

**FRIENDS PROVIDENT GROUP PLC**  
**FINANCIAL STATEMENTS AND**  
**DIRECTORS' REPORT**  
**FOR THE YEAR ENDED 31 DECEMBER 2009**

**REGISTERED NUMBER 6861305**

**Registered address: Pixham End, Dorking, Surrey RH4 1QA**

**FRIENDS PROVIDENT GROUP PLC  
REPORT OF THE DIRECTORS  
FOR THE YEAR ENDED 31 DECEMBER 2009**

**Directors**

D Allvey (Independent Director) –Appointed 5 November 2009  
E B Bourke (Chief Financial Officer) – Appointed 1 May 2009  
C A Cowdery (Non-executive Director) – Appointed 5 November 2009  
N S L Lyons (Independent Director) – Appointed 1 February 2010  
T J Matthews (Chief Executive Officer) – Appointed 16 April 2009  
R A Phipps (Independent Director) – Appointed 16 April 2009  
G B K Roggemann (Independent Director) – Appointed 16 April 2009  
D A Ross (Independent Director) – Appointed 1 February 2010  
J I Tiner (Non-executive Director) – Appointed 5 November 2009  
Sir Malcolm Williamson (Chairman) – Appointed 5 November 2009

The directors present their report for the financial year ended 31 December 2009. This report, together with the financial statements, will be laid before the shareholder in general meeting.

All information in the Annual Report & Accounts, to which this directors' report cross refers, is incorporated by reference in this directors' report.

**Principal activities**

Friends Provident Group plc was incorporated on 27 March 2009 under the Companies Act 1985 as a public limited company. On 15 June 2009, it was inserted as the new holding company of the Friends Provident group of companies (together referred to as the Group or Friends Provident) by means of a Scheme of Arrangement under Part 26 of the Companies Act 2006. On that date, its shares were admitted to the Official List of the UKLA, to enable trading on the London Stock Exchange.

On 4 November 2009, Friends Provident was acquired by Friends Provident Holdings (UK) Limited, a subsidiary of Resolution Limited (Resolution). Its ultimate parent company is Resolution Limited, a Guernsey-based public company with a primary listing on the London Stock Exchange.

The Group's principal activities comprise manufacturing and administering life and pensions products in the UK and related international markets. This encompasses the UK protection market, UK group pensions and vesting annuity market and international savings and investments, pensions and protection markets.

Particulars of the main subsidiary and associated undertakings are shown on page 78. Friends Provident Life and Pensions Limited has a branch office in Guernsey. Friends Provident International Limited, which is based in the Isle of Man, has branches in Dubai, Hong Kong and Singapore. Lombard International Assurance S.A. is based in Luxembourg and has branches in Switzerland and Finland.

## **Business review and future developments**

### **Trading summary**

The trading environment has been especially tough with the UK in recession for much of the year and slower business in most International markets, especially early in the year. Friends Provident continued to pursue its strategy, set out in January 2008, to deliver improved returns from its life and pensions business. This strategy has allowed Friends Provident to report improved cash generation compared to previous years. A large part of this improvement is due to the planned exit from the commission paying parts of the pensions market and a reduction in the cost base of the business. As a result of this, and reflecting the difficult market conditions, new business volumes were lower in the UK.

This constrained the reported profitability of new business in the UK. The latter part of the year saw improving client sentiment in International markets and opportunities for Lombard to write considerable volumes of new business. Each of the International businesses continues to have strong prospects based on being well established and respected in their chosen markets.

### **Strategy implementation**

A key element of Friends Provident's strategy is to drive out cost savings to deliver improved returns for shareholders. Friends Provident has completed its two year plan to deliver its targeted £80 million savings, reducing the UK and corporate cost base from a total of £275 million in 2007 to £223 million in 2009 and forecast to be below £215 million in 2010. This represents a reduction of over 20% on the 2007 cost base. These cost savings have been reflected in statutory reserve calculations, resulting in a positive £55 million item in shareholder cash generation for reduced expense reserves.

On 3 July 2009, Friends Provident demerged its 52% stake in F&C Asset Management plc by distributing the shares to its shareholders, a further important milestone in the execution of the strategy set out at the start of 2008.

