, the division has plans to add simple and flexible product propositions to satisfy the increased demand from customers for innovative solutions aligned to their needs.

The Retirement Income business will also continue to meet the needs of customers who value a guaranteed income in retirement. Given the upcoming legislative change there is naturally uncertainty as to the size of the individual annuity market going forward, albeit as a large proportion of the Group's annuity new business arises from policies with GAOs, our volumes are expected to fall comparatively less than the rest of the market. The business is also continuing to look at widening its reach by entering the bulk annuity and longevity swap markets; leveraging the Group's expertise in longevity modelling and fixed interest asset management.

The Corporate Benefits business will continue to drive growth in assets under administration through the right level of attention from relationship managers and appropriate focus on those clients transitioning from the Embassy platform, to ensure high levels of retention. Additional growth opportunities are expected from the development of the Master Trust proposition, recently launched on NGP, and the development of a proposition suitable for small to medium sized employers, which will be particularly important as the business expands distribution into the corporate IFA sector. The business is well placed to benefit from the expected economic recovery. Higher employment levels and salary inflation will drive increased contributions from workplace schemes and growth in financial markets will also drive higher revenue flows and increased operational leverage.

The Protection proposition suite remains highly regarded and the Group is well placed to benefit from strong relationships from the division's partnerships with estate agencies and intermediaries operating through panels. The Protection business continues to develop new channels through existing partners. In addition, greater focus is being placed on strengthening and expanding relationships with key partners, customers and extending distribution reach through employee benefit consultants.

International division

Half year 2014 highlights

- **The first half of 2014** has been a difficult trading period for the International business, FPI, with challenging market conditions and significant regulatory changes. VNB has fallen by 44% from the first half of 2013 and trading is expected to remain challenging in 2014.
- **The results of the International division** in the first half of 2014 are mixed, with assets under administration in line with 2013. IFRS based operating profit is below the first half of 2013 but in line with the full year 2013 result. MCEV operating profit is adverse to half year 2013, driven by a combination of lower new business volumes and adverse experience variances. Sustainable free surplus generation has been adversely impacted from lower expected return as a result of falling volumes in the past two years.
- **The focus of the FPI business** continues to be on investing in a new International IT platform and product development to support future growth. The project to build the new business platform is on track for the third quarter of 2014 with the in-force book expected to be on the new platform in 2015.
- **Solvency remains above the monitoring levels** of 380% coverage. However, in light of recent trading performance, adverse foreign exchange movements and a potential change in the biting capital constraint, the International division will not pay an interim dividend in 2014, and the full year dividend remains under review.

International division's 2013 full year and half year results have been restated to reflect the transfer of OLAB to the Heritage division.

Strategy

FPI continues to focus on building a sustainable business from its portfolio of international licenses in Singapore, Hong Kong, UAE and Isle of Man, focusing on profitable growth and cash generation.

The priorities of the division are to:

- selectively grow the business and generate sales of profitable products;
- improve the efficiency of the back-office and deploy more resources to Asia; and
- target growth in assets under administration to support future cash generation.

Financial performance

£m (unless otherwise stated)	2014	Restated ⁽ⁱ⁾	Restated ⁽ⁱ⁾
	Half year	2013 Half year	2013 Full year
VNB	5	9	21
Investment in new business	(14)	(24)	(39)
IRR	8.9%	11.4%	11.0%
APE	47	70	127

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

Due to difficult market conditions for regular premium unit-linked insurance business throughout the regions, as well as competitive and regulatory pressures, APE in the first half of the year has fallen by 33% to £47 million. As a result of the lower volumes combined with relatively fixed acquisition costs, VNB decreased by 44% to £5 million compared to the first half of 2013.

In North Asia, volumes in the first half of the year have principally been impacted by the regulatory changes applied during 2013, resulting in the whole unit-linked insurance market falling by approximately a half in the first quarter of 2014 compared to the first quarter of 2013. In addition, volumes in South Asia dropped by 36% and Middle East fell by 20% compared to the first half in 2013 due to aggressive competitor activity.

In the first half of 2014, FPI launched a new Flexible Future Benefit Trust in the UK offshore region and a Decreasing Term Assurance product in the Middle East region. Both of these new products are expected to improve future trading.

IFRS based operating result

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
New business strain	(9)	(11)	(24)
In-force surplus	46	55	100
Long-term investment return	-	-	(1)
Principal reserving changes and one-off items	-	-	(3)
Development costs	(4)	(3)	(7)
Other income and charges	(1)	-	(2)
IFRS based operating profit before tax	32	41	63

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

IFRS based operating result decreased to £32 million from £41 million in the same period of 2013. This reflects an adverse movement in both economic and experience variances within in-force surplus, due to positive variances in the first half of 2013, not repeated in 2014.

New business strain has decreased since 2013 principally due to lower sales of protection business.

Operating expenses

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Acquisition	11	9	21
Maintenance	11	13	23
	22	22	44
Development costs ⁽ⁱⁱ⁾	4	3	7
Total	26	25	51

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

(ii) Development costs are shown gross of the 2013 platform provision release and agree to IFRS based operating profit only

Operating expenses, which exclude commission payments and non-recurring costs, increased marginally to £26 million from £25 million in the first half of 2013. An increase in acquisition costs was offset by a reduction in maintenance costs. Development expenditure amounting to £4 million principally reflects the cost of building the new IT platform. All planned future expenditure on the new International IT platform was provided for in 2013 under MCEV and SFS.

Sustainable free surplus generation

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Expected return from in-force business	28	44	77
Investment in new business	(14)	(24)	(39)
Underlying free surplus generation	14	20	38
Development costs	(1)	(3)	(7)
Operating experience variances	(4)	-	-
Other operating variances	-	(3)	(9)
Other income and charges	-	-	(2)
Sustainable free surplus generation	9	14	20

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

Sustainable free surplus decreased by £5 million to £9 million, mainly due to lower expected return as a result of falling volumes in the past two years.

Expected return from in-force business has decreased by £16 million due to lower in-force surplus emerging from the FPI back-book as a result of 2013 sales volumes being lower than 2012. Given the levels of APE in 2014 it is expected that the returns will drop further in 2015. This is partially offset by investment in new business being £10 million lower than the first half of 2013 also principally due to lower sales volumes.

MCEV operating result

£m	2014 Half year	Restated ⁽ⁱ⁾ 2013 Half year	Restated ⁽ⁱ⁾ 2013 Full year
Value of new business	5	9	21
Expected existing business contribution	11	8	16
Operating experience variances	(2)	2	3
Operating assumption changes	-	-	11
Other operating variances	-	(1)	(2)
Development costs	(1)	(3)	(7)
Life and pensions covered business operating profit before tax	13	15	42
Other income and charges	(1)	-	(2)
MCEV operating profit before tax	12	15	40

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

MCEV operating profit of £12 million has decreased by £3 million and principally reflects a £4 million fall in VNB as a result of difficult market conditions for regular premium unit-linked insurance business throughout the regions.

The expected existing business contribution has increased from £8 million to £11 million, reflecting a larger book of business combined with higher expected rates of return.

The operating experience variances of £(2) million is driven by a small increase in provisions.

Outlook

Despite disappointing first half results in 2014, the Group continues to focus on turning around the FPI business and remains confident that the International division will make an increasing contribution towards generating shareholder cash and value for the future.

FPI has completed the process of reviewing its markets and de-risking its business. The business is focused on delivering profitable growth within its core markets and building on its licences and strong relationships in the Middle East and Asia. The Group believes that recent regulatory changes in the Middle East will strengthen FPI's competitive position in that region.

The new International platform is being implemented and is expected to be ready to accept new business by the end of the third quarter of 2014 with the in-force business phase following in 2015. This will support future growth and product development and improve the division's competitive position. The changes to the product range are underway with the launch of two new products on the existing platform.

Discontinued operations - Lombard

On 11 July 2014 the Group announced the sale of its Luxembourg based business, Lombard. The deal, which is subject to regulatory approval, is expected to complete in the second half of 2014. For more details on this transaction, see note 2d.

The financial impact of the proposed sale, including the operating and non-operating results for the period, are included below:

Financial performance

£m	IFRS			Free surplus ⁽ⁱ⁾			MCEV		
	HY 2014	HY 2013	FY 2013	HY 2014	HY 2013	FY 2013	HY 2014	HY 2013	FY 2013
Operating/Sustainable free surplus results	12	20	34	1	5	6	(2)	11	(46)
Non-operating results	(39)	(40)	(80)	(6)	1	(1)	(4)	2	11
Loss on remeasurement to fair value	(10)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Taxation	10	11	22	n/a	n/a	n/a	1	(3)	7
(Loss)/profit after tax from discontinued operations	(27)	(9)	(24)	(5)	6	5	(5)	10	(28)

(i) Free surplus is presented net of tax.

Within the MCEV result and consistent with CFO forum principles, a capital adjustment totalling £(268) million has been made for the remeasurement of the carrying value amount of Lombard. This is excluded from the above table.

IFRS based operating result

£m	2014 Half year	2013 Half year	2013 Full year
New business strain	(19)	(16)	(31)
In-force surplus	32	37	68
Development costs	(1)	(1)	(3)
IFRS based operating profit before tax	12	20	34

Lombard generated an IFRS based operating profit before tax of £12 million in the first half of 2014, £8 million below the first half of 2013. The decrease principally reflects one-off costs incurred as a result of the expected sale of the business and lower AMCs resulting from adverse persistency experience since 2013.

Assets under administration

	2014 Half Year		2013 Half Year		2013 Full Year	
	€bn	£bn	€bn	£bn	€bn	£bn
Opening	24.3	20.2	23.3	18.9	23.3	18.9
Inflows	0.9	0.7	1.0	0.9	2.3	2.0
Outflows	(1.2)	(1.0)	(1.0)	(0.9)	(2.3)	(2.0)
Net fund flows	(0.3)	(0.3)	-	-	-	-
Net investment return	0.5	0.4	0.2	0.2	1.0	0.8
Foreign exchange	-	(0.7)	-	1.0	-	0.5
Closing	24.5	19.6	23.5	20.1	24.3	20.2

Assets under administration increased by €0.2 billion since the beginning of the year, however fell by £0.6 billion mainly due to exchange losses. Adverse currency fluctuations, together with negative fund flows are only partly offset by a positive net investment return.

Sustainable free surplus generation

£m	2014 Half year	2013 Half year	2013 Full year
Expected return from in-force business	23	22	44
Investment in new business	(13)	(12)	(24)
Underlying free surplus generation	10	10	20
Development costs	(1)	(1)	(2)
Operating experience variances	(7)	(3)	(9)
Other operating variances	(1)	(1)	(3)
Sustainable free surplus generation	1	5	6

Sustainable free surplus of £1 million is down £4 million on 2013. The result is driven by one-off expenses incurred due to the sale of the business.

MCEV operating result

£m	2014 Half year	2013 Half year	2013 Full year
Value of new business	4	12	25
Expected existing business contribution	18	18	33
Operating experience variances	(23)	(18)	(25)
Operating assumption changes	-	-	(82)
Other operating variances	-	-	6
Development costs	(1)	(1)	(3)
MCEV operating (loss)/profit before tax	(2)	11	(46)

As a result of the difficult trading environment in Lombard's core markets, due largely to the regulatory and legal framework changes and uncertainty around the sale of the business, the MCEV operating result for 2014 is materially down on 2013, resulting in a loss of £(2) million. The result reflects a lower contribution from new business and materially adverse persistency experience particularly in Belgium as a result of tax and legal changes.

Expected existing business contribution has remained stable at £18 million because the impact of higher economic assumptions is offset by the lower opening value of the in-force book following the 2013 year end long term assumption changes.

Corporate review

The Corporate segment includes the corporate holding and service companies, as well as the net debt liabilities of the Group.

IFRS based operating result

£m	2014 Half year	2013 Half year	2013 Full year
Investment return and other items excluding external debt	61	61	123
External finance costs	(60)	(60)	(120)
Other corporate net costs	(15)	(13)	(34)
IFRS based operating loss before tax	(14)	(12)	(31)

The Corporate IFRS based operating result is principally driven by external finance costs and corporate costs, offset by interest on internal debt.

The other corporate net costs of £(15) million principally relate to overhead costs associated with management of the Friends Life holding companies principally in respect of investor related activities.

Sustainable free surplus generation

£m	2014 Half year	2013 Half year	2013 Full year
Coupon on external debt	(47)	(45)	(92)
Other income and charges	(2)	(4)	(8)
Sustainable free surplus generation	(49)	(49)	(100)

The sustainable free surplus contribution from Corporate principally reflects the debt costs (net of tax) incurred by the Group. Increases in external debt costs in the first half of 2014 reflect the reduction in the rate of corporation tax. Sustainable free surplus excludes corporate costs in respect of investor related activities.

MCEV operating results

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

£m	2014 Half year	2013 Half year	2013 Full year
Expected existing business contribution on debt	(32)	(37)	(75)
Life and pensions covered business operating loss before tax	(32)	(37)	(75)
Other income and charges	(15)	(11)	(32)
MCEV operating loss before tax	(47)	(48)	(107)

The expected existing business contribution on debt has reduced following a decrease in the expected rate of return applied to external debt.

Financing and interest costs

The Group has a number of debt instruments and the operating costs of financing these for the period ended 30 June 2014 are presented below.

£m (unless otherwise stated)	Coupon	Principal	Clean market value of debt ⁽ⁱ⁾	Finance costs ⁽ⁱⁱⁱ⁾	
				IFRS	MCEV
LT2 subordinated debt 2021	12.00%	162	217	(10)	(4)
LT2 subordinated debt 2022	8.25%	500	569	(21)	(11)
UT2 reset perpetual subordinated debt ⁽ⁱⁱ⁾	7.875%	356	385	(14)	(8)
STICS 2003	6.875%	210	223	(7)	(4)
STICS 2005	6.292%	268	274	(8)	(5)
Total 30 June 2014		1,496	1,668	(60)	(32)
Total 31 December 2013		1,496	1,616	(120)	(75)

(i) Market value is based on listed ask price, at 30 June 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 30 June 2014. The finance cost of £14 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 £(47) million, being the IFRS amount of £(60) million net of tax.

Gearing and liquidity

IFRS gearing (£m)	30 June 2014	31 December 2013
Equity attributable to equity holders of the parent	4,949	5,229
Loans and borrowings ⁽ⁱ⁾	1,031	1,050
	17.2%	16.7%

(i) Loans and borrowings as reported on the IFRS balance sheet where debt is measured at amortised cost. See note 10. IFRS debt gearing excludes the 2003 and 2005 STICS, as these securities are classified as equity in IFRS.

MCEV gearing (£m)	30 June 2014	31 December 2013
Group MCEV, gross of debt	7,404	7,688
Debt ⁽ⁱ⁾	1,680	1,623
	22.7%	21.1%

(i) Debt being the clean market value of the debt as at 30 June 2014 and the currency swap associated with the UT2 reset perpetual subordinated debt.

At 30 June 2014, the ratio of debt to IFRS equity attributable to equity holders of the parent, gross of debt, was 17.2% (31 December 2013: 16.7%), with the change in equity principally reflecting the payment of dividends in the period.

The MCEV gearing of 22.7% (31 December 2013: 21.1%) is up in the period principally reflecting the decrease in gross Group MCEV.

The liquidity of the Group remains strong and is complemented with an undrawn £250 million funding facility with a consortium of banks.

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 including Lombard at 30 June 2014 remains strong with ASA of £917 million and an estimated IGCA surplus of £2.2 billion resulting in a coverage ratio, excluding WPICC, of 235%. At 30 June 2014 the estimated economic capital surplus at Group level was £4.0 billion corresponding to a coverage ratio of 193%.

Cash and capital definitions

- (i) **WPICC** represents the difference between the surplus capital calculated on a regulatory basis and that on a realistic basis, in accordance with regulations, and is excluded from both IGCA capital resources and capital resources requirements under the CMP.
- (ii) **Economic capital** represents management's internal risk-based estimate of the amount of capital needed to be held to mitigate the risk of insolvency to a minimum of a 99.5% confidence level over a one year period. The coverage ratio represents the proportion of capital resources to capital resource requirements.
- (iii) The IGCA and economic capital position at 30 June 2014 of the Group and its subsidiaries are **estimated**.

Capital management policies and monitoring buffers

The Group's capital management policies ("CMPs") that apply at a life company level and at the Group level were set out in the 2013 full year results. These policies remain unchanged and are summarised below.

Life companies CMP

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

- 150% of Pillar 1 requirements, excluding WPICC, FPIL and Lombard; and
- 125% of Pillar 2 requirements, including any ICG and specifically excluding FPIL and Lombard.

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

Group CMP

The CMP at Group level is to meet 150% of IGCA requirements, excluding WPICC. In order to protect the CMP in the highly remote event that payment of debt costs would lead to a breach of the policy, the Group has an additional requirement in respect of debt servicing costs. This requirement is to hold excess capital, over 150%, in the form of cash or cash equivalents at holding company level sufficient to pay at least the next year's gross annual interest cost (currently £120 million per annum) and any mandatory repayments of principal that fall due on debt in the next year.

Capital monitoring buffers

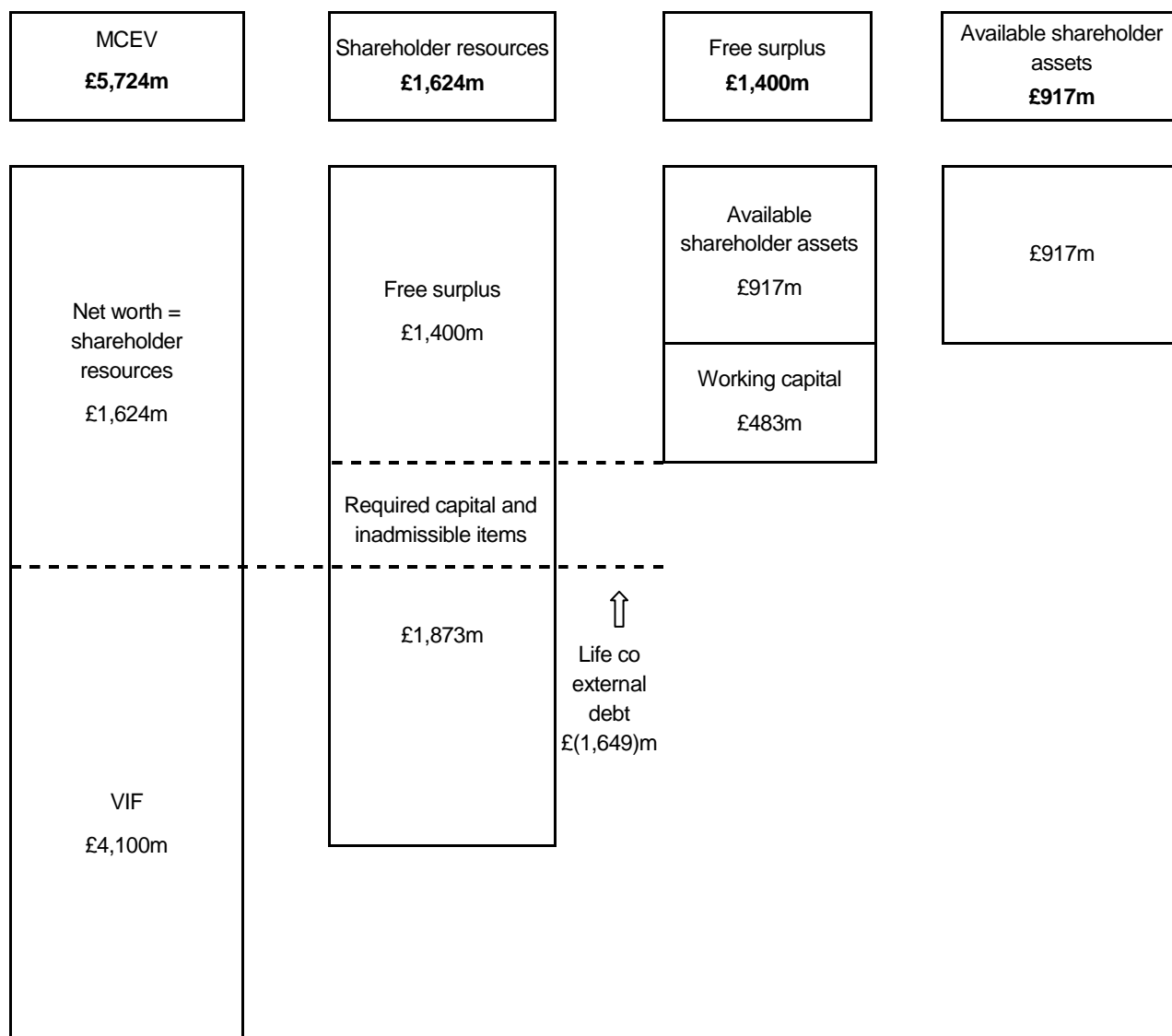
The Group has a robust monitoring system and in addition to the amounts held to meet its CMPs, it holds a prudence buffer together with a monitoring buffer held within working capital.

The prudence buffer is designed to cover an additional year of the Company's current dividend and the holding companies' corporate costs 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 30 June 2014 the biting constraint is the Group IGCA position, and a monitoring buffer of 10% of the IGCA requirements, excluding WPICC, is held within the working capital.

Cash and capital management framework

The Group's cash and capital management framework is based on MCEV as this comprises the discounted value of expected future cash flows on a market consistent basis. The chart below shows how the core components of MCEV reconcile to ASA as at 30 June 2014.