### **Group reorganisation, debt restructure and acquisition by Resolution Limited**

Depressed debt market conditions in 2009 enabled the buy back of £322 million of Step-up Tier one Insurance Capital Securities (STICS). In May 2009 Friends Provident plc, the then holding company of the Friends Provident group, offered holders of its two STICS the opportunity to exchange their holdings for a new subordinated instrument maturing in 2021. Holders of £322 million of the debt outstanding before the exchange elected to receive £162 million of the new issue. This transaction allowed the Company to reduce the ultimate amount of debt outstanding, extend the call and maturity dates and modestly reduce annual interest costs, with no detriment to policyholder interests or IGD surplus. The net impact of the financial restructuring is to increase equity attributable to ordinary shareholders by £113 million. Further details are set out in note 34.

In order to create sufficient distributable reserves to pay the final 2008 dividend and distribute the Group's stake in F&C, the Company was inserted as a new holding company on 15 June 2009 following a court-sanctioned reorganisation. On that date, its shares were admitted to the Official List of the UKLA to enable trading on the London Stock Exchange.

On 3 July 2009, the Company demerged its 52% stake in F&C Asset Management plc by distributing the shares to its own shareholders. Small shareholders who would have received 250 or fewer F&C shares were mainly paid in cash raised through a placement of their shares in the market. The demerger effectively returned 6.2 pence per Friends Provident share. The Company covered the costs of the transaction by selling residual shares in F&C.

Subsequent capital reductions have created a significant amount of distributable reserves. The Company declared and paid on 24 July 2009 a dividend of 2.6 pence per share representing the final dividend for 2008. On 9 October 2009 the Company declared and paid a dividend of 1.3 pence per share being an interim dividend in respect of 2009.

On 4 November 2009, Friends Provident Holdings (UK) Limited, a subsidiary of Resolution, acquired a 100% interest in the Company. The purchase of the Group was the first acquisition by Resolution as part of its strategy to seek consolidation and restructuring opportunities in the life insurance sector.

### **Outlook**

Friends Provident has good prospects in overseas markets while the UK market will remain challenging and highly competitive.

There are signs of returning demand in a number of FPI's markets, including the key Hong Kong operation. It is expected that available returns and growth prospects will remain attractive for this business. AmLife continues to develop new opportunities in Malaysia. Lombard's outlook remains positive, having made strides in Switzerland in 2009 and with uncertainty around the tax regimes in Spain and Germany in 2009 now largely resolved. Lombard looks forward to continuing to improve the cash flow characteristics of its products.

Friends Provident will focus on writing profitable new business in its chosen markets and increasing the value from its in-force book. Friends Provident provides a strong and stable base for Resolution's strategy for consolidation and restructuring in UK life and pensions and asset management markets.

## Financial performance

### Key performance indicators

	Full year ended	
	31 Dec 2009	31 Dec 2008 (ii)
<b>IFRS</b>		
IFRS based operating profit/(loss) (i) before tax	<b>£272m</b>	£(246)m
IFRS profit/(loss) before tax from continuing operations	<b>£218m</b>	£(588)m
<b>Shareholder cash generation</b>		
Life and pensions net cash operating surplus	<b>£120m</b>	£(131)m
Shareholder cash generation/(outflow)	<b>£233m</b>	£(361)m
Internal rate of return on new business (i)	<b>12.3%</b>	12.9%
Undiscounted cash payback on new business (i)	<b>11 years</b>	11 years
<b>Capital</b>		
IGD estimated surplus capital resources (i)	<b>£1.02bn</b>	£0.83bn

(i) As defined in Appendix 1

(ii) The 2008 figures have been restated to exclude the results of the demerged asset management business which are presented as a discontinued operation in the consolidated income statement

#### IFRS

- Increased IFRS based operating profit before tax of £272 million (2008: £(246) million), with new business strain and in-force surplus both improved, plus significant benefit from the recovery in corporate bond assets backing annuity business of £176 million (2008: £217m charge).
- IFRS profit before tax from continuing operations was £218 million (2008: £(588)m) reflecting the improvements in IFRS based operating profit and the turnaround in the returns attributable to third parties.

#### Shareholder cash generation

- In-force surplus increased to £309 million (2008: £243m) with improved cash flows from higher annual management charge income as funds under management increased for UK pensions, FPI and Lombard.
- New business strain in the UK reduced to £(113) million from £(150) million in 2008 due to lower volumes of unfunded commission paying pensions business and reduced acquisition expenses, while FPI and Lombard new business strain decreased slightly to £(150) million from £(153) million.
- Life and pensions net cash operating surplus grew to £120 million from a £(131) million deficit in 2008, largely due to the recovery in corporate asset values.
- Internal rate of return on new business was 12.3% (2008: 12.9%) and undiscounted cash payback was 11 years (2008: 11 years) as higher profitability of annuity business was offset by reduced volumes in the UK.

## Summary of IFRS results

	2009	2008
	£m	£m
UK	261	(243)
FPI	(19)	(14)
Lombard	11	11
All other	15	11
Corporate	4	(11)
<b>IFRS based operating profit/(loss) before tax</b>	<b>272</b>	<b>(246)</b>
Non-recurring items	(86)	(51)
Amortisation and impairment of intangibles	(71)	(40)
Interest payable on STICS	39	52
Short-term fluctuations in investment return	(19)	(71)
Returns on funds attributable to third parties	16	(154)
Policyholder taxation	67	(78)
<b>IFRS profit/(loss) before tax from continuing operations</b>	<b>218</b>	<b>(588)</b>

IFRS based operating profit before tax for the 12 months has increased significantly from £(246) million to £272 million, primarily due to the UK result.

The UK result was largely due to the strong positive impact from improved credit market conditions and adjustments to the reserving basis of £176 million compared to £(217) million, as well as some improvement in operating flows (in force surplus less new business strain).

The FPI result saw stronger operating flows offset by negative one offs of £30 million, including additional expense reserves on German business.

The Lombard result has benefited from the improvement in operating flows (in force surplus less new business strain).

Corporate result has increased due to the recharge of 2009 corporate expenses to the UK life and pensions business.

Non recurring items comprised, strategic review costs of £49 million (2008: £42m), Group reorganisation costs of £41 million and other net items of £(4) million (2008: £9m).

Amortisation and impairment of intangibles related to acquired VIF £25 million (2008: £26m), other amortisation £15 million (2008: £14m) and impairment of £31 million.

Interest payable on STICS was reduced because of the buyback of £322 million STICS in 2009.

The returns on funds attributable to third parties related primarily to the non-Group share of the profits from F&C Commercial Property Trust plc.

The movement in taxation was due to improved investment returns in 2009.

## New business sales and profitability

	<b>APE</b> <b>2009</b> <b>£m</b>	APE 2008 £m	APE Change %
UK Corporate	<b>319</b>	429	(26)
UK Individual	<b>89</b>	120	(26)
<b>UK Total</b>	<b>408</b>	549	(26)
FPI	<b>183</b>	210	(13)
Lombard	<b>273</b>	246	11
AmLife	<b>9</b>	n/a	n/a
<b>Intl Total</b>	<b>465</b>	456	2
<b>Total</b>	<b>873</b>	1,005	(13)

Total new business APE was down 13% in 2009. This reflects Friends Provident's decision in 2008 to withdraw from less profitable lines of business in the UK (most notably unfunded commission paying pensions and investment bonds) and the continuing difficult global market conditions experienced by the life industry in 2009. In the UK, £95 million of the reduction in Corporate APE was due to lower increments on existing schemes in the depressed economic conditions.

International new business increased by 2%, benefiting from exchange rate movements (down 5% in constant currency terms), strong inflows to Lombard from Italy and Belgium, and the addition of Friends Provident's 30% share of AmLife's APE.

The IRR on new business was 12.3% down from 12.9% in 2009. Annuities contributed significantly to the UK business IRR. Overall, cash payback period (undiscounted) remained unchanged.

### Shareholder cash generation

Shareholder cash generation is the cash and capital generated by the business during the year that is available to cover capital requirements and meet dividends. This is calculated on the regulatory basis and includes tax, realised and unrealised investment movements and one-offs. IFRS based operating profit can be reconciled to shareholder cash generation as follows:

	<b>2009</b> <b>£m</b>	2008 £m
<b>IFRS based operating profit/(loss) before tax</b>	<b>272</b>	(246)
Taxation	<b>72</b>	27
Non-recurring items	<b>(58)</b>	(78)
DAC and DFF	<b>(25)</b>	(60)
IFRS reserving	<b>(5)</b>	26
Other	<b>(23)</b>	(30)
<b>Shareholder cash generation</b>	<b>233</b>	(361)

Taxation is adjusted for as shareholder cash generation is net of taxation, based on the regulatory reserving basis.

Non-recurring items in 2009 consists primarily of £57 million of Group reorganisation costs and £7 million strategic review costs, less £10 million of pension service credit due to the restructuring of pension scheme benefits whilst non-recurring items in 2008 were principally strategic review costs. The regulatory basis for recognising strategic review costs differs to the IFRS basis in recognising a provision for the costs made at the end of 2008.

Deferred Acquisition Costs (DAC) and Deferred Front-End Fees (DFF) are accounting adjustments for deferral purposes to match expense items against future income.