The total MCEV is split between the net worth, or shareholder resources, and the VIF. Shareholder resources comprise the free surplus, required capital and inadmissible assets of the business. Required capital is based on the most onerous CMP for the Group, currently the IGCA. For the holding companies and other non-regulated businesses, free surplus is defined as IFRS net assets less required capital and inadmissible assets on an IGCA basis (for MCEV, where these assets relate to non-covered business, they are all included within free surplus). VIF comprises the value of the future cash flows arising from the policies currently in-force.

External debt issued by FLH is offset against required capital in the life businesses as this debt has been guaranteed by life operating companies and has been used to support their activities.

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

ASA consists of cash and other liquid assets held by the Friends Life holding companies, together with any dividends declared and approved by the operating companies that are yet to be remitted. As such, ASA is stated after the deduction of working capital from free surplus. ASA represents cash available to cover Friends Life's corporate costs, to service debt issued by holding companies and, subject to shareholder approval, to pay dividends or returns to shareholders. The generation of ASA therefore represents a key performance metric of the Group.

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

£m (net of tax)	Value in-force	Shareholder resources		Total MCEV
		Required capital ⁽ⁱ⁾	Free surplus	
Opening MCEV at 1 January 2014	4,369	245	1,451	6,065
Free surplus generated in the period	21	(26)	172	167
Dividend payment	-	-	(199)	(199)
Discontinued operations	(277)	2	(5)	(280)
Other reserve movements	(13)	3	(19)	(29)
Closing MCEV at 30 June 2014⁽ⁱ⁾	4,100	224	1,400	5,724

(i) Required capital is calculated based on the requirements under the Group CMP, and includes required capital of £202 million (2013: £224 million) in respect of non-covered business and £22 million (2013: £21 million) in respect of covered business.

The free surplus generated in the period of £172 million principally reflects the £163 million sustainable free surplus result with the benefit of positive economic variances partially offset by non-recurring items.

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

Working capital and other assets and liabilities

The working capital at 30 June 2014 of £483 million has reduced from the £534 million held 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;
- an appropriate monitoring buffer to facilitate ongoing compliance with the Group's CMPs;
- amounts to cover the necessary funding to protect against any temporary shortfall in delivery of cash generation relative to Group targets; and
- restricted assets included within free surplus e.g. illiquid or intangible assets and any assets in excess of the CMP held within the life companies. This includes a contribution to the 2014 final dividend in the first half of the year which will only be released to ASA once the year end actuarial valuations have been completed.

The largest components of working capital are the monitoring buffer (£163 million), the amounts set aside to meet non-recurring costs (£106 million), and amounts retained within the life companies in excess of the CMP (£89 million).

Available shareholder assets

The ASA of £917 million comprises £778 million of shareholder cash at Friends Life holding company level (including the £120 million interim dividend proposed by FLL) and £139 million of investments in syndicated loans.

£m	30 June 2014	31 December 2013
Friends Life holding companies' cash	658	644
Investments in syndicated loans	139	-
Proposed dividend from FLL	120	273
Available shareholder assets	917	917

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

£m	30 June 2014	31 December 2013
Settlement of interim/final dividend	100	200
Prudence buffer in accordance with Group policy	325	325
Settlement of expected share buy-back	56	-
Non-specified ASA holdings	436	392
Available shareholder assets	917	917

The ASA balance as at 30 June 2014 is held to cover the costs of the proposed interim dividend and to maintain a prudence buffer of £325 million which is designed to cover an additional year of the Company's current dividend cost, and the holding companies corporate costs. The Group CMP requirement to hold cash at FLH sufficient to meet one year of FLH's debt servicing costs is expected to be met from capital retained in the life companies. This is not considered to be a restriction on the availability of FLH cash, however is covered by the additional ASA holdings at Group level.

The proposed share buy-back of £317 million following completion of the sale of Lombard will be funded by £261 million of expected cash proceeds from the sale with the balance of £56 million being funded from ASA.

Economic capital position

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

The Group's CMP is to maintain capital resources at the life company level to cover 125% of the capital requirements on an economic capital basis.

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

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

The estimated Group economic capital surplus above capital requirements as at 30 June 2014 is strong at £4.0 billion (a coverage ratio of 193%). The change since 31 December 2013 (surplus of £3.9 billion) primarily reflects the generation of operating profit, offset by external dividend payments.

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

- an estimated £(0.7) billion in the event of a combined 40% fall in equity markets and a 30% fall in property markets;
- an estimated £0.2 billion in the event of a 200bps 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 impact of the sale of Lombard and proposed share buy-back of £317 million on the Group's estimated economic capital surplus is expected to be a reduction of £(0.3) billion, which if the sale and share buy-back had occurred at 30 June 2014 would have reduced the Group's estimated economic capital surplus from £4.0 billion to £3.7 billion with the coverage ratio marginally reducing

to 192%. The estimated sensitivities of the economic capital surplus to interest rates and corporate bond spreads remain unchanged, but the sensitivity to a 40% fall in equities and 30% fall in property values would change from £(0.7) billion to £(0.6) billion.

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 Group CRR (excluding WPICC).

The balance sheet remains strong with an estimated IGCA surplus of £2.2 billion at 30 June 2014, with Group capital resources being 235% of Group CRR (excluding WPICC of £4.3 billion).

The movement in IGCA surplus over the period largely reflects the generation of surplus offset by external dividend paid.

Movement in IGCA surplus	£m
1 January 2014	2,236
Surplus emerging	218
Dividend paid	(199)
Finance costs and other movements	(55)
30 June 2014	2,200

At 30 June 2014 the capital held to meet CMPs was £816 million (1 January 2014: £812 million) and the excess over the CMPs was £1,384 million (1 January 2014: £1,424 million).

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

- an estimated £(0.2) billion in the event of a combined 40% fall in equity markets and a 30% fall in property markets;
- an estimated £0.2 billion in the event of a 200bps 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 impact of the sale of Lombard and proposed share buy-back of £317 million on the Group's Pillar 1 capital is expected to be a reduction in the IGCA surplus of £0.1 billion, which if the sale and share buy-back had occurred on 30 June 2014 would have reduced the Group's estimated IGCA surplus to £2.1 billion and with coverage marginally reducing to 233%. The estimated sensitivities of the IGCA surplus to market shocks would be unchanged.

Asset quality and exposure

The Group's financial assets as at 30 June 2014, excluding cash, are summarised as follows:

					30 June 2014 Total	31 December 2013 Total
£bn	Unit-linked	With-profits	Non-profit	Shareholder		
Shares, unit trusts and OEICs	49.2	6.5	0.2	-	55.9	70.0
Government securities	6.8	6.6	1.8	0.1	15.3	16.2
Corporate bonds and asset-backed securities	2.4	7.5	9.8	0.2	19.9	22.4
Derivatives	-	0.1	-	-	0.1	0.3
Deposits	-	-	-	-	-	0.2
Total	58.4	20.7	11.8	0.3	91.2	109.1

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

					30 June 2014 Total	31 December 2013 Total
£bn	Unit-linked	With-profits	Non-profit	Shareholder		
Corporate bonds and asset-backed securities	2.4	7.5	9.8	0.2	19.9	22.4
less: policyholder exposure	2.4	6.4	-	-	8.8	11.9
Shareholder exposure	-	1.1	9.8	0.2	11.1	10.5
AAA		0.1	1.1	-	1.2	1.1
AA		0.2	3.3	-	3.5	3.4
A		0.4	3.6	0.1	4.1	3.8
BBB		0.3	1.7	-	2.0	2.0
Sub-BBB or rating not available		0.1	0.1	0.1	0.3	0.2
% Investment grade					97.3%	98.1%

97.3% of the corporate bonds and asset-backed securities to which the shareholder funds are exposed are investment grade. The Group controls its exposures to corporate issuers by rating, type of instrument and type of issuer. The sub-investment grade bonds held in investment portfolios are monitored closely in order to maximise exit values. Where asset-backed securities and other complex securities are held, the Group monitors closely its exposures to ensure that the relevant structure, liquidity and tail credit risks are well understood and controlled.

No defaults have been experienced in the period to 30 June 2014. The Group holds default reserves to cover the risk of defaults and credit rating downgrades on corporate bonds that back all annuity business within Friends Life group. The reserves reflect assumed defaults over the outstanding terms to maturity of the bonds. The shareholder share of default reserves at 30 June 2014 was £0.44 billion (31 December 2013: £0.45 billion). This represents a haircut of 50% of the overall corporate bond spreads over gilts of equivalent term (31 December 2013: 48%).

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.

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

Principal risks and uncertainties

The Group actively manages its risk profile and the Group's risk appetite framework drives the identification and mitigation of strategic, group, financial and operational risks to support the achievement of its objectives. The Group included details of the principal risks and uncertainties related to its business on pages 67 to 69 of its 2013 Annual Report and Accounts. The principal risks and uncertainties to which the Group has been exposed during the first six months of 2014 are unchanged from those described in the 2013 Annual Report and Accounts. These are:

- Regulatory change, including taxation and Solvency II
- Economic conditions
- Credit
- Principal valuation assumptions
- Outsourcing

All of these are expected to remain relevant and applicable for the remainder of 2014.

The well publicised proposals in the Chancellor's 2014 Budget for increased choice within the pensions and retirement market pose a challenge to the current structure of the annuity market. The implications of the change will be borne out over time, with the new flexibility available to retirees expected to result in a sustained reduction in annuity new business volumes across the industry.

The Group considers itself well placed to deal with the changes to the annuity market, as currently known. The fundamentals for growth in the retirement provision market and the strength of the business' competitive position within this market are both unchanged. As part of the Group's annual strategic review, the Group will consider the customer engagement profile and are developing broader retirement income propositions to provide more flexibility and choice through the retirement process. The proposals will not affect the Group's short term ability to generate cash but will impact on the delivery of the value of new business target.

Linked to the annuity developments, the Chancellor has committed that all vesting customers will have access to free, impartial guidance. The Group will continue to monitor emerging requirements and consider how best to ensure compliance while maintaining the best interests of existing and potential customers.

In March, the Financial Conduct Authority ('FCA') announced that they would undertake an industry wide review into the fair treatment of long standing customers in life insurance. A review is underway into the way in which the FCA's proposed review was announced given that the announcement had a significant detrimental effect on the share price of leading life insurers with closed funds, including Friends Life. Given the significant book of legacy business within the Heritage division, the Group will proactively engage with the FCA review and closely monitor implications for the industry arising from the review outcomes.

Solvency II, which starts on 1 January 2016, will have implications for the whole industry as to the way in which companies calculate capital. There remains further work to transition the Group across to a Solvency II basis and the Group's internal programme to achieve this is fully mobilised. Through the transition, there will be an impact in terms of the way in which the Group needs to hold capital and this will be adjusted accordingly and in a manner that best serves Friends Life's customers and shareholders.

There is a risk that politically motivated changes will impact on the insurance market in the run up to the next UK General Election which will be called on or before 7 May 2015. Further, the economic implications of Scottish independence, whether it is attained or not, along with rising anti-EU sentiment across the UK and Europe present uncertainty for UK businesses.

More broadly, the Eurozone's economic recovery suffered a setback in the first quarter after slower-than-expected growth. The economy grew just 0.2% in the first three months of 2014; GDP in the second quarter has been forecasted to increase by 0.4% on the first quarter. Global economic activity has broadly strengthened, whilst remaining fragile and is expected to improve through 2014, with much of the impetus coming from developed economies

The reliance of the Group on outsource service providers is unchanged. Processes for managing all outsourcing contracts are actively monitored and managed, in particular in relation to service improvement plans.

As stated in note 1 to the condensed consolidated financial statements, the directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the condensed consolidated financial statements.

Going concern and Directors' responsibility statement

Going concern

The directors have undertaken a going concern assessment in accordance with "Going Concern and Liquidity Risk: Guidance for UK directors of UK Companies 2009", published by the Financial Reporting Council in October 2009. As a result of this assessment, the directors are satisfied that the Group and the Company have adequate resources to continue to operate as a going concern for the foreseeable future and have prepared the financial statements on that basis. In assessing whether the going concern basis is appropriate, the directors have considered the information contained in the financial statements, the latest business plan profit forecasts, the latest working capital forecasts and estimated forecast solvency of the regulated subsidiaries of the Group. These forecasts have been subject to sensitivity tests and the directors are satisfied that the Group and Company have adequate resources to continue in operational existence for the foreseeable future. Key information in respect of the Group's business activities, financial performance (including cash generation and financial strength) and risks is set out on pages 12 to 42.

Directors' responsibilities

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

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

On behalf of the Board

Tim Tookey

Chief Financial Officer

5 August 2014

Independent review report to Friends Life Group Limited

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the interim results statement for the six months ended 30 June 2014 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of IFRS based operating profit, the condensed consolidated statement of financial position, the condensed consolidated statement of changes in equity, the condensed consolidated statement of cash flows and the related notes 1 to 14. We have read the other information contained in the interim results statement and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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

Directors' responsibilities

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

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

Our responsibility

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

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim results statement for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Ernst & Young LLP
London
5 August 2014

IFRS FINANCIAL INFORMATION

Condensed consolidated income statement

For the half year ended 30 June 2014	Notes	2014 Half year £m	Restated 2013 Half year £m	Restated 2013 Full year £m
Revenue				
Gross earned premiums	2	945	1,044	1,971
Premiums ceded to reinsurers	2	(312)	(300)	(595)
Net earned premiums	2	633	744	1,376
Fee and commission income and income from service activities		345	380	715
Investment return		3,291	7,065	7,959
Total revenue		4,269	8,189	10,050
Other income	2	–	20	20
Claims, benefits and expenses				
Gross claims and benefits paid		(2,092)	(2,337)	(4,494)
Amounts receivable from reinsurers		342	333	688
Net claims and benefits paid		(1,750)	(2,004)	(3,806)
Change in insurance contract liabilities		(971)	86	2,331
Change in investment contract liabilities		(519)	(4,877)	(6,170)
Transfer (to)/from unallocated surplus		(52)	1	29
Movement in net asset value attributable to unit-holders	2	(18)	(108)	(89)
Movement in policyholder liabilities		(1,560)	(4,898)	(3,899)
Acquisition expenses	2	(284)	(260)	(554)
Administrative and other expenses	2	(527)	(601)	(1,255)
Finance costs	2	(68)	(79)	(141)
Total claims, benefits and expenses		(4,189)	(7,842)	(9,655)
Profit before tax from continuing operations		80	367	415
Policyholder tax	5	(111)	(277)	(334)
(Loss)/profit before shareholder tax from continuing operations		(31)	90	81
Total tax charge	5	(96)	(297)	(156)
Policyholder tax	5	111	277	334
Shareholder tax	5	15	(20)	178
(Loss)/profit after tax from continuing operations		(16)	70	259
Loss after tax from discontinued operations	2	(27)	(9)	(24)
(Loss)/profit for the period		(43)	61	235
Attributable to:				
Equity holders of the parent				
From continuing operations		(32)	54	228
From discontinued operations	2	(27)	(9)	(24)
Non-controlling interests from continuing operations		16	16	31
(Loss)/profit for the period		(43)	61	235

		2014 Half year pence	Restated 2013 Half year pence	Restated 2013 Full year pence
Basic earnings per share				
Basic earnings per share from continuing operations	4	(2.26)	3.81	16.08
Basic earnings per share from discontinued operations	4	(1.91)	(0.64)	(1.69)
Total basic earnings per share		(4.17)	3.17	14.39

		2014 Half year pence	Restated 2013 Half year pence	Restated 2013 Full year pence
Diluted earnings per share				
Diluted earnings per share from continuing operations	4	(2.26)	3.81	16.07
Diluted earnings per share from discontinued operations	4	(1.91)	(0.64)	(1.69)
Total diluted earnings per share		(4.17)	3.17	14.38

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

The condensed consolidated income statement includes the results of Lombard as a discontinued operation. A single amount is shown on the face of the income statement comprising the segment's post-tax result, the post-tax loss recognised on the remeasurement of its net assets to fair value less cost to sell and associated corporate non-recurring costs of disposal. 2013 results have been restated to reflect Lombard as a discontinued operation.

Condensed consolidated statement of comprehensive income

For the half year ended 30 June 2014	Equity holders of the parent £m	Non-controlling interests £m	Total £m
(Loss)/profit from continuing operations	(32)	16	(16)
Loss from discontinued operations	(27)	–	(27)
(Loss)/profit for the period	(59)	16	(43)
Other comprehensive income from continuing operations:			
Items that will not be reclassified to profit and loss:			
Remeasurement losses on the defined benefit scheme	(4)	–	(4)
Total items that will not be reclassified to profit and loss	(4)	–	(4)
Items that may be reclassified subsequently to profit and loss:			
Foreign exchange adjustments ⁽ⁱ⁾	(2)	–	(2)
Shadow accounting ⁽ⁱⁱ⁾	2	–	2
Total items that may be reclassified subsequently to profit and loss	–	–	–
Other comprehensive loss, net of tax, from continuing operations	(4)	–	(4)
Other comprehensive loss, net of tax, from discontinued operations	(12)	–	(12)
Total other comprehensive loss, net of tax	(16)	–	(16)
Total comprehensive (loss)/income, net of tax, from continuing operations	(36)	16	(20)
Total comprehensive loss, net of tax, from discontinued operations	(39)	–	(39)
Total comprehensive (loss)/income net of tax	(75)	16	(59)

For the half year ended 30 June 2013	Restated Equity holders of the parent £m	Non-controlling interests £m	Restated Total £m
Profit from continuing operations	54	16	70
Loss from discontinued operations	(9)	–	(9)
Profit for the period	45	16	61
Other comprehensive income from continuing operations:			
Items that will not be reclassified to profit and loss:			
Remeasurement losses on the defined benefit scheme	(70)	–	(70)
Income tax relating to items that will not be reclassified	50	–	50
Total items that will not be reclassified to profit and loss	(20)	–	(20)
Items that may be reclassified subsequently to profit and loss:			
Foreign exchange adjustments ⁽ⁱ⁾	7	–	7
Shadow accounting ⁽ⁱⁱ⁾	(8)	–	(8)
Total items that may be reclassified subsequently to profit and loss	(1)	–	(1)
Other comprehensive loss, net of tax, from continuing operations	(21)	–	(21)
Other comprehensive income, net of tax, from discontinued operations	21	–	21
Total other comprehensive income, net of tax	–	–	–
Total comprehensive income, net of tax, from continuing operations	33	16	49
Total comprehensive income, net of tax, from discontinued operations	12	–	12
Total comprehensive income, net of tax	45	16	61

For the year ended 31 December 2013	Restated Equity holders of the parent £m	Non-controlling interests £m	Restated Total £m
Profit from continuing operations	228	31	259
Loss from discontinued operations	(24)	–	(24)
Profit for the period	204	31	235
Other comprehensive income from continuing operations:			
Items that will not be reclassified to profit and loss:			
Remeasurement losses on the defined benefit scheme	(113)	–	(113)
Income tax relating to items that will not be reclassified	36	–	36
Total items that will not be reclassified to profit and loss	(77)	–	(77)
Items that may be reclassified subsequently to profit and loss:			
Foreign exchange adjustments ⁽ⁱ⁾	(5)	–	(5)
Shadow accounting ⁽ⁱⁱ⁾	4	–	4
Total items that may be reclassified subsequently to profit and loss	(1)	–	(1)
Other comprehensive loss, net of tax, from continuing operations	(78)	–	(78)
Other comprehensive income, net of tax, from discontinued operations	10	–	10
Total other comprehensive loss, net of tax	(68)	–	(68)
Total comprehensive income, net of tax, from continuing operations	150	31	181
Total comprehensive loss, net of tax, from discontinued operations	(14)	–	(14)
Total comprehensive income, net of tax	136	31	167

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

(ii) Shadow accounting that may be reclassified subsequently to profit and loss is as a result of a loss of £(2) million (30 June 2013: gain of £8 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").

Condensed consolidated statement of IFRS based operating profit

For the half year ended 30 June 2014	Notes	2014 Half year £m	Restated 2013 Half year £m	Restated 2013 Full year £m
Profit before tax from continuing operations	2	80	367	415
Policyholder tax	5	(111)	(277)	(334)
(Loss)/profit before shareholder tax from continuing operations excluding returns generated within policyholder funds		(31)	90	81
Non-recurring items	2	55	37	131
Amortisation and impairment of acquired present value of in-force business	7	153	167	342
Amortisation and impairment of other intangible assets	7	23	26	63
Interest payable on Step-up Tier one Insurance Capital Securities ("STICS")	2	(16)	(16)	(31)
Short-term fluctuations in investment return	2	(25)	(133)	(184)
IFRS based operating profit before tax from continuing operations	2	159	171	402
Tax on operating profit		4	(3)	4
IFRS based operating profit after tax from continuing operations attributable to equity holders of the parent⁽ⁱ⁾		163	168	406

Earnings per share		2014 Half year pence	Restated 2013 Half year pence	Restated 2013 Full year pence
Operating earnings per share from continuing operations	4	11.53	11.85	28.64
Diluted operating earnings per share from continuing operations	4	11.52	11.85	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.

Condensed consolidated statement of financial position

As at 30 June 2014	Notes	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
Assets				
Intangible assets	7	3,289	4,115	3,855
Property and equipment		46	51	50
Investment properties		2,618	2,621	2,561
Investment in associate		4	4	4
Financial assets	8	91,232	111,427	109,064
Deferred acquisition costs		843	881	897
Reinsurance assets		2,893	3,130	2,837
Current tax assets		51	–	33
Insurance and other receivables		1,174	1,453	1,100
Cash and cash equivalents		7,810	9,804	9,690
Assets of operations classified as held for sale	2	20,206	–	–
Total assets		130,166	133,486	130,091
Liabilities				
Insurance contracts		35,654	37,175	34,590
Unallocated surplus		679	655	627
Financial liabilities:				
– Investment contracts		63,021	83,679	83,502
– Loans and borrowings	10	1,031	1,112	1,050
– Amounts due to reinsurers		1,594	1,720	1,580
Net asset value attributable to unit-holders		629	808	621
Provisions		190	232	227
Pension scheme deficit	6	59	31	52
Deferred tax liabilities		967	1,066	980
Current tax liabilities		6	35	1
Insurance payables, other payables and deferred income		1,180	1,411	1,312
Liabilities of operations classified as held for sale	2	19,896	–	–
Total liabilities		124,906	127,924	124,542
Equity attributable to equity holders of the parent				
– Share capital	11	4,211	4,225	4,223
– Other reserves		738	1,008	1,006
		4,949	5,233	5,229
Attributable to non-controlling interests		311	329	320
Total equity		5,260	5,562	5,549
Total equity and liabilities		130,166	133,486	130,091

Condensed consolidated statement of changes in equity

For the half year ended 30 June 2014	Attributable to equity holders of the parent			Non-controlling interests £m	Total £m
	Share capital £m	Other reserves £m	Total £m		
At 1 January 2014	4,223	1,006	5,229	320	5,549
(Loss)/profit for the period	–	(59)	(59)	16	(43)
Other comprehensive loss	–	(16)	(16)	–	(16)
Total comprehensive (loss)/income	–	(75)	(75)	16	(59)
Dividends paid	–	(199)	(199)	–	(199)
Interest paid on STICS	–	–	–	(24)	(24)
Appropriations of profit	–	(199)	(199)	(24)	(223)
Tax relief on STICS interest	–	3	3	–	3
Increase in own shares held by the Group	(13)	–	(13)	–	(13)
Share-based payments, net of settlements ⁽ⁱ⁾	1	3	4	(1)	3
At 30 June 2014	4,211	738	4,949	311	5,260

For the half year ended 30 June 2013	Attributable to equity holders of the parent			Non-controlling interests £m	Total £m
	Share capital £m	Other reserves £m	Total £m		
At 1 January 2013	4,225	1,152	5,377	321	5,698
Profit for the period	–	45	45	16	61
Other comprehensive income	–	–	–	–	–
Total comprehensive income	–	45	45	16	61
Dividends paid	–	(200)	(200)	–	(200)
Interest paid on STICS	–	–	–	(7)	(7)
Appropriations of profit	–	(200)	(200)	(7)	(207)
Tax relief on STICS interest	–	4	4	–	4
Share-based payments, net of settlements ⁽ⁱ⁾	–	7	7	(1)	6
At 30 June 2013	4,225	1,008	5,233	329	5,562

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

- (i) The other reserves movement for equity-settled schemes is £3 million for the period (30 June 2013: £7 million, 31 December 2013: £7 million) and relates to the expense, net of final settlement, of the Lombard long-term incentive plan ("LTIP") along with the expense for the deferred share award plans ("DSAP") and the Friends Life Holdings group LTIP, net of the value of shares delivered from the Group's Employee Benefit Trust ("EBT") to employees under share based payment schemes.
- (ii) For 31 December 2013, other movements comprise the consolidation of the 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.

Condensed consolidated statement of cash flows

For the half year ended 30 June 2014	2014 Half year £m	2013 Half year £m	2013 Full year £m
Operating activities			
(Loss)/profit for the period	(43)	61	235
Adjusted for:			
– profit on disposal of investment in associate	–	(20)	(20)
– net realised and unrealised gains on assets at fair value	(2,173)	(5,318)	(5,507)
– finance costs	68	79	142
– amortisation and impairment of intangible assets	211	233	483
– fair value write down on assets of operations classified as held for sale	10	–	–
– depreciation of property and equipment	2	3	5
– movement in deferred acquisition costs	(1)	(40)	(59)
– total tax charge	86	286	134
– purchase of shares and other variable yield securities	(13,665)	(12,918)	(23,948)
– proceeds from sale of shares and other variable yield securities	14,070	13,380	25,363
– purchase of loans, debt securities and other fixed income securities	(12,088)	(10,163)	(26,911)
– proceeds from sale of loans, debt securities and other fixed income securities	12,957	10,825	28,257
– purchase of investment properties	(24)	(9)	(45)
– proceeds from sale of investment properties	53	90	265
– increase/(decrease) in insurance contract liabilities	1,064	(57)	(2,642)
– (decrease)/increase in investment contract liabilities	(108)	4,391	4,840
– increase/(decrease) in unallocated surplus	52	(1)	(29)
– decrease in provisions	(28)	(46)	(51)
– net movement in receivables and payables	(118)	(210)	216
Pre-tax cash inflow from operating activities	325	566	728
Tax paid	(27)	(44)	(48)
Net cash inflow from operating activities	298	522	680
Investing activities			
Disposal of held for sale assets, net of cash transferred	–	50	50
Additions to internally generated intangible assets	(1)	(2)	(4)
Net disposals/(additions) of property and equipment	2	(1)	(2)
Net cash inflow from investing activities	1	47	44
Financing activities			
Shares purchased in settlement of incentive schemes	–	(1)	(1)
Shares purchased by employee benefit trust	(13)	–	–
Finance costs	(99)	(110)	(143)
STICS interest	(24)	(7)	(31)
Net movement in other borrowings, net of expenses	(18)	12	(40)
Dividends paid to equity holders of the parent	(199)	(200)	(300)
Net cash outflow from financing activities	(353)	(306)	(515)
(Decrease)/increase in cash and cash equivalents	(54)	263	209
Balance at beginning of period	9,690	9,449	9,449
Exchange adjustments on the translation of foreign operations	(68)	92	32
Balance at end of period	9,568	9,804	9,690
Included in cash and cash equivalents	7,810	9,804	9,690
Included in assets of operations classified as held for sale	1,758	–	–

Notes to the condensed consolidated accounts

For the half year ended 30 June 2014

1. Basis of preparation

The interim financial statements of the Company as at and for the half year ended 30 June 2014 comprise the condensed consolidated interim financial statements of the Company and its subsidiaries (together referred to as “the Group”) and the Group’s interests in its associate. The results of Lombard have been included as a discontinued operation, following its classification as held for sale on 30 June 2014.

For the half year ended 30 June 2013 and year ended 31 December 2013 the consolidated income statement includes the results of AmLife Insurance Berhad and AmFamily Takaful Berhad (collectively “AmLife”) up until the date of their disposal on 4 January 2013.

The annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the European Union (“EU”). The condensed consolidated interim financial statements as at and for the half year ended 30 June 2014 have been prepared in accordance with the Disclosure and Transparency Rules of the Prudential Regulation Authority, with IAS 34: Interim financial reporting as adopted by the EU and with accounting policies adopted in respect of the financial statements for the year ended 31 December 2013, as updated by changes that are intended to be made in the full year 2014 financial statements as a result of changes to IFRS.

These condensed interim financial statements do not comprise statutory accounts within the meaning of section 435 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2013 were approved by the Board of Directors on 17 March 2014 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified, did not contain an emphasis of matter paragraph and did not contain any statement under section 498 of the Companies Act 2006. These condensed interim financial statements have been reviewed by Ernst & Young LLP and their review opinion appears after the strategic report.

Below is a list of new standards and changes to existing standards issued by the International Accounting Standards Board (“IASB”) which are relevant to the Group and effective 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): Investment in associates and joint ventures. This standard supersedes IAS 28: Investments in associates and prescribes the accounting for 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 IFRS combines, enhances and replaces disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. None of these disclosure requirements are applicable for interim condensed consolidated financial statements, unless significant events and transactions in the interim period require that they are provided. Accordingly, the Group has not made such disclosures for the half year ended 30 June 2014.
- 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. These amendments have no impact on the Group.

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

The directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the financial statements. Further information is included within the principal risks and uncertainties section of the strategic report.

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

Unless otherwise stated, the carrying amount of financial assets and liabilities not measured at fair value is considered to be the same as their fair value.

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");
- FPI comprising Friends Provident International Limited ("FPI"); and
- Lombard, which has been classified as a discontinued operation with a single amount shown on the face of the 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 and associated corporate non-recurring costs of 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 the comparatives for half year 2013 and full year 2013 have been restated.

b) Operating segment information

(i) IFRS based operating profit

For the half year ended 30 June 2014	UK £m	Heritage £m	FPI £m	Corporate £m	Total £m
Life and pensions operating profit	18	166	37	–	221
Longer term shareholder investment return	8	(28)	–	1	(19)
Other (expense)/income	(4)	3	(1)	(15)	(17)
Development costs	(12)	(10)	(4)	–	(26)
IFRS based operating profit/(loss) before tax from continuing operations	10	131	32	(14)	159
Tax on operating profit					4
IFRS based operating profit after tax from continuing operations attributable to equity holders of the parent					163
Operating earnings per share (pence)					11.53

For the half year ended 30 June 2013	UK £m	Restated Heritage £m	Restated FPI £m	Corporate £m	Restated Total £m
Life and pensions operating profit	45	156	44	–	245
Longer term shareholder investment return	5	(37)	–	1	(31)
Other expense	(5)	–	–	(13)	(18)
Development costs	(19)	(3)	(3)	–	(25)
IFRS based operating profit/(loss) before tax from continuing operations	26	116	41	(12)	171
Tax on operating profit					(3)
IFRS based operating profit after tax from continuing operations attributable to equity holders of the parent					168
Operating earnings per share (pence)					11.85

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 half year ended 30 June 2014	UK £m	Heritage £m	FPI £m	Corporate £m	Total £m
IFRS based operating profit/(loss) before tax from continuing operations	10	131	32	(14)	159
Non-recurring items ^{(i)(ii)(iii)(iv)}	(11)	(38)	(2)	(4)	(55)
Amortisation and impairment of acquired value of in-force business	(24)	(93)	(36)	–	(153)
Amortisation and impairment of other intangible assets	(20)	–	(3)	–	(23)
Interest payable on STICS	–	16	–	–	16
Short-term fluctuations in investment return ^{(v)(vi)}	(10)	42	(5)	(2)	25
(Loss)/profit before policyholder and shareholder tax	(55)	58	(14)	(20)	(31)
Policyholder tax	7	104	–	–	111
(Loss)/profit before tax from continuing operations	(48)	162	(14)	(20)	80
Policyholder tax	(7)	(104)	–	–	(111)
Shareholder tax	7	5	–	3	15
(Loss)/profit after tax from continuing operations	(48)	63	(14)	(17)	(16)
Loss after tax from discontinued operations					(27)
Loss after tax for the period					(43)

For the half year ended 30 June 2013	UK £m	Restated Heritage £m	Restated FPI £m	Corporate £m	Restated Total £m
IFRS based operating profit/(loss) before tax from continuing operations	26	116	41	(12)	171
Non-recurring items ^{(vii)(viii)(ix)}	(15)	(131)	20	89	(37)
Amortisation and impairment of acquired value of in-force business	(25)	(105)	(37)	–	(167)
Amortisation and impairment of other intangible assets	(21)	(2)	(3)	–	(26)
Interest payable on STICS	–	16	–	–	16
Short-term fluctuations in investment return ^(vi)	38	89	3	3	133
Profit/(loss) before policyholder and shareholder tax	3	(17)	24	80	90
Policyholder tax	3	274	–	–	277
Profit before tax from continuing operations	6	257	24	80	367
Policyholder tax	(3)	(274)	–	–	(277)
Shareholder tax	1	1	1	(23)	(20)
Profit/(loss) after tax from continuing operations	4	(16)	25	57	70
Loss after tax from discontinued operations					(9)
Profit after tax for the period					61

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 ^{(x)(xi)(xii)}	(35)	(226)	18	112	(131)
Amortisation and impairment of acquired value of in-force business	(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 ^(vi)	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 period					235

- (i) UK non-recurring items of £(11) million for half year ended 30 June 2014 include separation and integration costs of £(5) million, costs of £(5) million relating to service improvement elements of the outsourcing arrangement with Diligenta and £(1) million of Solvency II costs.
- (ii) Heritage non-recurring items of £(38) million for half year ended 30 June 2014 include £(21) million of costs in respect of the Diligenta outsourcing agreement, £(12) million of Solvency II costs of which £(4) million relates to a provision for future costs and unit linked transformation costs of £(5) million.
- (iii) FPI non-recurring items of £(2) million for half year ended 30 June 2014 relate to finance transformation costs.
- (iv) Corporate non-recurring items of £(4) million for half year ended 30 June 2014 relate to strategic review fees.
- (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.

- (vii) UK non-recurring items for the half year ended 30 June 2013 include £(12) million of costs in respect of the transition and service improvement elements of the outsourcing agreement with Diligenta, £(2) million of costs relating to the 2013 capital optimisation programme and £(1) million of Solvency II and finance systems development costs.
- (viii) Heritage non-recurring items for the half year ended 30 June 2013 include £(10) million in respect of separation and integration costs, £(18) million of costs in respect of the transition and service improvement elements of the outsourcing agreement with Diligenta, £(9) million of Solvency II and finance systems development costs and £(5) million of costs relating to the 2013 capital optimisation programme. Also included within Heritage is a cost of £(89) 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.
- (ix) FPI non-recurring items of £20 million for the half year ended 30 June 2013 relate to the profit on disposal of the Group's entire 30% holding in Amlife.
- (x) UK non-recurring items of £(35) million for the year ended 31 December 2013 include separation and integration costs of £(14) million, costs of £(12) million relating to service improvement elements of the outsourcing arrangement with Diligenta, £(5) million in respect of Solvency II costs of which £(3) million relates to a provision for future costs, costs in respect of capital optimisation programme of £(3) million and finance transformation costs of £(1) million.
- (xi) 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 of 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.
- (xii) FPI non-recurring items of £18 million for the year ended 31 December 2013 include profit on disposal of the Group's entire 30% holding in AmLife of £20 million and finance transformation costs of £(2) million.

(iii) Revenue and expenses

For the half year ended 30 June 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	1,438	942	457	–	–	2,837
Investment contract premiums ⁽ⁱⁱ⁾	(1,104)	(346)	(442)	–	–	(1,892)
Gross earned premiums	334	596	15	–	–	945
Premiums ceded to reinsurers	(58)	(252)	(2)	–	–	(312)
Net earned premiums	276	344	13	–	–	633
Fee and commission income	137	133	75	–	–	345
Investment return	583	2,614	93	43	(42)	3,291
Total revenue	996	3,091	181	43	(42)	4,269
Intersegment revenue	–	–	–	42	(42)	–
Total external revenue	996	3,091	181	1	–	4,269
Net claims and benefits paid	(76)	(1,669)	(5)	–	–	(1,750)
Change in insurance and investment contract liabilities	(632)	(770)	(88)	–	–	(1,490)
Transfer to unallocated surplus	–	(52)	–	–	–	(52)
Movement in net assets attributable to unit-holders	(4)	(14)	–	–	–	(18)
Acquisition expenses	(207)	(43)	(34)	–	–	(284)
Administrative and other expenses	(125)	(316)	(66)	(20)	–	(527)
Finance costs	–	(65)	(2)	(43)	42	(68)
Total claims, benefits and expenses	(1,044)	(2,929)	(195)	(63)	42	(4,189)
Intersegment expenses	–	(42)	–	–	42	–
Total external claims, benefits and expenses	(1,044)	(2,887)	(195)	(63)	–	(4,189)
(Loss)/profit before tax from continuing operations	(48)	162	(14)	(20)	–	80
Policyholder tax	(7)	(104)	–	–	–	(111)
Shareholder tax	7	5	–	3	–	15
(Loss)/profit after tax from continuing operations	(48)	63	(14)	(17)	–	(16)
Loss after tax from discontinued operations						(27)
Loss after tax for the period						(43)

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

(ii) Accounted for as deposits under IFRS.

For the half year ended 30 June 2013	UK £m	Restated Heritage £m	Restated FPI £m	Corporate £m	Elimination of inter- segment amounts ⁽ⁱ⁾ £m	Restated Total £m
Gross earned premiums on insurance and investment contracts	1,411	1,078	599	–	–	3,088
Investment contract premiums ⁽ⁱⁱ⁾	(1,073)	(388)	(583)	–	–	(2,044)
Gross earned premiums	338	690	16	–	–	1,044
Premiums ceded to reinsurers	(57)	(242)	(1)	–	–	(300)
Net earned premiums	281	448	15	–	–	744
Fee and commission income	160	155	65	–	–	380
Investment return	1,642	4,912	506	47	(42)	7,065
Total revenue	2,083	5,515	586	47	(42)	8,189
Intersegment revenue	–	–	–	42	(42)	–
Total external revenue	2,083	5,515	586	5	–	8,189
Other income ⁽ⁱⁱⁱ⁾	–	–	20	89	(89)	20
Net claims and benefits paid	(85)	(1,914)	(5)	–	–	(2,004)
Change in insurance and investment contract liabilities	(1,622)	(2,691)	(478)	–	–	(4,791)
Transfer from unallocated surplus	–	1	–	–	–	1
Movement in net assets attributable to unit-holders	(42)	(66)	–	–	–	(108)
Acquisition expenses	(183)	(45)	(32)	–	–	(260)
Administrative and other expenses	(145)	(468)	(64)	(13)	89	(601)
Finance costs	–	(75)	(3)	(43)	42	(79)
Total claims, benefits and expenses	(2,077)	(5,258)	(582)	(56)	131	(7,842)
Intersegment expenses	–	(131)	–	–	131	–
Total external claims, benefits and expenses	(2,077)	(5,127)	(582)	(56)	–	(7,842)
Profit before tax from continuing operations	6	257	24	80	–	367
Policyholder tax	(3)	(274)	–	–	–	(277)
Shareholder tax	1	1	1	(23)	–	(20)
Profit/(loss) after tax from continuing operations	4	(16)	25	57	–	70
Loss after tax from discontinued operations						(9)
Profit after tax for the period						61

(i) Eliminations include intersegment premiums and 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 contributions of £89 million and profit on the disposal of AmLife of £20 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 £m
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 period						235

(i) Eliminations include intersegment premiums and 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 contributions of £116 million and profit on the disposal of AmLife of £20 million.

(iv) Assets and liabilities

As at 30 June 2014	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Elimination of inter- segment amounts ⁽ⁱ⁾ £m	Total £m
Assets							
Intangible assets	720	2,030	539	–	–	–	3,289
Financial assets	22,007	62,889	6,197	–	139	–	91,232
Assets of operations classified as held for sale ⁽ⁱⁱ⁾	–	–	–	20,206	–	–	20,206
Other assets	1,725	11,500	1,426	–	2,146	(1,358)	15,439
Total assets	24,452	76,419	8,162	20,206	2,285	(1,358)	130,166
Liabilities							
Insurance contracts	3,261	32,254	139	–	–	–	35,654
Investment contracts	18,992	36,384	7,645	–	–	–	63,021
Loans and borrowings	18	1,169	4	–	1,026	(1,186)	1,031
Liabilities of operations classified as held for sale ⁽ⁱⁱ⁾	–	–	–	19,896	–	–	19,896
Other liabilities	1,059	4,094	137	–	186	(172)	5,304
Total liabilities	23,330	73,901	7,925	19,896	1,212	(1,358)	124,906

As at 30 June 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	811	2,236	627	441	–	–	4,115
Financial assets	20,680	66,070	6,172	18,482	23	–	111,427
Other assets	2,478	11,522	1,414	1,862	2,147	(1,479)	17,944
Total assets	23,969	79,828	8,213	20,785	2,170	(1,479)	133,486
Liabilities							
Insurance contracts	3,049	33,994	132	–	–	–	37,175
Investment contracts	19,117	36,783	7,658	20,121	–	–	83,679
Loans and borrowings	11	1,190	18	13	1,064	(1,184)	1,112
Other liabilities	669	5,152	122	270	40	(295)	5,958
Total liabilities	22,846	77,119	7,930	20,404	1,104	(1,479)	127,924

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.

(ii) The assets and liabilities of Lombard are classified as held for sale. Further details are provided in note 2(d) Held for sale and discontinued operations.

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 half year ended 30 June 2014	UK £m	Rest of the world £m	Total £m
Gross earned premiums	882	63	945
Fee and commission income	267	78	345
Revenue from external customers	1,149	141	1,290
Investment return			3,291
Premiums ceded to reinsurers			(312)
Total revenue			4,269

For the half year ended 30 June 2013	Restated UK £m	Restated Rest of the world £m	Restated Total £m
Gross earned premiums	973	71	1,044
Fee and commission income	310	70	380
Revenue from external customers	1,283	141	1,424
Investment return			7,065
Premiums ceded to reinsurers			(300)
Total revenue			8,189

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) Held for sale and discontinued operations

As part of the strategy to maximise value from each part of the Group, and due to the limited strategic and operational synergies between Lombard and the rest of the Group, on 11 July 2014, the Group announced the disposal of its Lombard operating segment to Blackstone Group LP for an initial consideration of £317 million (€399 million). The sale is subject to anti-trust and regulatory approvals and is expected to complete in the second half of 2014.

The initial consideration of £317 million (€399 million) comprises £254 million (€320 million) upfront consideration and an estimated £7 million (€9 million) interest equivalent, both to be paid in cash upon completion, plus a £56 million (€70 million) deferred payment in the form of a vendor loan note. The estimated £7 million (€9 million) interest equivalent amount is equivalent to interest on the £254 million (€320 million) upfront consideration at 3% from 1 January 2014 until the expected completion date. The vendor loan note has an eight year term from the date of completion and a coupon of 7%.

An additional contingent element could increase or decrease the value of the vendor loan note by up to £39 million (€50 million). This will be 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 Group has also obtained regulatory consent to return £317 million to shareholders via a buy-back of shares, equal to the initial consideration.