IFRS reserving represents differences between the IFRS basis for insurance accounting and the regulatory basis used in reporting cash generated.

The other category consists mainly of variances in investment income from expected return, dividends received from discontinued business and expected return on pension assets.

### Summary of Shareholder cash generation

	2009	2008
	£m	£m
In-force surplus	309	243
New business strain	(263)	(303)
<b>Life and pensions gross cash generation</b>	<b>46</b>	(60)
Tax and other items	74	(71)
<b>Life and Pensions net cash operating result</b>	<b>120</b>	(131)
Investment return and other items	(63)	(13)
<b>Shareholder cash generation before credit spread effects</b>	<b>57</b>	(144)
Effect of credit spreads on assets and liabilities for annuities	176	(217)
<b>Shareholder cash generation</b>	<b>233</b>	(361)

Shareholder cash benefited from better UK gross cash generation of £52m (2008: £(20)m) together with a considerably improved impact of annuities, largely due to the recovery in the corporate bond market.

### Insurance Groups Directive (IGD) surplus resources

The capital position of Friends Provident strengthened with an estimated IGD surplus of £1.02 billion (2008: £0.83bn). The ratio of capital resources to capital requirement was 166%, reflecting capital resources of £2.5 billion less requirements of £1.5 billion.

The movement in IGD surplus from 31 December 2008 to 31 December 2009 can be analysed as follows:

	£bn
<b>Surplus 31 December 2008</b>	<b>0.83</b>
Payment of dividends and interest on long-term debt	(0.15)
Net transfers from long-term funds	0.21
F&C demerger	0.20
Acquisition of FpB and Resolution acquisition costs	(0.05)
Other	(0.02)
<b>Estimated surplus 31 December 2009</b>	<b>1.02</b>

A significant stress test to the IGD surplus has been carried out, comprising a fall in equity and property market values of 30% and 20% respectively, 300 basis points widening of credit spreads and a rise in risk-free rates of 100 basis points. The estimated IGD surplus as at 31 December 2009 under these combined stresses was £0.8 billion. The equity stress was not a material driver of the movement.

### Dividends

On 24 July 2009, the Company paid an interim dividend of 2.6 pence per share in respect of the year ended 31 December 2009 in lieu of the final dividend for 2008 payable by Friends Provident plc. Prior to the acquisition of the Company by Resolution, the Company paid a further interim dividend of 1.3 pence per share on 9 October 2009.

The Directors are declaring an interim dividend of £100 million payable on 30 March 2010.

### **Share capital**

The issued share capital of the Company as at 31 December 2009 consisted of 2,340,000,040 Ordinary Shares of 5p each and one deferred shares of 5p. Information on shareholder rights, including voting rights, is included in note 39 on page 120.

### **Directors**

Details of Board members at the date of this report are set out on page 2. Sir Mervyn Pedelty, former Chairman, was appointed a director on 16 April 2009 and ceased to be a director on 26 January 2010.

In addition, the following directors served during the year. Unless otherwise stated, all were appointed on 16 April 2009:

C A J Bellringer (Resigned 30 April 2009)

A L Grisay (Resigned 3 July 2009)

R G Hughes (Resigned 5 November 2009)

Lady Judge (Resigned 21 May 2009)

R King (Resigned 5 November 2009)

D Rough (Resigned 5 November 2009)

Sir Adrian Montague (Resigned 5 November 2009)

Hackwood Directors Limited (Appointed 27 March 2009; resigned 16 April 2009)

Paul Alan Newcombe (Appointed 27 March 2009; resigned 16 April 2009)

Other than their employment and service contracts, the indemnity referred to below and the related party transactions referred to in note 44 on page 125, there were no contracts in existence during or at the end of the financial year in which a director of the Company was interested.

### **Employees**

The Group's commitment to open collaboration and involvement with its employees continues. The methods used to implement this policy include:

- management briefings or presentations and discussion through the management structure;
- the issue of a full range of employee communications via the Company's intranet or other internal publication of relevant information, which inform employees of current issues, developments and progress;
- an established and regular staff opinion survey that encourages employees anonymously to present their views, thereby generating workplace and business improvements; and
- the establishment of effective working relationships with employee representative bodies.

The primary aim of all of these activities is to ensure employees know the objectives and activities of the Group so that they can contribute fully to their continued success.

The Company is committed to providing equal opportunities for all irrespective of their gender, sexual orientation, marital status, race, religion, age, disability, nationality, ethnic origin or union membership status in all its dealings with employees. The Company is an inclusive employer and values the diversity in its employees. These commitments extend to

recruitment and selection, training, career development, flexible working arrangements, promotion and performance management.