As at 30 June 2014, the Lombard operating segment met the criteria as 'held for sale', as the carrying amount will be recovered through a sale transaction rather than through continuing use, and it was considered that the sale was 'highly probable' at the balance sheet date.

The Lombard operating segment has been measured at the lower of its carrying amount and fair value less costs to sell, of £310 million, and has been presented as a discontinued operation. A single amount is shown on the face of the 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 condensed consolidated income statement, condensed consolidated statement of comprehensive income and condensed consolidated statement of IFRS based operating profit comparatives have been restated. In the 30 June 2014 condensed consolidated statement of financial position, the assets and liabilities are presented separately from other assets and liabilities of the Group.

(i) Results of discontinued operations

	2014 Half year £m	2013 Half year £m	2013 Full year £m
Fee and commission income and income from service activities	51	54	112
Investment return	446	166	827
Total revenue	497	220	939
Change in investment contract liabilities	(394)	(114)	(730)
Acquisition expenses	(25)	(22)	(49)
Administrative and other expenses	(105)	(104)	(205)
Finance costs	–	–	(1)
Total claims, benefits and expenses	(524)	(240)	(985)
Loss before shareholder tax	(27)	(20)	(46)
Shareholder tax	10	11	22
Loss after tax from discontinued operations	(17)	(9)	(24)
Loss on remeasurement to fair value	(10)	–	–
Loss from discontinued operations	(27)	(9)	(24)
Other comprehensive (loss)/income, net of tax	(12)	21	10
Total comprehensive (loss)/income, net of tax	(39)	12	(14)

(ii) Cash flows of discontinued operations

	2014 Half year £m	2013 Half year £m	2013 Full year £m
Operating cash flows	28	31	197
Investing cash flows	(1)	(2)	(4)
Financing cash flows	(6)	(3)	(23)
Total cash flows	21	26	170

(iii) Major classes of assets and liabilities

	30 June 2014 £m
Intangible assets	343
Financial assets	17,905
Other assets	1,968
Remeasurement to fair value	(10)
Assets	20,206
Investment contracts	19,616
Deferred tax liabilities	80
Other liabilities	200
Liabilities	19,896
Equity attributable to equity holders of the parent	310
Equity attributable to non controlling interest	–
Total equity	310
Total equity and liabilities	20,206

(iv) Fair value of assets and liabilities

The fair value of assets and liabilities of Lombard are recognised at 30 June 2014 on a non-recurring basis.

As at 30 June 2014	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets held at fair value				
Shares and other variable yield securities	11,683	1,042	1,446	14,171
Debt securities and other fixed income securities:				
– Government securities	357	233	–	590
– Corporate bonds and loans at fair value (including asset backed securities (“ABS”))	1,564	920	471	2,955
Derivative financial instruments	–	22	–	22
Deposits with credit institutions	–	167	–	167
Total assets held at fair value	13,604	2,384	1,917	17,905
Financial liabilities held at fair value				
Unit-linked investment contracts	–	19,616	–	19,616
Derivative financial instruments	–	1	–	1
Total liabilities held at fair value	–	19,617	–	19,617

Details of the levelling and fair value methodologies are included in note 9. Transfers between levels and movements in level 3 assets prior to Lombard’s classification as held for sale are included in note 9.

3. Appropriations of profit

	2014 Half year £m	2013 Half year £m	2013 Full year £m
Ordinary dividends declared and charged to equity in the period:			
Final 2013 – 14.09 pence per share, paid on 16 May 2014	199	–	–
Interim 2013 – 7.05 pence per share, paid on 4 October 2013	–	–	100
Final 2012 – 14.09 pence per share, paid on 20 May 2013	–	200	200
Total dividends	199	200	300
Interest on 2003 STICS (coupon rate 6.875%)	7	7	14
Interest on 2005 STICS (coupon rate 6.292%)	17	–	17
Total appropriations of profit	223	207	331

An interim dividend of 7.05 pence per ordinary share will be paid on 6 October 2014, expected to amount to £100 million. This amount is not reflected in these financial statements. Shareholders have been offered a dividend reinvestment plan ("DRIP"), which allows them to purchase additional shares on the dividend payment date from the proceeds of their cash dividend.

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

The STICS are accounted for as equity instruments under IFRS and consequently the interest on these instruments is treated as an appropriation of profit, charged directly to equity.

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 from continuing operations

Earnings per share have been calculated based on the profit or loss after tax and on the operating profit after tax from continuing operations 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.

	2014 Half year earnings £m	2014 Half year pence per share	Restated 2013 Half year earnings £m	Restated 2013 Half year pence per share	Restated 2013 Full year earnings £m	Restated 2013 Full year pence per share
(Loss)/profit after tax from continuing operations attributable to equity holders of the parent	(32)	(2.26)	54	3.81	228	16.08
Add back:						
– short-term fluctuations in investment return	(25)	(1.77)	(133)	(9.38)	(184)	(12.98)
– non-recurring items	55	3.89	37	2.61	131	9.24
– amortisation and impairment of intangible assets	176	12.45	193	13.61	405	28.57
– tax credit on items excluded from operating profit	(11)	(0.78)	17	1.20	(174)	(12.27)
Operating profit after tax from continuing operations attributable to equity holders of the parent	163	11.53	168	11.85	406	28.64
(Loss)/profit after tax from continuing operations attributable to equity holders of the parent	(32)	(2.26)	54	3.81	228	16.08
Loss after tax from discontinued operations attributable to equity holders of the parent	(27)	(1.91)	(9)	(0.64)	(24)	(1.69)
(Loss)/profit after tax attributable to equity holders of the parent	(59)	(4.17)	45	3.17	204	14.39

b) Diluted basic earnings per share from continuing operations

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

For the half year ended 30 June 2014	Earnings £m	Weighted average number of shares	Pence per share
Loss after tax from continuing operations attributable to equity holders of the parent	(32)	1,414,295,152	(2.26)
Dilutive effect of share awards	–	1,223,508	–
Diluted basic earnings per share on loss after tax from continuing operations attributable to equity holders of the parent	(32)	1,415,518,660	(2.26)

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

There were no dilutive factors for the half year ended 30 June 2013.

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

For the half year ended 30 June 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	163	1,414,295,152	11.53
Dilutive effect of share awards	–	1,223,508	(0.01)
Diluted basic earnings per share on operating profit after tax from continuing operations attributable to equity holders of the parent	163	1,415,518,660	11.52

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

There were no dilutive factors for the half year ended 30 June 2013.

c) Diluted basic earnings per share from discontinued operations

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

For the half year ended 30 June 2014	Earnings £m	Weighted average number of shares	Pence per share
Loss after tax from discontinued operations attributable to equity holders of the parent	(27)	1,414,295,152	(1.91)
Dilutive effect of share awards	–	1,223,508	–
Diluted basic earnings per share on loss after tax from discontinued operations attributable to equity holders of the parent	(27)	1,415,518,660	(1.91)

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)

There were no dilutive factors for the half year ended 30 June 2013.

5. Taxation

a) Tax recognised in the consolidated income statement

	2014 Half year £m	Restated 2013 Half year £m	Restated 2013 Full year £m
Current tax			
UK corporation tax at 21.5% (2013: 23.25%)	3	67	1
Adjustments in respect of prior periods	2	(6)	(6)
Overseas tax	10	6	15
Total current tax charge	15	67	10
Deferred tax			
Origination and reversal of temporary differences	82	230	266
Change in tax rates	(1)	–	(70)
Recognition of deferred tax assets previously unrecognised	–	–	(50)
Total deferred tax charge	81	230	146
Total tax charge	96	297	156
Analysis:			
– policyholder tax	111	277	334
– shareholder tax	(15)	20	(178)
Total tax charge	96	297	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 the tax charge for the period

	2014 Half year £m	Restated 2013 Half year £m	Restated 2013 Full year £m
Profit before tax from continuing operations	80	367	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%)	17	85	96
Effects of:			
– non-taxable income	(27)	(101)	(93)
– deductions not allowable for tax purposes	4	10	(9)
– tax on reserving adjustments and other IFRS adjustments	–	(14)	–
– overseas tax	(1)	(1)	(6)
– valuation of tax assets and liabilities	(16)	(28)	(49)
– valuation of unrealised capital losses	–	67	–
– adjustments in respect of prior periods	(5)	2	(21)
– impact of reduction in corporation tax rate to 20% on deferred tax asset/liability	(1)	–	(70)
– policyholder tax	111	277	334
– other	14	–	(26)
Total tax charge	96	297	156

6. Staff pension schemes

a) Introduction

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

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

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

b) Closed FPPS defined benefit scheme overview

On an IAS 19: Employee benefits (Revised 2011) basis, a gross deficit of £(12) million has been recognised in respect of the FPPS at 30 June 2014 (30 June 2013: gross surplus of £39 million; 31 December 2013: gross 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. That plan set out a new schedule of deficit reduction contributions of £175 million, in addition to a £20 million payment which was made in July 2012 and £20 million in July 2013 under the previous deficit reduction plan. The new recovery plan commenced in January 2013 with a payment of £1.5 million, and a further £1.5 million was paid in July 2013 in addition to the £20 million previously agreed. Further deficit reduction contributions totalling £172 million will be paid into the scheme, with payments of £21.5 million to be made by 31 July each year for the eight years from 2014 to 2021.

Under IFRIC 14, deficit reduction contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available after they are paid into the scheme, a liability is recognised when the obligation arises. In accordance with s207(4) Finance Act 2004, an additional liability of £(47) million has been recognised at 30 June 2014 (30 June 2013: £(70) million; 31 December 2013: £(48) million), reflecting the 35% tax that would arise on any notional refund in respect of the resultant IAS 19 surplus of £133 million (£172 million of deficit reduction contributions at a present value of £145 million, partially offset by the current deficit of £(12) million). A deferred tax asset of £34 million (30 June 2013: £44 million; 31 December 2013: £34 million) has also been recognised to reflect tax relief at a rate of 20% (30 June 2013: 23%; 31 December 2013: 20%) that is expected to be available on the deficit reduction contributions, in future periods.

The scheme’s assets, which are administered by five external investment managers, are held under the control of the Trustee and used to secure benefits for the members of the scheme and their dependants in accordance with the Trust Deed and Rules.

The Trustee Board consists of a chairman who is appointed by the employer and up to six additional directors of which up to three are employer-appointed directors and up to three are member-nominated trustee directors.

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

Amounts recognised in the consolidated statement of financial position

	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
IAS 19 (deficit)/surplus (excluding deficit reduction contribution)	(12)	39	(4)
Authorised payments surplus charge (penal tax) at 35% of available surplus following deficit reduction contribution, discounted to present value ⁽ⁱ⁾	(47)	(70)	(48)
Net pension deficit (excluding deficit reduction contribution)	(59)	(31)	(52)

(i) Included in the charge for the half year ended 30 June 2014 is a finance charge of £(1) million (30 June 2013: £nil; 31 December 2013: £(2) million) relating to penal tax on the present value of pension deficit funding, which is recognised in the consolidated income statement.

Movement in IAS 19 pension surplus

	2014 Half year £m	2013 Half year £m	2013 Full year £m
Pension (deficit)/surplus at 1 January	(4)	62	62
Current service cost ⁽ⁱ⁾	–	(1)	–
Net interest on net defined benefit liability/asset ⁽ⁱ⁾⁽ⁱⁱ⁾	–	1	3
Employer contributions	–	6	28
Remeasurement losses	(7)	(29)	(96)
Administration costs ⁽ⁱ⁾	(1)	–	(1)
Pension (deficit)/surplus	(12)	39	(4)
Present value of deficit reduction contributions	145	164	136
Available surplus subject to authorised payments surplus charge	133	203	132

(i) Recognised in the consolidated income statement.

(ii) The actual return on plan assets for the half year ended 30 June 2014 is £54 million (30 June 2013: £105 million; 31 December 2013: £81 million).

The total loss recognised in the income statement for the half year ended 30 June 2014 was £(2) million (30 June 2013: £nil; 31 December 2013: £nil). In addition to administration costs of £(1) million shown in the table above, a finance charge of £(1) million (30 June 2013: £nil; 31 December 2013: £(2) million) relating to penal tax on the present value of pension deficit funding has also been recognised in the income statement.

Analysis of net pension deficit and related deferred tax asset

As at 30 June 2014	Pension deficit £m	Deferred tax £m
Gross IAS 19 pension deficit and related deferred tax asset	(12)	2
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus) ⁽ⁱ⁾	(47)	–
Restriction of asset due to authorised payments surplus charge	–	(2)
Tax relief available on deficit reduction contributions	–	34
Net pension deficit and related deferred tax asset	(59)	34

As at 30 June 2013	Pension surplus/(deficit) £m	Deferred tax £m
Gross IAS 19 pension surplus and related deferred tax liability	39	(9)
Irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus) ⁽ⁱ⁾	(70)	–
Restriction of liability due to authorised payments surplus charge	–	9
Tax relief available on deficit reduction contributions	–	44
Net pension deficit and related deferred tax asset	(31)	44

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

(i) 30 June 2014 includes a finance charge of £(1) million (30 June 2013: £nil; 31 December 2013: £(2) million) relating to penal tax recognised on the present value of pension deficit funding.

Amounts recognised in the condensed consolidated statement of comprehensive income

	2014 Half year £m	2013 Half year £m	2013 Full year £m
Remeasurement losses:			
– actuarial losses of the defined benefit scheme	(36)	(109)	(117)
– return on pension asset (excluding amounts included in net interest on net defined benefit liability/asset)	29	80	21
– irrecoverable element of deficit reduction contributions (authorised payments surplus charge on available surplus) ⁽ⁱ⁾	3	(41)	(17)
Remeasurement losses of the defined benefit scheme	(4)	(70)	(113)
Taxation	–	50	36
Remeasurement losses of the net defined benefit scheme after tax	(4)	(20)	(77)

(i) An additional finance charge of £(1) million (30 June 2013: £nil; 31 December 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 charge of £(1) million (30 June 2013: credit of £39 million; 31 December 2013: credit of £34 million) in respect of deficit reduction contributions and credits of £1 million (30 June 2013: £11 million; 31 December 2013: £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, including the transfer of Lombard's intangible assets to assets of operations classified as held for sale, are as follows:

	AVIF £m	Other £m	Total £m
For the half year ended 30 June 2014			
Cost			
At 1 January 2014	5,520	560	6,080
Additions	–	1	1
Foreign exchange adjustments	(23)	(6)	(29)
Transfer to assets of operations classified as held for sale	(576)	(153)	(729)
At 30 June 2014	4,921	402	5,323
Amortisation and impairment			
At 1 January 2014	1,893	332	2,225
Amortisation charge for the period ⁽ⁱ⁾	174	37	211
Foreign exchange adjustments	(11)	(5)	(16)
Transfer to assets of operations classified as held for sale	(271)	(115)	(386)
At 30 June 2014	1,785	249	2,034
Carrying amounts at 30 June 2014	3,136	153	3,289

For the half year ended 30 June 2013	AVIF £m	Other £m	Total £m
Cost			
At 1 January 2013	5,505	560	6,065
Additions	–	2	2
Foreign exchange adjustments	33	9	42
At 30 June 2013	5,538	571	6,109

Amortisation and impairment			
At 1 January 2013	1,497	247	1,744
Amortisation charge for the period ⁽ⁱ⁾	192	41	233
Foreign exchange adjustments	12	5	17
At 30 June 2013	1,701	293	1,994
Carrying amounts at 30 June 2013	3,837	278	4,115

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 ⁽ⁱⁱ⁾	–	(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⁾⁽ⁱⁱⁱ⁾	11	–	11
Disposals ⁽ⁱⁱ⁾	–	(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. The amortisation charge for Lombard is included within loss after tax from discontinued operations in the consolidated income statement.

(ii) Disposals in 2013 related to the sale of fully amortised software of £(8) million. (iii) AVIF impairment of £(11) million has been recognised within OLAB as a result of worsening persistency.

AVIF is shown gross of policyholder and shareholder tax of £569 million (30 June 2013: £810 million; 31 December 2013: £693 million), with the offsetting balance included in deferred taxation.

In determining the fair value of identified intangible assets, appropriate valuation methodologies were applied, given the nature of the intangible assets acquired.

Intangible assets relating to customer relationships and distribution channels have been valued using an income approach method, specifically the Multi-period Excess Earnings Method ("MEEM"). The principle behind the MEEM is that the value of an intangible asset is equal to the present value of the after tax cash flows attributable only to that intangible asset. Other intangibles include in-house developed IT systems and databases which have been valued using a replacement cost approach which assesses the cost of reproducing the equivalent technology in its current form.

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

On acquisition of a portfolio of insurance contracts and/or investment contracts, either directly or through the acquisition of a subsidiary undertaking, the net present value of the Group's interest in the expected pre-tax cash flows of the in-force business is capitalised in the statement of financial position as AVIF, using a market consistent embedded value methodology.

i) AVIF

An analysis of AVIF by operating segments used for segmental reporting (see note 2) is set out below. The comparatives for half year 2013 and full year 2013 have been restated following the transfer of OLAB to Heritage in January 2014, as explained in note 2.

As at 30 June 2014	Cost £m	Amortisation and impairment £m	Net book value £m
UK	896	(315)	581
Heritage	3,113	(1,083)	2,030
FPI	912	(387)	525
Total	4,921	(1,785)	3,136

As at 30 June 2013	Cost £m	Amortisation and impairment £m	Net book value £m
UK	896	(269)	627
Heritage - restated	3,113	(875)	2,238
FPI - restated	912	(314)	598
Lombard	617	(243)	374
Total	5,538	(1,701)	3,837

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 30 June 2014	Cost £m	Amortisation and impairment £m	Net book value £m
Distribution channels and customer relationships	314	(166)	148
Brand	37	(32)	5
Software	39	(39)	–
Goodwill	12	(12)	–
Total	402	(249)	153

As at 30 June 2014 other intangibles of £38 million (£28 million distribution channels and customer relationships; £2 million brand; £8 million software) relating to Lombard have been transferred to assets of operations classified as held for sale.

As at 30 June 2013	Cost £m	Amortisation and impairment £m	Net book value £m
Distribution channels and customer relationships	449	(210)	239
Brand	49	(32)	17
Software	61	(39)	22
Goodwill	12	(12)	–
Total	571	(293)	278

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

iii) Impairment

All identifiable intangible assets are reviewed at each reporting date, or where impairment indicators are present, to assess whether there are any circumstances that might indicate that they are impaired. If such circumstances exist, impairment testing is performed and any resulting impairment losses are charged to the consolidated income statement.

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

As at 30 June 2014, based on an impairment review of each of the cash generating units ("CGU"), 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 ("VIU"), 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

Lombard's financial assets are treated as held for sale as at 30 June 2014 and are excluded from the table below as at that date.

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

	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
Fair value through profit or loss (note 8(a))			
Designated on initial recognition	91,037	111,138	108,791
Held for trading	188	283	265
Loans at amortised cost (note 8(b))	7	6	8
Total financial assets	91,232	111,427	109,064

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

As at 30 June 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	6,533	49,174	–	152	2	55,861
Debt securities and other fixed income securities:						
– Government securities	6,561	6,843	1,106	720	52	15,282
– Corporate bonds and loans at fair value	7,458	2,364	8,466	1,352	240	19,880
Derivative financial instruments	134	27	22	5	–	188
Deposits with credit institutions	–	14	–	–	–	14
Total financial assets held at fair value	20,686	58,422	9,594	2,229	294	91,225

As at 30 June 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	7,110	62,485	–	139	15	69,749
Debt securities and other fixed income securities:						
– Government securities	8,647	7,541	1,013	1,072	97	18,370
– Corporate bonds and loans at fair value	8,533	5,991	6,776	1,311	192	22,803
Derivative financial instruments	185	48	19	7	24	283
Deposits with credit institutions	–	216	–	–	–	216
Total financial assets held at fair value	24,475	76,281	7,808	2,529	328	111,421

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

The unit-linked column and with-profits column in the tables above include £622 million (30 June 2013: £781 million; 31 December 2013: £614 million) of financial assets relating to the non-controlling interests in the OEICs that have been consolidated as the Group is deemed to have control. These comprise £535 million of shares and other variable yield securities, £65 million of government securities and £22 million of corporate bonds (30 June 2013: £582 million of shares and other variable yield securities, £91 million of government securities and £108 million of corporate bonds; 31 December 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.

ABS (excluding those held by the linked funds) amount to £4,324 million (30 June 2013: £4,102 million; 31 December 2013: £4,124 million) and 98% (30 June 2013: 97%; 31 December 2013: 98%) of these are at investment grade as set out in note 9(e).

b) Loans at amortised cost

	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
Mortgage loans	3	2	4
Other loans	4	4	4
Total loans	7	6	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 the insurance and investment contract liabilities relating to unit-linked business are included within the relevant balances in the consolidated statement of financial position and are analysed as follows:

	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
Shares and other variable yield securities	49,174	62,485	63,145
Debt securities and other fixed income securities	9,207	13,532	12,647
Derivative financial instruments	27	48	66
Deposits with credit institutions	14	216	217
Total financial assets held at fair value	58,422	76,281	76,075
Investment properties	1,350	1,354	1,302
Insurance and other receivables	535	864	639
Cash and cash equivalents	2,822	5,165	4,783
Assets of operations classified as held for sale	19,651	–	–
Total assets	82,780	83,664	82,799
Net asset value attributable to unit-holders ⁽ⁱ⁾ and other payables	(1,479)	(2,161)	(1,655)
Total unit-linked net assets	81,301	81,503	81,144

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

9. Fair values of assets and liabilities

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

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

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

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

The majority of the Group's assets held at fair value are valued based on quoted market information or market observable data. Approximately 6% (11% excluding unit-linked assets) of the Group's assets are based on valuation techniques where significant observable market data is not available (30 June 2013: 6% (9% excluding unit-linked assets); 31 December 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. Where the number of transactions has declined under the current market conditions, valuations have become more subjective. Bond prices provided by pricing services are based on the best estimate of market price determined by market makers based on a variety of factors and are considered to be observable prices. In determining fair value, market makers will take into account transactions they have observed in identical or similar assets as well as movements in market indices and any other factors that they regard as relevant. In some cases, consensus prices have been based on fewer, and potentially more historic, transactions.

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

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

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

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

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

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

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

The classifications of financial liabilities take into account the types of inputs used to determine the fair value measurements.

The Group is unable to reliably measure the fair value of investment contracts with discretionary participation features 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) Fair value measurements

Following the reclassification of Lombard as a discontinued operation at 30 June 2014, all assets and liabilities of Lombard have been moved to assets and liabilities of operations held for sale. For fair value levelling, the financial instruments of Lombard are recognised at 30 June 2014 on a non-recurring basis. Fair value levelling disclosures for Lombard are disclosed in note 2(d)(iv) and accordingly are excluded from the table below.

Recurring fair value measurements

As at 30 June 2014	Including unit-linked				Excluding unit-linked			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Non-financial assets held at fair value								
Investment properties	–	–	2,618	2,618	–	–	1,268	1,268
Owner-occupied property	–	–	36	36	–	–	36	36
Financial assets held at fair value								
Shares and other variable yield securities	47,856	6,209	1,796	55,861	5,505	99	1,083	6,687
Debt securities and other fixed income securities:								
– Government securities	15,274	8	–	15,282	8,434	5	–	8,439
– Corporate bonds and loans at fair value (including ABS)	14,424	4,006	1,450	19,880	12,378	3,713	1,425	17,516
Derivative financial instruments	76	112	–	188	50	111	–	161
Deposits with credit institutions	14	–	–	14	–	–	–	–
Total assets held at fair value	77,644	10,335	5,900	93,879	26,367	3,928	3,812	34,107
Financial liabilities held at fair value								
Unit-linked investment contracts	–	51,905	–	51,905	–	–	–	–
Amounts due to reinsurers	–	1,594	–	1,594	–	1,594	–	1,594
Net asset value attributable to unit-holders	629	–	–	629	29	–	–	29
Derivative financial instruments	172	163	–	335	3	98	–	101
Total liabilities held at fair value	801	53,662	–	54,463	32	1,692	–	1,724

As at 30 June 2013	Including unit-linked				Excluding unit-linked			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<i>Non-financial assets held at fair value</i>								
Investment properties	–	–	2,621	2,621	–	–	1,267	1,267
Owner-occupied property	–	–	40	40	–	–	40	40
<i>Financial assets held at fair value</i>								
Shares and other variable yield securities	60,513	5,849	3,387	69,749	5,434	598	1,232	7,264
Debt securities and other fixed income securities:								
– Government securities	17,875	489	6	18,370	10,666	157	6	10,829
– Corporate bonds and loans at fair value (including ABS)	16,174	5,349	1,280	22,803	12,563	3,620	629	16,812
Derivative financial instruments	59	224	–	283	21	214	–	235
Deposits with credit institutions	216	–	–	216	–	–	–	–
Total assets held at fair value	94,837	11,911	7,334	114,082	28,684	4,589	3,174	36,447
<i>Financial liabilities held at fair value</i>								
Unit-linked investment contracts	–	72,635	–	72,635	–	–	–	–
Amounts due to reinsurers	–	1,720	–	1,720	–	1,720	–	1,720
Net asset value attributable to unit-holders	808	–	–	808	20	–	–	20
Derivative financial instruments	55	334	–	389	33	330	–	363
Total liabilities held at fair value	863	74,689	–	75,552	53	2,050	–	2,103

There are no non-recurring fair value measurements at 30 June 2013.

As at 31 December 2013	Including unit-linked				Excluding unit-linked			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<i>Non-financial assets held at fair value</i>								
Investment properties	–	–	2,561	2,561	–	–	1,259	1,259
Owner-occupied property	–	–	40	40	–	–	40	40
<i>Financial assets held at fair value</i>								
Shares and other variable yield securities	64,679	1,943	3,463	70,085	5,725	81	1,134	6,940
Debt securities and other fixed income securities:								
– Government securities	15,716	395	–	16,111	8,885	45	–	8,930
– Corporate bonds and loans at fair value (including ABS)	15,549	4,974	1,855	22,378	12,375	3,200	1,337	16,912
Derivative financial instruments	34	231	–	265	10	189	–	199
Deposits with credit institutions	217	–	–	217	–	–	–	–
Total assets held at fair value	96,195	7,543	7,919	111,657	26,995	3,515	3,770	34,280
<i>Financial liabilities held at fair value</i>								
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.

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

For the Friends Life 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

During the period, for financial instruments recognised at fair value on a recurring basis, £6,603 million (30 June 2013: £368 million; 31 December 2013: £2,175 million) of corporate bonds, shares and other variable yield securities were transferred from level 1 to level 2 and £799 million (30 June 2013: £2,460 million; 31 December 2013: £6,102 million) of corporate bonds, shares and other variable yield securities were transferred from level 2 to level 1. The transfers between level 1 to level 2 in the period and as at 31 December 2013 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 recognised at fair value on a recurring basis.

	Investment property £m	Owner- occupied property £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 in consolidated income statement ⁽ⁱ⁾	86	–	599	244	929
Purchases	24	–	8	62	94
Sales	(53)	(4)	(397)	(108)	(562)
Issues	–	–	–	4	4
Settlements	–	–	–	(2)	(2)
Net transfer to level 1 and level 2 ⁽ⁱⁱ⁾	–	–	(374)	(116)	(490)
Foreign exchange adjustments	–	–	(57)	(18)	(75)
Transfer to assets of operations classified as held for sale ⁽ⁱⁱⁱ⁾	–	–	(1,446)	(471)	(1,917)
At 30 June 2014	2,618	36	1,796	1,450	5,900
Total unrealised gains for the year included in profit or loss for assets held at 30 June 2014	25	–	137	107	269

	Investment property £m	Owner-occupied property £m	Shares and other variable yield securities £m	Government securities £m	Corporate bonds and loans at fair value (including ABS) £m	Total assets held at fair value £m
At 1 January 2013	2,735	40	2,812	8	1,148	6,743
Total (losses)/gains in consolidated income statement ⁽ⁱ⁾	(33)	—	2	—	7	(24)
Purchases	9	—	31	—	75	115
Sales	(91)	—	(250)	—	(100)	(441)
Issues	—	—	2	—	108	110
Settlements	—	—	—	—	(14)	(14)
Net transfer from/(to) level 1 and level 2 ⁽ⁱⁱ⁾	—	—	712	(2)	26	736
Foreign exchange adjustments	1	—	78	—	30	109
At 30 June 2013	2,621	40	3,387	6	1,280	7,334
Total unrealised (losses)/gains for the year included in profit or loss for assets held at 30 June 2013	(32)	—	(9)	—	4	(37)

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

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

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

(iii) Lombard assets have been transferred to assets of operations classified as held for sale as at 30 June 2014. Movements in Lombard level 3 assets to that date have been analysed above.

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:

- Shares and other variable yield securities include private equity investments, £324 million (30 June 2013: £217 million; 31 December 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

	As at 30 June 2014		As at 30 June 2013		As at 31 December 2013	
	Carrying amount £m	Effect of reasonably possible alternative assumptions £m	Carrying amount £m	Effect of reasonably possible alternative assumptions £m	Carrying amount £m	Effect of reasonably possible alternative assumptions £m
Unit-linked investments	738	–	2,806	–	2,847	–
Shares and other variable yield securities	1,083	217	1,232	246	1,134	227
Government securities	–	–	6	1	–	–
Corporate bonds and loans at fair value (including ABS)	1,425	143	629	63	1,337	134
Total level 3 financial assets	3,246	360	4,673	310	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 could reasonably be expected to be higher or lower by approximately 20%.

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

e) Creditworthiness of financial assets

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

As at 30 June 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	186	3,663	5,334	3,529	282	143	55	13,192
Asset-backed securities	1,466	894	1,366	532	32	30	4	4,324
Derivative financial instruments	–	12	141	–	–	–	8	161
Reinsurance assets	–	2,792	101	–	–	–	–	2,893
Cash and cash equivalents	3,809	428	672	68	–	–	11	4,988
Insurance and other receivables	28	118	129	80	6	1	277	639
Total	5,489	7,907	7,743	4,209	320	174	355	26,197
%	21%	30%	30%	16%	1%	1%	1%	100%

As at 30 June 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	320	3,784	4,904	3,248	352	61	41	12,710
Asset-backed securities	1,397	787	1,356	450	56	36	20	4,102
Derivative financial instruments	–	2	214	–	–	–	19	235
Reinsurance assets	–	2,979	150	–	–	–	1	3,130
Cash and cash equivalents	2,334	436	1,818	13	–	–	38	4,639
Insurance and other receivables	24	84	113	102	6	3	257	589
Total	4,075	8,072	8,555	3,813	414	100	376	25,405
%	16%	32%	34%	15%	2%	0%	1%	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:

		30 June 2014		30 June 2013		31 December 2013	
	Coupon %	Carrying Amount £m	Fair Value £m	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	177	217	180	204	178	210
Friends Life Holdings plc £500 million LT2 subordinated debt due 2022	8.25	497	569	497	525	497	550
Friends Life Holdings plc US\$575 million UT2 reset perpetual subordinated debt	7.875	335	385	371	396	339	378
Financial reinsurance:							
UK financial reinsurance treaties	Various	5	5	–	–	–	–
Heritage financial reinsurance treaties	Various	13	13	26	26	17	17
FPI financial reinsurance treaties	Various	4	4	17	17	11	11
Lombard financial reinsurance treaties ⁽ⁱ⁾	Various	–	–	4	4	3	3
Other:							
Amounts owed to credit institutions (overdrafts)		–	–	17	17	5	5
Total loans and borrowings		1,031	1,193	1,112	1,189	1,050	1,174

(i) Lombard has been excluded from the table above for half year ended 30 June 2014.

Subordinated liabilities

The Friends Life Holdings plc ("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.

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%. The Company 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, Friends Life and Pensions Limited entered into a financial reinsurance treaty with Munich Reinsurance Company UK Limited ("Munich Re") to finance UK new protection business written in the first half of 2014. The total amount owed to Munich Re under this financial reinsurance agreement as at 30 June 2014 was £5 million.

FLL has three financial reinsurance contracts with Munich Re to finance Heritage new German unit-linked pensions business 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 30 June 2014 was £13 million (30 June 2013: £26 million; 31 December 2013: £17 million).

During 2013, FPIL entered into a financial reinsurance agreement with Munich Re to finance new Rest of World Premier regular premium savings business written between 1 January 2013 and 31 December 2013 in certain territories. The total amount owed to Munich Re under this financial reinsurance agreement as at 30 June 2014 was £4 million (30 June 2013: £8 million; 31 December 2013: £11 million).

In 2012, FPIL entered into a financial reinsurance agreement with Munich Re to finance new Rest of World Premier regular premium savings business written between 1 January 2012 and 31 December 2012. The total amount owed to Munich Re under this financial reinsurance agreement as at 30 June 2013 was £9 million and it was fully repaid by the end of 2013.

Other

Amounts owed to credit institutions (overdrafts) include £nil million (30 June 2013: £8 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. As at the date of this report, the facility remains undrawn.

11. Share capital

The authorised share capital of the Company is represented by an unlimited number of ordinary shares of no par value.

	30 June 2014		30 June 2013		31 December 2013	
	Number of shares (million)	Share capital £m	Number of shares (million)	Share capital £m	Number of shares (million)	Share capital £m
Issued and fully paid						
Shares of no par value fully paid	1,414.1	4,211	1,418.1	4,225	1,417.5	4,223
Total	1,414.1	4,211	1,418.1	4,225	1,417.5	4,223

Changes to share capital

	30 June 2014		30 June 2013		31 December 2013	
	Number of shares (million)	Share capital £m	Number of shares (million)	Share capital £m	Number of shares (million)	Share capital £m
Issued and fully paid						
Opening share capital at 1 January	1,417.5	4,223	1,418.1	4,225	1,418.1	4,225
Net increase in own shares held by the Group	(3.4)	(12)	–	–	(0.6)	(2)
Closing share capital at reporting date	1,414.1	4,211	1,418.1	4,225	1,417.5	4,223

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

The movement in own shares held by the Group relates to shares held in an EBT. The Group uses the EBT to purchase and hold shares of the Company for delivery to employees under various share based payment schemes. Shares held in the EBT are valued at cost and are shown as a deduction from shareholders' equity in the consolidated statement of financial position until they vest to employees.

12. Contingent liabilities

In the normal course of its business, the Group is subject to matters of litigation or dispute and interpretation of tax law. While there can be no assurances, at this time the directors believe, based on the information currently available to them, that it is not probable that the ultimate outcome of any of these matters will have a material adverse effect on the financial condition of the Group.

Friends Life Holdings plc has given a letter of support to SBG to assist them in meeting their liabilities as they fall due. A number of business reviews are currently being undertaken in these companies and provisions of £31 million have been included in respect of customer redress. There is considerable uncertainty surrounding the outcome of these reviews, the number of future complaints and the associated costs for dealing with redress and complaint administration activities. Any costs arising from this are not expected to have a material adverse impact for the Group.

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. There have been no material related party transactions within the period.

Resolution Holdco No.1 LP and RCAP UK LP

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

The value share arrangement was established at the time the Company was formed and, in broad terms, entitles RCAP to 10% of all distributions made from RHN1 where the accumulated value of the deployed equity capital contributed into RHN1 (as set out below), plus an agreed return, has been returned to the Company or its shareholders, or there has been a change of control of the Group. There is no time limit applying to the value share arrangements and the arrangements are not affected by the termination of the operating agreement between ROL and the Company 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 £1,315 million of capital returned to the Company to date) is approximately £3,360 million as shown below.

Transaction	Gross equity deployed		
	The Company £m	RCAP £m	Total £m
Friends Provident ⁽ⁱ⁾	1,915.8	0.2	1,916.0
AXA UK Life Business ⁽ⁱⁱ⁾	2,139.8	0.2	2,140.0
BHA ⁽ⁱⁱⁱ⁾	—	—	—
Total	4,055.6	0.4	4,056.0

(i) See page 102 of Friends Provident Group plc acquisition prospectus for more details of equity deployed.

(ii) See page 89 of AXA UK Life Business acquisition prospectus for more details of equity deployed.

(iii) The acquisition of BHA was funded using existing FLH group resources.

	Half year 2014 £m	Half year 2013 £m	Full year 2013 £m
Accumulated value of net equity deployed			
At 1 January	3,543	3,752	3,752
Distributions from RHN1	(250)	(250)	(350)
Accumulations in the period	67	71	141
At reporting date	3,360	3,573	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.

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

Property lease obligations

Transactions with Clive Cowdery, John Tiner or the entities with which they are associated are related party transactions under Listing Rule 11 by virtue of them having been directors of the Company during the half year period (Clive Cowdery and John Tiner stepped down from the Board with effect from the end of the Annual General Meeting on 8 May 2014). During the period, the Company entered into a Deed of Variation and Settlement with ROL and Resolution Capital Limited (entities controlled by Clive Cowdery) which released the Company from certain obligations which arose from the business sale agreement entered into between the parties 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 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 11 July 2014, the Group announced the disposal of its Lombard operating segment to Blackstone Group LP. Further details are provided in note 2(d).

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

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

In preparing the MCEV supplementary information, the directors have:

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

On behalf of the Board

Tim Tookey
Chief Financial Officer
5 August 2014

Independent review report to Friends Life Group Limited

Introduction

We have been engaged by the Company to review the set of MCEV financial statements in the interim results statement for the six months ended 30 June 2014 which comprises the consolidated income statement – MCEV basis, the earnings per share – MCEV basis, the consolidated statement of comprehensive income – MCEV basis, the consolidated statement of changes in equity – MCEV basis, the consolidated statement of financial position – MCEV basis, the Group MCEV analysis of earnings and the related notes 1 to 11. We have read the other information contained in the interim results statement and considered whether it contains any apparent misstatements or material inconsistencies with the information in the MCEV financial statements.

We have reported separately on the condensed financial statements of Friends Life Group Limited prepared on an IFRS basis for the six months ended 30 June 2014. The information contained in the MCEV financial statements should be read in conjunction with the condensed set of financial statements prepared on an IFRS basis.

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

Directors' responsibilities

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

Our responsibility

Our responsibility, as set out in our engagement letter with you dated 30 July 2014, is to express to the Company a conclusion on the MCEV financial statements based on our review.

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the set of MCEV financial statements in the interim results statement for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with the MCEV Principles and the basis of preparation set out in note 1.

Ernst & Young LLP
London
5 August 2014

MCEV FINANCIAL INFORMATION

Consolidated income statement – MCEV basis

For the half year ended 30 June 2014	Notes	2014 Half year £m	Restated 2013 Half year £m	Restated 2013 Full year £m
Covered business				
Value of new business	6	65	85	179
Expected existing business contribution		124	108	215
Operating experience variances		–	(13)	(32)
Operating assumption changes		43	34	101
Other operating variances		3	30	172
Development costs	9	(22)	(25)	(47)
Covered business operating profit before tax	3	213	219	588
Other income and charges		(20)	(16)	(53)
Operating profit before tax		193	203	535
Economic variances	3	134	226	401
Non-recurring items and non-operating variances	3	(108)	(33)	(143)
Profit from continuing operations before tax		219	396	793
Tax on operating profit		(38)	(51)	(127)
Tax on other activities		(14)	(34)	(59)
Profit from continuing operations after tax		167	311	607
(Loss)/profit from discontinued operations	3	(5)	10	(28)
Profit for the period⁽ⁱ⁾		162	321	579

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

Notes 1 to 11 form an integral part of these financial statements.

The consolidated income statement for the half year ended 30 June 2013 and for the year ended 31 December 2013 include the results of AmLife Insurance Berhad and AmFamily Takaful Berhad (collectively "AmLife") up until the date of disposal on 4 January 2013.

The consolidated income statement includes the results of Lombard as a discontinued operation. The Lombard result after tax for the period 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 half year ended 30 June 2014	Note	2014 Half year pence	Restated 2013 Half year pence	Restated 2013 Full year pence
Earnings per share				
Operating earnings per share on MCEV basis after tax from continuing operations, attributable to equity holders of the parent				
– Basic	4	10.96	10.72	28.78
– Diluted	4	10.95	10.72	28.76
Earnings per share on MCEV basis after tax from continuing operations, attributable to equity holders of the parent				
– Basic	4	11.81	21.93	42.81
– Diluted	4	11.80	21.93	42.78
Earnings per share on MCEV basis after tax from discontinued operations, attributable to equity holders of the parent				
– Basic	4	(0.36)	0.71	(1.97)
– Diluted	4	(0.36)	0.71	(1.97)

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

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

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

Consolidated statement of comprehensive income – MCEV basis

For the half year ended 30 June 2014	2014 Half year £m	Restated 2013 Half year £m	Restated 2013 Full year £m
Profit from continuing operations after tax	167	311	607
(Loss)/profit from discontinued operations	(5)	10	(28)
Profit for the period	162	321	579
Remeasurement losses on defined benefit pension schemes, net of tax	(4)	(20)	(77)
Foreign exchange adjustments	(23)	35	16
Other comprehensive loss for the period from continued operations	(4)	(20)	(77)
Other comprehensive (loss)/income for the period from discontinued operations	(23)	35	16
Total other comprehensive (loss)/income for the period, net of tax	(27)	15	(61)
Total comprehensive income for the period from continued operations	163	291	530
Total comprehensive income for the period from discontinued operations	(28)	45	(12)
Total comprehensive income for the period⁽ⁱ⁾	135	336	518

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

Consolidated statement of changes in equity – MCEV basis

For the half year ended 30 June 2014	2014 Half year £m	2013 Half year £m	2013 Full year £m
Opening ordinary shareholders' equity	6,065	5,831	5,831
Disposal of AmLife as at 4 January 2013	–	7	7
Total comprehensive income for the period	135	336	518
Increase in own shares held by the Group	(13)	–	(2)
Dividends on equity shares	(199)	(200)	(300)
Share-based payments, net of settlements	4	6	7
Classification of Lombard as held for sale ⁽ⁱ⁾	(268)	–	–
Other movements ⁽ⁱⁱ⁾	–	–	4
(Decrease)/increase in MCEV reserves for the period	(341)	149	234
Closing ordinary shareholders' equity	5,724	5,980	6,065

(i) On 11 July 2014 the Company announced the disposal of Lombard. In line with the treatment under IFRS, Lombard has been measured at the lower of its carrying amount and fair value less costs to sell. The remeasurement of the Lombard carrying amount adjusts the £578 million Lombard MCEV down by £268m to the £310 million held for sale carrying value.

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

Consolidated statement of financial position – MCEV basis

As at 30 June 2014	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
Assets			
VIF covered business excluding assets of operations classified as held for sale	3,875	4,410	4,369
Intangible assets	7	8	7
Property and equipment	46	51	50
Investment properties	2,618	2,621	2,561
Financial assets	91,232	111,427	109,064
Deferred acquisition costs	–	86	76
Reinsurance assets	2,893	3,130	2,837
Current tax assets	51	–	33
Insurance and other receivables	1,192	1,454	1,134
Cash and cash equivalents	7,810	9,804	9,690
Assets of operations classified as held for sale	20,110	–	–
Total assets	129,834	132,991	129,821
Liabilities			
Insurance contracts	35,717	37,241	34,647
Unallocated surplus	679	655	627
Financial liabilities			
– investment contracts	62,116	82,698	82,574
– loans and borrowings	1,667	1,618	1,633
– amounts due to reinsurers	1,594	1,720	1,580
Net asset value attributable to unit holders	629	808	621
Provisions	191	234	230
Pension scheme deficit	59	31	52
Deferred tax liabilities	517	619	544
Current tax liabilities	6	38	1
Insurance payables, other payables and deferred income	1,134	1,347	1,245
Liabilities of operations classified as held for sale	19,800	–	–
Total liabilities	124,109	127,009	123,754
Equity attributable to:			
– Equity holders of the parent	5,724	5,980	6,065
– Non-controlling interests	1	2	2
Total equity	5,725	5,982	6,067
Total equity and liabilities	129,834	132,991	129,821

Group MCEV analysis of earnings

For the half year ended 30 June 2014	2014 Half year			Restated 2013 Half year	Restated 2013 Full year
	Covered business £m	Non-covered business £m	Total business £m	Total business £m	Total business £m
Opening Group MCEV	5,054	1,011	6,065	5,831	5,831
Opening adjustments:					
- disposal of AmLife	–	–	–	7	7
Adjusted opening Group MCEV	5,054	1,011	6,065	5,838	5,838
Operating MCEV earnings	170	(15)	155	152	408
Non-operating MCEV earnings	16	(4)	12	159	199
Total MCEV earnings from continuing operations	186	(19)	167	311	607
(Loss)/profit from discontinued operations	(5)	–	(5)	10	(28)
Other movements in IFRS net equity	–	(4)	(4)	(20)	(77)
Closing adjustments:					
– capital and dividend flows	(254)	46	(208)	(194)	(291)
– foreign exchange variances	(23)	–	(23)	35	16
– classification of Lombard as held for sale	(268)	–	(268)	–	–
Closing Group MCEV	4,690	1,034	5,724	5,980	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 5 August 2014.

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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 30 June 2013 and 31 December 2013 have been restated.

On 11 July 2014 the Company announced the disposal of Lombard. In line with the treatment under IFRS, Lombard is classified as held for sale and has been measured at the lower of its carrying amount and fair value less costs to sell. The results of Lombard for the half year ended 30 June 2014 have been shown under discontinued operations, and comparatives for the year ended 31 December 2013 and half year ended 30 June 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 9.

b) Value of in-force covered business

The value of in-force covered business consists of:

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

Present value of future profits ("PVFP")

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

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

The PVFP includes the capitalised value of profits and losses arising in subsidiary companies providing 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 using a stochastic model derived from the current Realistic Balance Sheet ("RBS") model. This model has been calibrated to market conditions at the valuation date. Allowance has been made under the different scenarios for management actions, such as altered investment strategy, consistent with the RBS model. The TVOG would be markedly higher without the hedging activities and management actions currently undertaken. No allowance has been made for the impact of dynamic policyholder behaviour under the different scenarios, however the impact is not considered to be material.

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

Frictional costs of required capital

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

The frictional costs of required capital are calculated as the difference between the market value of assets backing required capital and the present value of future releases of that capital allowing for future investment return (net of frictional costs) on that capital.

The calculation allows for the run-off of the required capital over time using projections of the run-off of the underlying risks and regulatory requirements.

Details of the level of required capital are set out in note 9.

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

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

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

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

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

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

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

Participating business

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

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

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

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

Consolidation adjustments

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

Goodwill and intangible assets

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

Exchange rates

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

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

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 half year ended 30 June 2014

Net of tax	Covered business				Non-covered business £m	Total MCEV £m
	Free surplus £m	Required capital £m	VIF £m	Total £m		
Opening Group MCEV	664	21	4,369	5,054	1,011	6,065
Value of new business	(88)	42	98	52	–	52
Expected existing business contribution:						
–reference rate	8	(5)	15	18	–	18
–in excess of reference rate	2	(20)	100	82	–	82
Transfers from VIF and required capital to free surplus	279	(2)	(277)	–	–	–
Operating experience variances and development costs	(38)	5	15	(18)	–	(18)
Operating assumption changes	–	–	34	34	–	34
Other operating items	4	–	(2)	2	(15)	(13)
Operating Group MCEV earnings	167	20	(17)	170	(15)	155
Economic variances	60	(39)	77	98	–	98
Other non-operating items	(34)	(9)	(39)	(82)	(4)	(86)
Total Group MCEV earnings from continuing operations	193	(28)	21	186	(19)	167
Earnings from discontinued operations	(5)	2	(2)	(5)	–	(5)
Total Group MCEV earnings	188	(26)	19	181	(19)	162
Other movements in IFRS net equity	–	–	–	–	(4)	(4)
Closing adjustments:						
– capital and dividend flows	(284)	30	–	(254)	46	(208)
– foreign exchange variances	–	(3)	(20)	(23)	–	(23)
– classification of Lombard as held for sale	–	–	(268)	(268)	–	(268)
Closing Group MCEV	568	22	4,100	4,690	1,034	5,724

For the half year ended 30 June 2013

Net of tax	Restated Covered business				Restated Non-covered business £m	Restated Total MCEV £m
	Free surplus £m	Required capital £m	VIF £m	Total £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	(98)	32	133	67	–	67
Expected existing business contribution:						
– expected existing business contribution: reference rate	7	(4)	15	18	–	18
– expected existing business contribution: in excess of reference rate	3	(25)	88	66	–	66
Transfers from VIF and required capital to free surplus	275	(3)	(272)	–	–	–
Operating experience variances and development costs	(34)	1	6	(27)	–	(27)
Operating assumption changes	(11)	7	30	26	–	26
Other operating variances	(1)	–	24	23	(21)	2
Operating Group MCEV earnings	141	8	24	173	(21)	152
Economic variances	62	17	100	179	–	179
Other non-operating items	(113)	–	24	(89)	69	(20)
Total Group MCEV earnings from continuing operations	90	25	148	263	48	311
Earnings from discontinued operations	4	1	5	10	–	10
Total Group MCEV earnings	94	26	153	273	48	321
Other movements in IFRS net equity	–	–	–	–	(20)	(20)
Closing adjustments:						
– capital and dividend flows	(249)	17	(1)	(233)	39	(194)
– foreign exchange variances	–	4	31	35	–	35
Closing Group MCEV	483	62	4,410	4,955	1,025	5,980

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 half year ended 30 June 2014

	Covered business					Non-covered business	Total
Gross of tax	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	business £m	£m
Value of new business	71	(11)	5	–	–	–	65
Expected existing business contribution	38	107	11	–	(32)	–	124
Operating experience variances	(14)	16	(2)	–	–	–	–
Operating assumption changes	14	29	–	–	–	–	43
Other operating variances	(5)	8	–	–	–	–	3
Development costs	(12)	(9)	(1)	–	–	–	(22)
Covered business operating profit/(loss) before tax	92	140	13	–	(32)	–	213
Other income and charges	–	–	–	–	–	(20)	(20)
Operating profit/(loss) before tax	92	140	13	–	(32)	(20)	193
Economic variances	43	186	(10)	–	(85)	–	134
Other non-operating items	(52)	(50)	(2)	–	–	(4)	(108)
Profit/(loss) from continuing operations before tax	83	276	1	–	(117)	(24)	219
Attributed tax on operating result	(19)	(30)	–	–	6	5	(38)
Attributed tax on other activities	3	(32)	–	–	15	–	(14)
Profit/(loss) from continuing operations after tax	67	214	1	–	(96)	(19)	167
Loss from discontinued operations after tax	–	–	–	(5)	–	–	(5)
Profit/(loss) after tax	67	214	1	(5)	(96)	(19)	162

For the half year ended 30 June 2013

	Covered					Restated Non-covered business ⁽ⁱⁱ⁾ £m	Restated Total ⁽ⁱⁱ⁾ £m
	UK £m	Restated Heritage ⁽ⁱ⁾ £m	Restated FPI ⁽ⁱ⁾ £m	Restated Lombard ⁽ⁱⁱ⁾ £m	Corporate £m		
Gross of tax							
Value of new business	89	(13)	9	–	–	–	85
Expected existing business contribution	30	107	8	–	(37)	–	108
Operating experience variances	–	(15)	2	–	–	–	(13)
Operating assumption changes	–	34	–	–	–	–	34
Other operating variances	–	31	(1)	–	–	–	30
Development costs	(19)	(3)	(3)	–	–	–	(25)
Covered business operating profit/(loss) before tax	100	141	15	–	(37)	–	219
Other income and charges	–	–	–	–	–	(16)	(16)
Operating profit/(loss) before tax	100	141	15	–	(37)	(16)	203
Economic variances	63	110	31	–	22	–	226
Other non-operating items	4	(126)	–	–	–	89	(33)
Profit/(loss) before tax	167	125	46	–	(15)	73	396
Attributed tax on operating result	(22)	(33)	–	–	9	(5)	(51)
Attributed tax on other activities	(18)	11	(1)	–	(6)	(20)	(34)
Profit/(loss) from continuing operations after tax	127	103	45	–	(12)	48	311
Profit from discontinued operations after tax	–	–	–	10	–	–	10
Profit/(loss) after tax	127	103	45	10	(12)	48	321

(i) Heritage and FPI half year ended 30 June 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 30 June 2014 and consequently the 30 June 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 £92 million (30 June 2013: £100 million).

VNB

Further details of the calculation and analysis of the value of new business ("VNB") are discussed in note 6.

Expected existing business contribution

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

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

The reference rate is based on the one-year swap return plus, for UK immediate annuity business only, an illiquidity premium equivalent to 60bps (30 June 2013: 75bps) at the beginning of the period.

The additional earnings are the excess over the reference rate and reflect management's long-term expectation of asset returns, based on assumed asset mix.

The total expected contribution of £38 million (30 June 2013: £30 million) comprises £35 million (30 June 2013: £27 million) from applying expected rates of return to the value of in-force of £1,033 million at the start of the period and £3 million (30 June 2013: £3 million) of expected return on shareholders' net assets. The UK expected contribution on shareholders' net assets of £3 million reflects primarily 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 £(14) million (30 June 2013: £nil million) and comprise the following elements:

- £(4) million charge from worse than assumed morbidity experience, in particular on the group income protection business;
- £(4) million charge from worse than expected persistency experience, in particular on the Corporate Benefits business. At 31 December 2013 a provision of £35 million was held to cover renegotiation of terms on existing schemes. £3 million of this provision has been used to meet the adverse experience during the first half of 2014.
- £(3) million charge from short term expense overrun on the Corporate Benefits platform as the volume of business gets up to scale; and
- £(3) million charge from other sources.

Operating assumption changes

An operating assumptions benefit of £14 million has been recognised during the period (30 June 2013: £nil million) reflecting savings on future investment expenses, of which the strategic investment partnership with Schroders had a significant contribution.

Other operating variances

Other net operating variances amounting to £(5) million in the period to 30 June 2014 (30 June 2013: £nil million) reflect enhancements to models following internal review.

Development costs

Development costs of £(12) million (30 June 2013: £(19) million) relate to costs that are expected to enhance current propositions and generate future profits which are not captured in the MCEV. These costs relate principally to:

- the development and delivery of the retirement income annuity business strategy;
- the development of the corporate investment platform;
- the development of business systems for the introduction of auto-enrolment; and
- the development of the protection proposition development.

Heritage covered business

The life and pensions covered business operating profit before tax for the Heritage segment was £140 million (30 June 2013: £141 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 £107 million (30 June 2013: £107 million) comprises £98 million (30 June 2013: £98 million) from applying expected rates of return to the value of in-force of £2,397 million at the start of the period and £9 million (30 June 2013: £9 million) of expected return on shareholders' net assets. The Heritage expected contribution on shareholders' net assets of £9 million primarily reflects the return based on the reference rate.

Operating experience variances

Operating experience variances totalled £16 million (30 June 2013: £(15) million) and comprise the following elements:

- £10 million benefit from better than assumed persistency experience, in particular on unit-linked bonds and German pensions business;
- £3 million benefit from better than assumed mortality experience, in particular on life protection business;

- £(3) 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 on-going cost base; and
- £6 million benefit from other sources.

Operating assumption changes

Operating assumption changes of £29 million (30 June 2013: £34 million) comprise:

- £18 million benefit from an increase in the value of deferred tax assets following a finalisation of assumptions driving the valuation of deferred acquisition expenses; and
- £11 million benefit reflecting savings on future investment expenses, of which the strategic investment partnership with Schroders had a significant contribution.

Other operating variances

Other net operating variances amounting to £8 million in the period to 30 June 2014 (30 June 2013: £31 million) reflect various modelling improvements.

Development costs

Development costs of £(9) million (30 June 2013: £(3) 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 development projects including phase 2 of the with-profits annuity redirection.

FPI covered business

The life and pensions covered business operating profit before tax for the FPI segment was £13 million (30 June 2013: £15 million).

VNB

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

Expected existing business contribution

The expected contribution of £11 million (30 June 2013: £8 million) comprises £10 million (30 June 2013: £8 million) from applying expected rates of return to the value of in-force of £424 million at the start of the period and £1 million (30 June 2013: £nil million) of expected return on shareholders' net assets.

Operating experience variances

Operating experience variances of £(2) million (30 June 2013: £2 million) comprise:

- £(2) million charge from actual expenses being higher than expected;
- £2 million benefit from mortality experience being better than anticipated; and
- £(2) million charge from other variances.

Operating assumption changes

There have been no changes to the operating assumptions in the period to 30 June 2014 (30 June 2013: £nil).

Other operating variances

There are no material other operating variances in the period to 30 June 2014 (30 June 2013: £(1) million).

Development costs

Development costs of £(1) million (30 June 2013: £(3) million) relate to the development of the International platform.

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 £(32) million (30 June 2013: £(37) million) represents the expected interest costs arising on the debt held within the life and pensions covered business with the main decrease being driven by a reduction in the short term rate of interest.

Non-covered business

The non-covered business reported an operating loss of £(20) million (30 June 2013: £(16) million) which comprises the following elements:

- £(15) million of corporate costs;
- £(4) million operating result of Sesame Bankhall; and
- £(1) million operating result of fpb AG.

Economic variances

Economic variances combine the impact of changes to economic assumptions with the investment return variances to expected investment returns over the period. The total economic variances were £134 million (30 June 2013: £226 million) and these comprise:

- £92 million due to the narrowing of credit spreads on corporate bonds, primarily in annuity funds;
- £37 million tax benefit mainly due to losses brought into value by equity realisations and gilt and bond gains during the year;
- £24 million from an increase in value of fixed interest assets which for unit-linked business also increases the value of future charges;
- £17 million from a decrease in inflation assumptions;
- £10 million from an increase in value of shareholder assets;
- £(85) million from an increase in the market value of debt; and
- £39 million of other economic variances.

Other non-operating items

Total other non-operating items of £(108) million (30 June 2013: £(33) million) comprise:

- £(50) million from establishing a provision 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;
- £(25) million from the initial costs associated with the outsourcing agreement with Diligenta, partially offset by the utilisation of the provision established against these costs (discussed in note 9);
- £(15) million from an increase in the provision for future Solvency II 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; and
- £(8) million from other non recurring items.

Discontinued operations

Lombard business

The loss from discontinued operations after tax of £(5) million (30 June 2013: £10 million profit) is the net of tax earnings from the Lombard business.

Lombard operating loss of £(2) million (30 June 2013: £10 million profit) reflects a lower contribution from new business and materially adverse persistency experience particularly in Belgium as a result of tax and legal changes. Economic variances were £1 million and other non-operating items of £(5) million are primarily from the costs related to the sale of Lombard with a £1 million attributable tax benefit.

4. Earnings per share

Basic and operating earnings per share

Half year ended 30 June 2014	Earnings £m	Pence per share
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	167	11.81
Add back:		
- Economic variances	(134)	(9.48)
- Non-recurring items and non-operating variances	108	7.64
- Tax credit on items excluded from operating profit	14	0.99
Operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	155	10.96
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	167	11.81
Loss after tax from discontinued operations attributable to ordinary equity holders of the parent	(5)	(0.36)
Profit after tax attributable to ordinary equity holders of the parent	162	11.45
Half year ended 30 June 2013	Restated Earnings £m	Restated Pence per share
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	311	21.93
Add back:		
- Economic variances	(226)	(15.94)
- Non-recurring items and non-operating variances	33	2.33
- Tax credit on items excluded from operating profit	34	2.40
Operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	152	10.72
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	311	21.93
Profit after tax from discontinued operations attributable to ordinary equity holders of the parent	10	0.71
Profit after tax attributable to ordinary equity holders of the parent	321	22.64

Year ended 31 December 2013	Restated Earnings £m	Restated Pence per share
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	607	42.81
Add back:		
- Economic variances	(401)	(28.28)
- Non-recurring items and non-operating variances	143	10.09
- Tax credit on items excluded from operating profit	59	4.16
Operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	408	28.78
Profit after tax from continuing operations attributable to ordinary equity holders of the parent	607	42.81
Loss after tax from discontinued operations attributable to ordinary equity holders of the parent	(28)	(1.97)
Profit after tax attributable to ordinary equity holders of the parent	579	40.84

Diluted earnings per share from continuing operations

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

For the half year ended 30 June 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	167	1,414,295,152	11.81
Dilutive effect of share awards	–	1,223,508	(0.01)
Diluted basic earnings per share on profit after tax from continuing operations attributable to ordinary equity holders of the parent	167	1,415,518,660	11.80

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	(0.03)
Diluted basic earnings per share on profit after tax from continuing operations attributable to ordinary equity holders of the parent	607	1,418,712,862	42.78

There were no dilutive factors for the half year ended 30 June 2013.

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

For the half year ended 30 June 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	155	1,414,295,152	10.96
Dilutive effect of share awards	–	1,223,508	(0.01)
Diluted basic earnings per share on operating profit after tax from continuing operations attributable to ordinary equity holders of the parent	155	1,415,518,660	10.95

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 basic 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

There were no dilutive factors for the half year ended 30 June 2013.

Diluted earnings per share from discontinued operations

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

For the half year ended 30 June 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	(5)	1,414,295,152	(0.36)
Dilutive effect of share awards	–	1,223,508	–
Diluted basic earnings per share on profit after tax from discontinued operations attributable to ordinary equity holders of the parent	(5)	1,415,518,660	(0.36)

For the year ended 31 December 2013	Restated Earnings £m	Weighted Average number of shares	Restated Pence per share
Profit 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 basic earnings per share on profit after tax from discontinued operations attributable to ordinary equity holders of the parent	(28)	1,418,712,862	(1.97)

There were no dilutive factors for the half year ended 30 June 2013.

Weighted average number of ordinary shares

For the half year ended 30 June 2014

	Actual	Weighted
Issued ordinary shares at beginning of period	1,417,508,151	1,417,508,151
Effect of:		
– purchase of own shares	(3,371,145)	(3,212,999)
Number of ordinary shares at end of period	1,414,137,006	1,414,295,152

For the half year ended 30 June 2013

	Actual	Weighted
Issued ordinary shares at beginning of period	1,418,109,028	1,418,109,028
Number of ordinary shares at end of period	1,418,109,028	1,418,109,028

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	(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:

	30 June 2014 £m	Restated 30 June 2013 £m	31 December 2013 £m
Equity attributable to ordinary shareholders on an IFRS basis	4,949	5,233	5,229
Less items only included on an IFRS basis (net of tax):			
– IFRS reserving and other IFRS adjustments ⁽ⁱ⁾	598	478	540
– Deferred front end fees	63	54	58
– Deferred acquisition costs	(797)	(749)	(795)
– Acquired present value of in-force	(2,782)	(3,061)	(2,933)
– Other intangible assets	(157)	(210)	(186)
Add items only included on a MCEV basis (net of tax):			
– Adjustment for long-term debt to market value ⁽ⁱ⁾	(250)	(175)	(217)
Net worth on a MCEV basis	1,624	1,570	1,696
Value of in-force covered business	4,100	4,410	4,369
Equity attributable to ordinary shareholders on a MCEV basis	5,724	5,980	6,065

(i) The 30 June 2013 balances have been restated to reflect a presentational adjustment relating to STICs.

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;
- 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 period has ranged from 70 bps to 80 bps.

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

For Corporate Benefits new business 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 the period to 30 June 2014 this short term overrun was £3 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

Half year ended 30 June 2014	New business premiums		APE £m	Average annual premium multiplier ⁽ⁱ⁾	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New Business margin %
	Single £m	Regular £m						
UK Corporate Benefits	357	292	328	4.0	1,529	9	12	0.8
UK Protection	–	47	47	7.1	336	24	31	9.2
UK Retirement Income ⁽ⁱⁱ⁾	299	–	30	–	299	22	28	9.4
UK total	656	339	405	4.4	2,164	55	71	3.3
Heritage	90	14	23	3.4	138	(8)	(11)	(8.0)
FPI	224	25	47	4.8	343	5	5	1.5
Total from continuing operations	970	378	475	4.4	2,645	52	65	2.5
Discontinued operations⁽ⁱⁱⁱ⁾	727	–	73	–	727	3	4	0.6
Total	1,697	378	548	4.4	3,372	55	69	2.0

Half year ended 30 June 2013	New business premiums		APE £m	Average annual premium multiplier ⁽ⁱ⁾	PVNBP £m	Post-tax VNB £m	Pre-tax VNB £m	New business margin %
	Single £m	Regular £m						
UK Corporate Benefits	251	228	253	4.2	1,213	10	13	1.1
UK Protection	–	39	39	7.4	290	25	32	11.0
UK Retirement Income ⁽ⁱⁱ⁾	324	–	32	–	324	34	44	13.6
UK total	575	267	324	4.7	1,827	69	89	4.9
Heritage – restated^(iv)	111	25	36	5.1	239	(11)	(13)	(5.4)
FPI – restated^(iv)	312	38	70	4.9	499	9	9	1.8
Total from continuing operations	998	330	430	4.7	2,565	67	85	3.3
Discontinued operations⁽ⁱⁱⁱ⁾	872	–	87	–	872	9	12	1.4
Total	1,870	330	517	4.7	3,437	76	97	2.8

(i) Defined as (PVNBP less total amount of single premiums)/(total annualised amount of regular premiums) this is shown as zero for UK Retirement Income and the discontinued operations as these businesses have only single premium business therefore PVNBP is the same as the premiums received in the period.

(ii) The UK Retirement Income value of new business for annuities shown in the tables above has been valued assuming an illiquidity premium ranging from 70 bps to 80 bps over the six months to 30 June 2014, and ranging from 70 bps to 85 bps over the six months to 30 June 2013.

(iii) Lombard is classified as held for sale and is shown under discontinued operations.

(iv) OLAB was transferred from the FPI segment to the Heritage segment in January 2014 and the segmental comparatives for 30 June 2013 have been restated.

UK

The VNB from the UK segment was £71 million (30 June 2013: £89 million), comprising:

- UK Corporate Benefits VNB of £12 million (30 June 2013: £13 million), reflecting price competition and a higher proportion of lower margin auto-enrolment business, partially offset by favourable volumes;
- UK Protection VNB of £31 million (30 June 2013: £32 million), driven by a higher proportion of Group Life Schemes and reduced margins in individual protection, partially offset by favourable volumes; and
- UK Retirement Income VNB of £28 million (30 June 2013: £44 million), reflecting reduced margins as a result of improvements in the competitive pricing of annuities.

Heritage

Heritage VNB was £(11) million (30 June 2013: £(13) million), 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, where VNB is negative.

FPI

FPI VNB was £5 million (30 June 2013: £9 million), 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 Lombard IRR takes account of the Luxembourg regulatory regime in which DAC is an allowable asset.

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

New business key performance metrics

	Half year ended 30 June 2014			Restated Half year ended 30 June 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	12	9.4	10	13	7.6	12
UK Protection	31	13.3	7	32	15.0	7
UK Retirement Income	28	15.0	7	44	>25.0	1
UK total	71	12.1	8	89	16.7	7
Heritage	(11)	(2.8)	n/a	(13)	(0.5)	n/a
FPI	5	8.9	8	9	11.4	7
Total from continuing operations	65	9.8	10	85	11.0	9
Discontinued operations⁽ⁱⁱ⁾	4	7.3	12	12	13.8	7
Total	69	9.5	10	97	11.2	9

(i) Heritage and FPI half year ended 30 June 2013 new business metrics have been restated following the transfer of OLAB business from FPI to Heritage in January 2014.

(ii) Lombard is classified as held for sale and is shown under discontinued operations.

The Group new business IRR from continuing operations was 9.8% (30 June 2013: 11.0%) and the payback period on new business was 10 years (30 June 2013: 9 years). The new business IRR on Open Insurance Businesses (UK Protection, UK Retirement Income and FPI) was 12.9% (30 June 2013: 22.8%).

The decrease in UK reflects the combination of reduced volumes and proportionately higher acquisition costs of business from Retirement Income, a decrease in margins of business from Protection and an increase in Corporate Benefits IRR.

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 combination of reduced volumes and proportionately higher acquisition costs.

7. Segmental analysis of Group MCEV

	30 June 2014							31 December 2013		
	Free surplus £m	Required capital £m	Total net worth £m	PVFP £m	TVOG £m	Frictional costs £m	CNHR £m	Total VIF £m	Total £m	Restated Total £m
UK	5	399	404	1,175	–	(31)	(63)	1,081	1,485	1,418
Heritage	522	1,164	1,686	2,656	(91)	(82)	(115)	2,368	4,054	4,161
FPI ⁽ⁱ⁾	43	26	69	451	–	(1)	(24)	426	495	508
Lombard	(2)	82	80	251	–	(3)	(23)	225	305	598
Corporate ⁽ⁱⁱ⁾										
– IFA and distribution	43	–	43	–	–	–	–	–	43	41
– Pension asset of FPPS	(25)	–	(25)	–	–	–	–	–	(25)	(18)
– Other	1,016	31	1,047	–	–	–	–	–	1,047	980
Gross Group MCEV⁽ⁱⁱⁱ⁾	1,602	1,702	3,304	4,533	(91)	(117)	(225)	4,100	7,404	7,688
Corporate– external STICS	–	(497)	(497)	–	–	–	–	–	(497)	(478)
Corporate– external debt ^(iv)	–	(1,183)	(1,183)	–	–	–	–	–	(1,183)	(1,145)
Net Group MCEV	1,602	22	1,624	4,533	(91)	(117)	(225)	4,100	5,724	6,065

(i) The FPI MCEV at 30 June 2014 of £495 million is after the transfer of OLAB business to Heritage, and includes £46 million in respect of the remaining non-core business relating to Japanese nationals.

(ii) Corporate excludes external STICS, the external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022.

(iii) For the purposes of this table “Gross” refers to the MCEV gross of the clean market value of the external STICS, the external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022. The accrued interest and tax adjustment on market valuation is included in the gross MCEV of Corporate.

(iv) The Corporate external debt comprises: the external LT2 subordinated debt 2021; the external LT2 subordinated debt 2022; and the external UT2 subordinated debt with associated currency swap.

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 individual capital management policies.

Required capital within MCEV is calculated and allocated to business units based on the Group’s capital management policy of holding 150% of the Group CRR (excluding WPICC) even where this allocation is in excess of local capital management policies. In practice the extra required capital held to meet the Group’s capital management policy can be covered by any of the companies within the Group.

The external STICS, external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 are included within the MCEV at market value, as detailed in note 9.

7.2 PVFP

The PVFP at 30 June 2014 includes: a £25 million net of tax (31 December 2013: £27 million) deduction in respect of anticipated adverse persistency on corporate pensions business in the UK segment to cover renegotiation of terms on existing schemes; a £20 million net of tax (31 December 2013: £19 million) deduction in respect of anticipated short term adverse persistency on group pensions business in the Heritage segment following the introduction of auto-enrolment; a £39 million net of tax (31 December 2013: £nil) deduction in respect of the anticipated impact from the imposition of a DWP charge cap of 0.75% p.a. on default funds for qualifying auto-enrolment schemes; and an £8 million net of tax (31 December 2013: £nil) deduction to cover the anticipated impact on future profits from the removal of Active Member Discounts on existing schemes.

In line with IFRS treatment, Lombard has been measured at the lower of its carrying amount and fair value less costs to sell. The write down has been allocated to PVFP and reflected within closing adjustments. The remeasurement of the carrying amount of Lombard of £(268) million adjusts the £578 million Lombard MCEV down to the £310 million held for sale carrying value. The total Lombard MCEV consists of £305 million in respect of Lombard covered business and £5 million in respect of Lombard non-covered business.

7.3 TVOG

The TVOG at 30 June 2014 of £91 million (31 December 2013: £114 million), is split between £60 million (31 December 2013: £79 million) market risk and £31 million (31 December 2013: £35 million) non-market risk. The non-market risks include lapses, annuitant longevity, and operational risk within the with-profits fund. The allowance for non-market risks is made by consideration of the impact of extreme scenarios from the Group's economic capital model.

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.

Additionally, the Group capital management policy in respect of FLGL is to hold 150% of Group CRR excluding WPICC (31 December 2013: 150%). The cost of holding any additional capital is shown in the FLGL covered business segment. At 30 June 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 £225 million (31 December 2013: £228 million) is presented as an equivalent annual cost of capital charge of 1.2% (31 December 2013: 1.2%) on projected risk-based Group required capital for all non-hedgeable risk. In line with management's view of the business, allowance has been made for diversification benefits within the non-hedgeable risks of the covered business.

8. Segmental analysis of Group MCEV earnings

The tables below show a further breakdown of the Group MCEV earnings 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.

Half year ended 30 June 2014	Covered business					Non- covered business £m	Total £m
	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m		
Opening Group MCEV	1,418	4,066	603	598	(1,631)	1,011	6,065
Operating MCEV earnings	73	110	13	–	(26)	(15)	155
Non-operating MCEV earnings	(6)	104	(12)	–	(70)	(4)	12
Group MCEV earnings from continuing operations	67	214	1	–	(96)	(19)	167
Earnings from discontinued operations	–	–	–	(5)	–	–	(5)
Total Group MCEV earnings	67	214	1	(5)	(96)	(19)	162
Other movements in IFRS net equity	–	–	–	–	–	(4)	(4)
Closing adjustments:							
– capital and dividend flows	–	(226)	(109)	3	78	46	(208)
– foreign exchange variances	–	–	–	(23)	–	–	(23)
– classification of Lombard as held for sale	–	–	–	(268)	–	–	(268)
Closing Group MCEV	1,485	4,054	495	305	(1,649)	1,034	5,724

Half year ended 30 June 2013	Covered business					Restated Non-covered business £m	Restated Total £m
	UK £m	Restated Heritage £m	Restated FPI £m	Restated Lombard £m	Corporate £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	78	108	15	–	(28)	(21)	152
Non-operating MCEV earnings	49	(5)	30	–	16	69	159
Group MCEV earnings from continuing operations	127	103	45	–	(12)	48	311
Earnings from discontinued operations	–	–	–	10	–	–	10
Total Group MCEV earnings	127	103	45	10	(12)	48	321
Other movements in IFRS net equity	–	–	–	–	–	(20)	(20)
Closing adjustments:							
– capital and dividend flows	(21)	(263)	(3)	(9)	63	39	(194)
– foreign exchange variances	–	–	–	35	–	–	35
Closing Group MCEV	1,333	4,021	510	651	(1,560)	1,025	5,980

Covered business							
Year ended	UK	Restated	Restated	Restated	Corporate	Restated	Restated
31 December 2013	£m	Heritage	FPI	Lombard	£m	Non-covered	Total
		£m	£m	£m		business	£m
						£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. MCEV assumptions

9.1 Economic assumptions – deterministic calculations

Economic assumptions are derived actively, based on market yields on risk-free fixed interest assets at the end of each reporting period.

Reference rates – risk free

The risk free reference rate is determined with reference to the swap yield curve appropriate to the currency of the cash flows. For some business types, where the impact on the 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		
	30 June 2014 %	30 June 2013 %	31 December 2013 %
UK & Heritage			
Long-term rate	2.90	2.70	3.10
Swap yield curve			
– Term 1 year	0.90	0.67	0.71
– Term 5 years	2.21	1.57	2.18
– Term 10 years	2.86	2.66	3.11
– Term 15 years	3.18	3.17	3.48
– Term 20 years	3.33	3.41	3.58
FPI long-term rate	2.90	2.70	3.10
Lombard long-term rate	1.82	2.43	2.62

Reference rate – Illiquidity premium adjustment

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

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

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

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

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

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

Investment strategy for annuity new business targets assets with higher illiquidity premiums than the back book portfolio. Given the contribution to new business is sensitive to the interest rate and illiquidity premium at outset, an appropriate rate for each month’s new business is used.

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

	Embedded value			New business		
	30 June 2014	30 June 2013	31 December 2013	30 June 2014	30 June 2013	31 December 2013
UK & Heritage immediate annuities	55 bps	75 bps	60 bps	70-80 bps	70-85 bps	65-85 bps

Expected asset returns in excess of reference rates

Margins are added to the reference rates to obtain investment return assumptions for equity, property and corporate bonds. These risk premia reflect management’s expectations of asset returns in excess of the reference rate from investing in different asset classes. As a market consistent approach has been followed, these investment return assumptions affect the expected existing

business contribution and the economic variances within the analysis of MCEV earnings, but do not affect the opening or closing embedded values. In addition, they will affect the additional disclosures of the payback periods.

For equities and property, the excess is calculated as the difference between the long-term rate of return and the one-year risk free reference rate. The long-term rate of return is derived using a 10 year swap rate plus a risk premium of 3% for equities (3% at 30 June 2013 and 31 December 2013) and 2% for property (2% at 30 June 2013 and 31 December 2013).

For cash and government bonds no excess over the one-year risk free reference rate has been assumed for UK, Heritage or FPI. Lombard assumes the long-term rate is achieved. For corporate bonds, the return is based on the excess of actual corporate bond spreads on the reporting date, less an allowance for defaults, over the one-year risk free reference rate for UK, Heritage and FPI. For Lombard the corporate bond return is derived using the long-term rate plus a risk premium of 1% (1% at 30 June 2013 and 31 December 2013).

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% (1% at 30 June 2013 and 31 December 2013) per annum in excess of the assumed long-term rate of inflation. Long-term inflation assumptions are set relative to gilt curves at appropriate durations.

Maintenance expenses for Lombard are assumed to increase in the future at a rate of 0.75% (0.75% at 30 June 2013 and 31 December 2013) per annum in excess of the assumed long-term rate of inflation. This is derived from an inflation swap curve based on a Eurozone price index taking into account the run-off profile of the business.

	Expense inflation		
	30 June 2014 %	30 June 2013 %	31 December 2013 %
UK	4.20	4.00	4.30
Heritage	4.20	4.00	4.30
FPI	4.20	4.00	4.30
Lombard	2.65	2.80	2.75

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		
	30 June 2014	30 June 2013	31 December 2013
Closing exchange rate	0.801	0.857	0.832
Average exchange rate	0.820	0.848	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 with-profits fund, the shareholder receives the management charges in the non-profit fund for these.

Following the Part VII transfer of business from FLC to FLL, the requirement to retain the FLC reattributed inherited estate ("RIE") to support FLC Old WPF and FLC New WPF along with other previously existing with-profit fund support arrangements have been incorporated into one FLL Scheme effective from 28 December 2012.

The FLL Scheme rules require that a test be undertaken every five years to determine the level of shareholder capital support required for FLC Old WPF and FLC New WPF. The test also determines whether it is possible to distribute any of the inherited estate retained in the FLC Old WPF in the form of Special Bonuses (and associated transfer to the shareholders' fund). The latest five yearly test was undertaken as at 31 December 2010.

The remaining RIE in the FLL NPF is predominantly in the form of the VIF of non-profit business written within the fund. To the extent that this VIF emerges into cash during the period 30 June 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.

9.2 Economic assumptions – stochastic calculations

Model

The time value of financial options and guarantees and the OLAB return of premium guarantee are determined using a Barrie & Hibbert economic scenario generator and are calculated using 2,000 simulations. The with-profits model is consistent with the model used for the Realistic Balance Sheet and is calibrated to market conditions at the valuation date using the gilt risk-free curve and implied volatilities in the market. The OLAB return of premium guarantee model is calibrated to market conditions at the valuation date using a Euro swap curve and implied volatilities in the market. Correlations between the asset classes are derived from historic data.

Swaption implied volatilities - with-profits time value of financial options and guarantees

Option term	30 June 2014 Swap term				30 June 2013 Swap term				31 December 2013 Swap term			
	10 yrs %	15 yrs %	20 yrs %	25 yrs %	10 yrs %	15 yrs %	20 yrs %	25 yrs %	10 yrs %	15 yrs %	20 yrs %	25 yrs %
UK Sterling												
10 years	18	17	16	15	18	17	16	15	18	17	16	15
15 years	18	17	17	16	18	17	16	16	19	18	17	16
20 years	17	16	15	14	16	16	15	15	17	16	15	14
25 years	16	15	14	13	16	16	16	15	16	15	14	13

Swaption implied volatilities - OLAB return of premium guarantee

Option term	30 June 2014 Swap term				30 June 2013 Swap term				31 December 2013 Swap term			
	10 yrs %	15 yrs %	20 yrs %	30 yrs %	10 yrs %	15 yrs %	20 yrs %	30 yrs %	10 yrs %	15 yrs %	20 yrs %	30 yrs %
Euro												
10 years	24	23	22	21	24	23	22	21	23	22	21	20
15 years	26	24	23	22	24	23	21	20	25	23	22	20
20 years	23	21	20	19	24	22	20	18	22	20	19	18
25 years	20	19	18	16	23	20	18	16	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 15% (30 June 2013: 15%, 31 December 2013: 15%) and a running yield of 4.3% (30 June 2013: 4.3%, 31 December 2013: 4.3%). Sample implied volatilities are shown in the table below.

Option term	30 June 2014		30 June 2013		31 December 2013	
	Equity %	Property %	Equity %	Property %	Equity %	Property %
5 years	19	15	24	15	19	15
10 years	23	15	26	15	22	15
15 years	25	15	27	15	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.

Option term	30 June 2014	30 June 2013	31 December 2013
	Equity %	Equity %	Equity %
5 years	18	22	20
10 years	19	25	21
15 years	19	26	21

9.3 Other assumptions

Required capital

Required capital under MCEV amounted to £22 million (£62 million at 30 June 2013, £21 million at 31 December 2013). The required capital is shown net of £1,649 million (£1,560 million at 30 June 2013, £1,631 million at 31 December 2013) 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 30 June 2013 and 31 December 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, Isle of Man and Luxembourg. Deferred tax is provided on the mark-to-market revaluation of the external STICS, external UT2 subordinated debt with associated currency swap, external LT2 subordinated debt 2021 and external LT2 subordinated debt 2022 allocated to the life and pensions covered business within Corporate. For UK, Heritage and OLAB business the appropriate tax rate has been calculated as the average rate of corporation tax applicable over the year, 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		
	30 June 2014 %	30 June 2013 %	31 December 2013 %
UK	21.5	23.5	23.25
Heritage	21.5	23.5	23.25
FPI	0.0	0.0	0.0
Lombard	22.5	22.5	22.5

The PVFP for UK and Heritage and 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 (31 December 2013: 23% to 21% over the period to 2014) and for an ultimate rate of 20% from April 2015 (31 December 2013: 20% from April 2015).

Legislation in respect of the new life tax regime was included in Finance Act 2012, which received Royal Assent on 17 July 2012. The new life tax regime took effect from 1 January 2013 and a best estimate of its effect is therefore included in MCEV, being a forward-looking measure. There remains an element of risk and uncertainty in estimating its effects given that the legislation is newly introduced therefore the outcomes may be subject to change as a result of either legislative update or by development in interpretation.

VAT in the UK of 20.0% (30 June 2013: 20.0%, 31 December 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.

A provision of £35 million (gross of tax) was held at 31 December 2013 in respect of anticipated adverse persistency on corporate pensions business in the UK segment to cover renegotiation of terms on existing schemes. During the first half of 2014 £3 million of the provision has been released against adverse experience and £32 million (gross of tax) of the provision remains at 30 June 2014.

A provision of £25 million (gross of tax) was held at 31 December 2013 to cover anticipated short term adverse persistency on group pensions business in the Heritage segment following the implementation of auto-enrolment. The provision remains at £25 million (gross of tax) at 30 June 2014.

Future improvements in annuitant mortality have been assumed to be in accordance with the projections published by the Continuous Mortality Investigation ("CMI") in 2011, with a long-term rate of 1.25% per annum (30 June 2013: 1.25%, 31 December 2013: 1.25%). For new business written in 2014 future improvements in annuitant mortality have been assumed to be in accordance with the projections published by CMI in 2013, with a long-term rate of 1.5% per annum.

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 £26 million was held at 30 June 2014 (31 December 2013: £39 million). In the first half of 2014, initial development costs of £(38) million have been incurred in relation to the Diligenta arrangement which have been partially offset by a £13 million utilisation of the remaining provision. The net cost of £(25) million is shown in the consolidated income statement within other non-operating items.

Other one-off costs shown within non-recurring items can be categorised as:

- Solvency II and Finance Transformation project costs;
- Separation and integration costs;
- Capital restructuring costs; or
- Corporate acquisitions/disposal costs.

Any other one-off costs that do not fall into these categories are treated as operating exceptional costs within operating experience variances.

The MCEV makes provision for certain development costs to the extent that these are known with sufficient certainty and in line with current plans.

Development costs of £22 million (30 June 2013: £26 million, 31 December 2013: £50 million) have been excluded from the calculation of unit costs and have been recognised in operating profits. Development costs relate to investment in activities expected to create value in the future, but where that expected value cannot be anticipated within the current period's financial results until the value is realised.

Development costs

	30 June 2014 £m	30 June 2013 ⁽ⁱ⁾ £m	31 December 2013 ⁽ⁱ⁾ £m
UK	12	19	30
Heritage	9	2	7
FPI	1	4	10
Total from continuing operations	22	25	47
Discontinued operations	–	1	3
Total	22	26	50

(i) Heritage and FPI 30 June 2013 and 31 Dec 2013 development costs have been restated following the transfer of OLAB business from FPI to Heritage in January 2014.

Non-hedgeable risks

A charge equivalent to 1.2% (30 June 2013: 1.3%, 31 December 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.

30 June 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	223	2	(4)	221
STICS 2005	268	274	–	(2)	272
LT2 subordinated debt 2021	162	217	2	(13)	206
LT2 subordinated debt 2022	500	569	8	(17)	560
UT2 subordinated debt ⁽ⁱⁱ⁾	356	385	4	(8)	381
Currency swap	–	12	–	(3)	9
Total	1,496	1,680	16	(47)	1,649

30 June 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	198	2	2	202
STICS 2005	268	252	17	(1)	268
LT2 subordinated debt 2021	162	204	2	(11)	195
LT2 subordinated debt 2022	500	525	8	(9)	524
UT2 subordinated debt ⁽ⁱⁱ⁾	356	396	4	(12)	388
Currency swap	–	(23)	–	6	(17)
Total	1,496	1,552	33	(25)	1,560

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.

10. Comparison of MCEV and IFRS classification and segments

The covered business segments within MCEV are consistent with the IFRS business segments.

The split of the MCEV by IFRS business segment is shown in the tables below:

	MCEV classification						
	UK £m	Heritage £m	FPI £m	Lombard £m	Corporate £m	Non- covered business ⁽ⁱ⁾ £m	Total MCEV by IFRS segments £m
Half year ended 30 June 2014							
IFRS segment							
UK	1,485	–	–	–	–	–	1,485
Heritage	–	4,054	–	–	–	44	4,098
FPI	–	–	495	–	–	(1)	494
Lombard	–	–	–	305	–	5	310
Corporate	–	–	–	–	(1,649)	986	(663)
Total MCEV (by MCEV segments)	1,485	4,054	495	305	(1,649)	1,034	5,724

(i) The non-covered business includes £206 million within Corporate representing the MCEV of the Friends Life Group holding companies above FLH.

MCEV classification							
Half year ended 30 June 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	1,333	—	—	—	—	23	1,356
Heritage – restated	—	4,021	—	—	—	3	4,024
FPI – restated	—	—	510	—	—	2	512
Lombard	—	—	—	651	—	16	667
Corporate	—	—	—	—	(1,560)	981	(579)
Total MCEV (by MCEV segments)	1,333	4,021	510	651	(1,560)	1,025	5,980

(i) The non-covered business includes £180 million within Corporate representing the MCEV of the Friends Life Group holding companies above FLH.

MCEV classification							
Year ended 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.

11. FLH annualised return on embedded value

	Half year 2014		Restated Half year 2013		Restated Full year 2013	
	£m	% p.a.	£m	% p.a.	£m	% p.a.
Value of new business	65	1.9	85	2.6	179	2.8
Expected existing business contribution ⁽ⁱ⁾	156	4.6	145	4.4	290	4.4
Operating experience variances	–	–	(13)	(0.4)	(32)	(0.6)
Operating assumption changes	43	1.3	34	1.0	101	1.6
Other operating variance	3	0.1	30	0.9	172	2.7
Development costs	(22)	(0.7)	(25)	(0.8)	(47)	(0.7)
Other income and charges ⁽ⁱ⁾	(8)	(0.2)	(6)	(0.2)	(26)	(0.4)
FLH MCEV operating profit before tax and financing	237	7.0	250	7.5	637	9.8
Impact of financing ⁽ⁱ⁾	(32)	1.0	(37)	1.0	(75)	1.7
Attributed tax charge on MCEV operating profit	(40)	(1.6)	(51)	(2.0)	(132)	(2.7)
FLH MCEV operating profit after tax	165	6.4	162	6.5	430	8.8
Economic variances	134	5.2	226	9.1	401	8.2
Other non-operating items	(108)	(4.2)	(33)	(1.2)	(143)	(2.9)
Attributed tax on other activities	(14)	(0.5)	(34)	(1.4)	(59)	(1.2)
FLH MCEV profit from continuing operations	177	6.9	321	13.0	629	12.9
(Loss)/profit from discontinued operations ⁽ⁱⁱ⁾	(5)	(0.9)	10	(1.2)	(28)	(2.0)
FLH MCEV profit	172	6.0	331	11.8	601	10.9
Remeasurement losses on defined benefit pension schemes	(4)	(0.2)	(20)	(0.7)	(77)	(1.4)
Foreign exchange adjustments	(23)	(0.7)	35	1.3	16	0.3
Total return on FLH MCEV over the period	145	5.1	346	12.4	540	9.8

(i) Impact of financing comprises the expected impact of financing of covered debt of £32 million for half year 2014 (£37 million for half year 2013, £75 million for full year 2013). 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. 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 and the MCEV relating to Lombard). 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		
	HY 2014 £m	HY 2013 ⁽ⁱ⁾ £m	Change %	HY 2014 £m	HY 2013 ⁽ⁱ⁾ £m	Change %
UK division						
– Corporate Benefits	292	228	28	357	251	42
– Protection	47	39	21	-	-	-
– Retirement Income	-	-	-	299	324	(8)
Total UK division	339	267	27	656	575	14
Heritage division	14	25	(44)	90	111	(19)
International division	25	38	(34)	224	312	(28)
Total Group - Continuing	378	330	15	970	998	(3)
Discontinued - Lombard	-	-	-	727	872	(17)
Total Group	378	330	15	1,697	1,870	(9)

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

	Regular premiums			Single premiums		
	Q2 2014 £m	Q2 2013 ⁽ⁱ⁾ £m	Change %	Q2 2014 £m	Q2 2013 ⁽ⁱ⁾ £m	Change %
UK division						
– Corporate Benefits	145	133	9	204	106	92
– Protection	23	21	10	-	-	-
– Retirement Income	-	-	-	152	179	(15)
Total UK division	168	154	9	356	285	25
Heritage division	7	13	(46)	49	51	(4)
International division	13	18	(28)	117	158	(26)
Total Group - Continuing	188	185	2	522	494	6
Discontinued - Lombard	-	-	-	448	405	11
Total Group	188	185	2	970	899	8

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

Group new business – APE

Annualised Premium Equivalent (“APE”) represents annualised new regular premiums plus 10% of single premiums.

	HY 2014 £m	HY 2013 ⁽ⁱ⁾ £m	Change %	Q2 2014 £m	Q2 2013 ⁽ⁱ⁾ £m	Change %
UK division						
– Corporate Benefits	328	253	30	166	144	15
– Protection	47	39	21	23	21	10
– Retirement Income	30	32	(6)	15	17	(12)
Total UK division	405	324	25	204	182	12
Heritage division	23	36	(36)	12	18	(33)
International division	47	70	(33)	24	35	(31)
Total Group - Continuing	475	430	10	240	235	2
Discontinued - Lombard	73	87	(16)	45	40	13
Total Group	548	517	6	285	275	4

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

International Division

APE by region (actual exchange rates)	HY 2014 £m	HY 2013 ⁽ⁱ⁾ £m	Change %
North Asia	9	19	(53)
South Asia	7	11	(36)
Middle East	16	20	(20)
UK & Rest of World	15	20	(25)
Total	47	70	(33)

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

Discontinued Lombard

APE by region (actual exchange rates)	HY 2014 £m	HY 2013 £m	Change %
UK and Nordic	26	34	(24)
Northern Europe	2	1	100
Southern Europe	42	48	(13)
Rest of World	3	4	(25)
Total including large cases	73	87	(16)
Of which: Large cases (greater than €10m)	22	24	(8)
Total excluding large cases	51	63	(19)

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:

	HY 2014 £m	HY 2013 ⁽ⁱ⁾ £m	Change %	Q2 2014 £m	Q2 2013 ⁽ⁱ⁾ £m	Change %
International division	48	70	(31)	25	35	(29)
Discontinued Lombard	75	87	(14)	46	40	15

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

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.

	HY 2014 £m	HY 2013 ⁽ⁱ⁾ £m	Change %	Q2 2014 £m	Q1 2014 £m
UK division					
– Corporate Benefits	1,529	1,213	26	788	741
– Protection	336	290	16	163	173
– Retirement Income	299	324	(8)	152	147
Total UK division	2,164	1,827	18	1,103	1,061
Heritage division	138	239	(42)	75	63
International division	343	499	(31)	176	167
Total Group - Continuing	2,645	2,565	3	1,354	1,291
Discontinued - Lombard	727	872	(17)	448	279
Total Group	3,372	3,437	(2)	1,802	1,570

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

Appendix 2: Additional information

Analysis of new business strain

A reconciliation from free surplus investment in new business to cash strain and to IFRS strain is set out below. Tax and other items include the cumulative adjustments for tax and long-term investment return which use different assumptions across the MCEV, regulatory ("or cash") and IFRS bases. IFRS strain also includes DAC/DFF and other IFRS adjustments.

£m	UK	Heritage	Int'l	HY 2014	Restated HY 2013
Investment in new business	(55)	(19)	(14)	(88)	(98)
Movement in required capital, tax and other items	33	1	1	35	26
New business cash strain	(22)	(18)	(13)	(53)	(72)
DAC/DFF	6	2	36	44	67
Other IFRS adjustments	(1)	1	(32)	(32)	(34)
IFRS new business strain	(17)	(15)	(9)	(41)	(39)

Analysis of IFRS in-force surplus

A reconciliation from free surplus expected return on in-force business to cash surplus and to the IFRS surplus is set out below.

£m	UK	Heritage	Int'l	HY 2014	Restated HY 2013
Expected return from in-force business	56	252	28	336	329
Movement in required capital, tax and other items	(13)	(62)	(4)	(79)	(76)
In-force cash surplus	43	190	24	257	253
DAC/DFF	(7)	(17)	(26)	(50)	(34)
Other IFRS adjustments	5	15	48	68	63
IFRS in-force surplus	41	188	46	275	282

Analysis of non-core OLAB business sustainable free surplus contribution

£m	HY 2014	HY 2013
Expected return from in-force business	13	13
Investment in new business	(1)	(16)
Underlying free surplus	12	(3)

Appendix 3 - Non-core OLAB inter-divisional restatement

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

£m

	HY 2013					FY 2013				
	Reported FPI	Reported Heritage	OLAB	Restated FPI	Restated Heritage	Reported FPI	Reported Heritage	OLAB	Restated FPI	Restated Heritage
IFRS operating profit										
New business strain	(24)	(8)	(13)	(11)	(21)	(40)	(25)	(16)	(24)	(41)
In-force surplus	79	153	24	55	177	140	264	40	100	304
Long-term investment return	-	(37)	-	-	(37)	(1)	(84)	-	(1)	(84)
Principal reserving changes and one-off items	3	(3)	3	-	-	15	141	18	(3)	159
Development costs	(4)	(2)	(1)	(3)	(3)	(10)	(7)	(3)	(7)	(10)
Other income and charges	-	-	-	-	-	(2)	2	-	(2)	2
IFRS based operating profit before tax	54	103	13	41	116	102	291	39	63	330

£m

	HY 2013					FY 2013				
	Reported FPI	Reported Heritage	OLAB	Restated FPI	Restated Heritage	Reported FPI	Reported Heritage	OLAB	Restated FPI	Restated Heritage
MCEV operating profit										
Value of new business	4	(8)	(5)	9	(13)	14	(19)	(7)	21	(26)
Expected existing business contribution	9	106	1	8	107	19	211	3	16	214
Operating experience variances	1	(14)	(1)	2	(15)	13	(12)	10	3	(2)
Operating assumption changes	-	34	-	-	34	14	93	3	11	96
Other operating variances	-	30	1	(1)	31	9	127	11	(2)	138
Development costs	(4)	(2)	(1)	(3)	(3)	(10)	(7)	(3)	(7)	(10)
Other income and charges	-	-	-	-	-	(2)	-	-	(2)	-
Operating profit/(loss) before tax	10	146	(5)	15	141	57	393	17	40	410

£m

	HY 2013					FY 2013				
	Reported FPI	Reported Heritage	OLAB	Restated FPI	Restated Heritage	Reported FPI	Reported Heritage	OLAB	Restated FPI	Restated Heritage
SFS										
Expected return from in-force business	57	223	13	44	236	97	442	20	77	462
Investment in new business	(40)	(20)	(16)	(24)	(36)	(61)	(30)	(22)	(39)	(52)
Underlying free surplus generation	17	203	(3)	20	200	36	412	(2)	38	410
Development costs	(4)	(1)	(1)	(3)	(2)	(9)	(7)	(2)	(7)	(9)
Operating experience	1	(18)	1	-	(17)	18	27	18	-	45
Other operating items	(1)	(2)	2	(3)	-	(9)	(1)	-	(9)	(1)
Other income and charges	-	-	-	-	-	(2)	-	-	(2)	-
Sustainable free surplus generation	13	182	(1)	14	181	34	431	14	20	445

Appendix 4 – Lombard discontinued operations Group restatement

£m	HY 2013			FY 2013		
	Reported Group	Lombard	Restated Group	Reported Group	Lombard	Restated Group
IFRS operating profit						
New business strain	(55)	(16)	(39)	(97)	(31)	(66)
In-force surplus	319	37	282	541	68	473
Long-term investment return	(31)	-	(31)	(69)	-	(69)
Principal reserving changes and one-off items	2	-	2	164	-	164
Development costs	(26)	(1)	(25)	(50)	(3)	(47)
Other income and charges	(18)	-	(18)	(53)	-	(53)
IFRS based operating profit before tax	191	20	171	436	34	402

£m	HY 2013			FY 2013		
	Reported Group	Lombard	Restated Group	Reported Group	Lombard	Restated Group
MCEV operating profit						
Value of new business	97	12	85	204	25	179
Expected existing business contribution	126	18	108	248	33	215
Operating experience variances	(31)	(18)	(13)	(57)	(25)	(32)
Operating assumption changes	34	-	34	19	(82)	101
Other operating variances	30	-	30	178	6	172
Development costs	(26)	(1)	(25)	(50)	(3)	(47)
Other income and charges	(16)	-	(16)	(53)	-	(53)
Operating profit/(loss) before tax	214	11	203	489	(46)	535

£m	HY 2013			FY 2013		
	Reported Group	Lombard	Restated Group	Reported Group	Lombard	Restated Group
SFS						
Expected return from in-force business	351	22	329	682	44	638
Investment in new business	(110)	(12)	(98)	(213)	(24)	(189)
Underlying free surplus generation	241	10	231	469	20	449
Development costs	(20)	(1)	(19)	(41)	(2)	(39)
Coupon on debt	(45)	-	(45)	(92)	-	(92)
Operating experience variances	(17)	(3)	(14)	25	(9)	34
Other operating items	(2)	(1)	(1)	2	(3)	5
Other income and charges	(10)	-	(10)	(32)	-	(32)
Sustainable free surplus generation	147	5	142	331	6	325

Appendix 5 – Analysis of Heritage division and Corporate Benefits pensions

£m	Number of customers (millions)	In-force Premium (£m)	Assets under administration (£bn)
Heritage division ⁽ⁱ⁾	1.0	210	27.6
Corporate Benefits	1.3	920	20.8
Total	2.3	1,130	48.4

(i) Heritage division data includes unit-linked and with-profits pension business.

Corporate Benefits assets under administration includes £13.4bn of active investments which have an average investment management charge of <15bps, and £7.4bn of passive investments which have an average investment management charge of <5bps.

Definitions

AmFamily means AmFamily Takaful Berhad

AmLife means, collectively, AmFamily and AmLife Insurance Berhad

Annual Premium Equivalent (“APE”) represents annualised new regular premiums plus 10% of single premiums.

Annualised operating return on embedded value is calculated as the MCEV operating profit after tax over the period divided by the net Group MCEV at the start of the period adjusted to allow for the timing of dividend payments and any acquisitions or disposals through the period. Where the period is not a full year, the calculated rate is then annualised.

Asset quality is the percentage of corporate bonds and asset-backed securities in the shareholder and non-profit funds at investment grade compared to the total of such assets in these funds.

Asset share is a measure of the share of assets attributable to a with-profits policy, calculated by accumulating premiums paid at the rates of return earned on the assets assumed to be backing the policy, after allowing for deductions for partial payments of benefits and charges such as expenses, mortality, distributions to shareholders and tax.

Available shareholder assets (“ASA”) 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.

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.

Core International consists of Friends Provident International Limited and excludes all non-core FPI business (OLAB, AmLife).

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

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.

IFRS based operating profit/(loss) is the profit (or loss) based on longer-term investment return excluding: (i) all investment return variances from expected investment return which is calculated on a long-term rate of return, (ii) policyholder tax, (iii) returns attributable to minority interests in policyholder funds, (iv) significant non-recurring items, (v) amortisation and impairment of acquired intangible assets and present value of acquired in-force business; and is stated after deducting interest payable on STICS.

IFRS profit/(loss) after tax is the profit (or loss) after tax as shown in the consolidated income statement.

IGCA surplus is the Insurance Groups Capital Adequacy surplus capital as defined by the PRA in the Insurance Groups Directive. It is calculated as the surplus of the available capital resources over the capital resources requirement. It excludes the surplus capital held within the long-term funds.

Internal Model Approval Process (“IMAP”) is the process whereby the PRA reviews and approves the appropriateness of a firm’s internal model for use within the Solvency II framework.

Internal rate of return (“IRR”) on new business is equivalent to the discount rate at which the present value of the after tax cash flows expected to be earned over the lifetime of the business written is equal to the capital invested to support the writing of the business. With the exception of investment return, all assumptions and expenses are consistent with those used for calculating VNB. IRR assumes best estimate investment returns after an allowance for default risk, whereas VNB assumes (market consistent) risk-free rates. IRR also takes into account the funding and release of regulatory capital requirements.

MCEV operating profit/(loss) is the MCEV profit (or loss) based on expected investment return and excludes: (i) amortisation and impairment of non-covered business acquired intangible assets, (ii) effect of economic variances (including the impact of economic assumption changes) and (iii) significant non-recurring items.

MCEV profit/(loss) after tax is the MCEV profit (or loss) after tax as shown in the consolidated income statement - MCEV basis.

New business margins are defined as the pre-tax VNB divided by the PVNBP.

New Life Tax Regime (“NLTR”) refers to legislation enacted in the Finance Act 2012 and supporting regulations. NLTR applies to life insurance companies with effect from 1 January 2013 and has not altered the “I minus E” basis of taxation.

Pillar 1 surplus is the excess of capital resources over capital resource requirements calculated in accordance with regulatory requirements.

Pillar 2 surplus is the excess of capital resources over the capital calculated on an economic basis required to ensure that the regulated entities can meet their liabilities, with a high likelihood, as they fall due. The result is reviewed and may be modified by the PRA. Pillar 2 requirements are not generally disclosed.

Present value of new business premiums (“PVNBP”) represents new single premiums plus the expected present value of new business regular premiums expressed at the point of sale.

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

Resolution Operations LLP (“ROL”) is a privately owned advisory and operating firm which, as part of the Resolution Group, has provided services to Resolution Limited within the framework of an operating agreement. On 27 March 2013, under a Business Sale Agreement, ROL transferred to the Company business activities that related to the services provided to the Company and the ROL employees who provided the services. At the same time, ROL ceased to provide services to the Company.

Shareholder resources are a measure of the tangible assets available to the life and pensions business and attributable to shareholders. The movement in shareholder resources provides a view of the sustainability of the business model. Shareholder resources are based on shareholders’ invested net assets included within the embedded value.

Shareholders and Investors In this Report, these terms are used variously to describe investors who hold shares in 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 policyholders and reducing the possibility of market disruption in insurance. The new regime will now formally come into force on 1 January 2016.

Sustainable Free Surplus (“SFS”) is the surplus generated within 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
AVIF	Acquired Value of In-Force
AXA IM	AXA Investment Management
BHA	Friends Life BHA Limited
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGU	Cash Generating Unit
CMI	Continuous Mortality Investigations
CMIR	Continuous Mortality Investigations Report
CMPs	Capital Management Policies
CNHR	Cost of Non-Hedgeable Risk
COP	Capital Optimisation Programme
CRO	Chief Risk Officer
CRR	Capital Resource Requirements
DAC	Deferred Acquisition Costs
DFF	Deferred Front End Fees
DPF	Discretionary Participation Features
EBC	Employee Benefit Consultant
EBR	Equity Backing Ratio
ECJ	European Court of Justice
EEA	European Economic Area
ERC	Executive Risk Committee
EU	European Union
FAL	Friends Annuities Limited
FASLH	Friends ASLH Limited
FCA	Financial Conduct Authority
FLAS	Friends Life Assurance Society Limited
FLC	Friends Life Company Limited
FLDL	Friends Life Distribution Limited
FLGL	Friends Life Group Limited (formerly known as Resolution Limited)
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	Financial Business Partners AG
FPI	A segment within the International division comprising FPIL (Friends Provident International Limited)
FPL	Friends Life FPL 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
FUM	Funds Under Management
GAO	Guaranteed Annuity Options
GCE	Group Chief Executive
GEC	Group Executive Committee
GMP	Guaranteed Minimum Pension
HNWI	Higher Net Worth Individuals
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICA	Individual Capital Assessment
ICG	Individual Capital Guidance
IFA	Independent Financial Adviser
IFRIC	IFRS Interpretation Committee
IFRS	International Financial Reporting Standards
IGCA	Insurance Groups Capital Adequacy
IMAP	Internal Model Approval Process
INB	Investment in New Business
IPEV	International Private Equity and Venture Capital
IRR	Internal Rate of Return
KPI	Key Performance Indicator
LDI	Liability Driven Investment
LTIP	Long-Term Incentive Plan
LT2	Lower Tier 2
MCEV	Market Consistent Embedded Value
MVR	Market Value Reduction
NBS	New Business Strain
NGP	New Generation Pension
NLTR	New Life Tax Regime
NPF	Non-Profit Fund
OCI	Other Comprehensive Income
OEIC	Open Ended Investment Company
OLAB	Overseas Life Assurance Business
OMO	Open Market Option
PBSE	Post-Balance Sheet Event
PPFM	Principles and Practices of Financial Management
PRA	Prudential Regulation Authority

PUP	Paid Up Policies
PVFP	Present Value of Future Profits
PVNB	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
SSF	Segregated Sub Fund
STICS	Step-up Tier one Insurance Capital Securities
TIP	Trustee Investment Plan
TVOG	Time Value of financial Options and Guarantees
UT2	Upper Tier 2
VIF	Value of In-Force
VLN	Vendor Loan Note
VNB	Value of New Business
WPF	With-Profits Fund
WPICC	With Profits Insurance Capital Component