The Company respects the dignity of individuals and their beliefs. The Company does not tolerate any sexual, racial, physical or mental harassment of employees in the workplace.

The Group has amongst its employees a number who are disabled. It gives full and fair consideration to applications for employment from disabled persons. In the event of employees becoming disabled, every effort is made to ensure that their employment with the Group continues and to provide specialised training where this is appropriate.

### **Creditor payment policy**

While the Company does not follow any code or standard on payment practice, it is the Company's policy to adhere to the payment terms agreed with individual suppliers and to pay in accordance with their contractual and other legal obligations. The standard payment terms of the Company and the UK life and pensions subsidiaries require settlement within 30 days.

The ratio, expressed in days, between the amount invoiced to the Group by its suppliers during 2009 and the amount owed to its trade creditors at 31 December 2009, was 7 days (2008: 10 days).

### **Use of financial instruments**

Information on the Group's risk management process and the policies for mitigating certain types of risk are set out on pages 100 to 115. Details of the financial instruments used for these purposes are on pages 105 to 110 in note 31 to the accounts.

### **Environment**

The Company's engagement and commitment to environmental issues is explained on its website at [www.friendsprovident.com/responsibility](http://www.friendsprovident.com/responsibility)

### **Charitable and political donations**

Friends Provident has a long history of supporting the communities directly affected by its operations through an employee-led programme, which benefits the Company's business and community needs. Full details of the community investment programme are available at [www.friendsprovident.com/responsibility](http://www.friendsprovident.com/responsibility). In 2009, cash donations to charitable causes amounted to £436,859.

During 2009, the Friends Provident Charitable Foundation, an independent grant-making charity, continued to focus its resources on financial inclusion and grants approved amounted to £491,021. Details of all aspects of the Foundation's work can be found at [www.friendsprovidentfoundation.org](http://www.friendsprovidentfoundation.org)

No political donations were made by the Group during 2009 (2008: nil).

### **Significant agreements: Change of control**

The Company benefits from a £300 million multi-currency revolving credit facility with Barclays Capital, Citigroup Global Markets Limited, HSBC Bank Plc and The Royal Bank of Scotland Plc, with HSBC Bank Plc as agent, entered into on 26 April 2006 (as amended). If a third party, who does not presently have control of the Company, acquires such control, the Company must notify the agent immediately. In this circumstance, the lenders are not obliged to fund utilisation and may notify the agent to cancel their commitments under the

facility. This would have the effect of rendering all of their loans immediately repayable. As at the date of this report, the facility remains undrawn.

### **Directors and officers – Indemnity and insurance**

The Company's parent, Friends Provident Holdings (UK) Limited, maintains insurance cover with respect to the liabilities of directors and officers within the Group. In addition, qualifying third party indemnity arrangements (as defined in section 234 of the Companies Act 2006) are in force for the benefit of the directors within the Group and were in force for the benefit of former directors of the Group during 2009. Copies are available for inspection at the Company's registered office.

### **Principal risks and uncertainties**

The Board believes that the principal risks and uncertainties facing the Group are as set out below and is satisfied that there are appropriate arrangements in place to manage and mitigate them.

### **Financial market and economic conditions**

The earnings and profitability of the Group's businesses are influenced by a number of factors including the performance and liquidity of investment markets, interest rate movements and inflation. The Group uses a number of risk management techniques to mitigate the volatility from these factors. The Group cannot control extreme market events and these can affect the successful implementation of its strategies. The approach to the management of financial risk is given in note 31 to the financial statements.

### **Regulation and legislation**

Companies within the Friends Provident group, both in the UK and internationally, operate in highly regulated markets. This regulation impacts on all aspects of the Group's business, including the design, marketing and distribution of products, the acceptance and administration of business and the capital that Group companies are required to hold. Government policy on taxation can also impact on the design of the Group's products, on its ability to retain existing business and the reserves held for future liabilities.

### **Competitor activity and business model**

Companies in the Friends Provident group operate in highly competitive markets. The long-term success of its business model envisages the achievement of a scale that allows margins to rise and payback periods to fall to levels that provide greater returns for its shareholder. This must be achieved against a backdrop of strong competition and sometimes aggressive pricing that puts pressure on margins and working capital. The consolidation and restructuring strategy of Resolution should, if successfully executed, strengthen the Group's position in the UK market in particular, but further acquisitions are not guaranteed and the timing of their occurrence is outside its direct control.

### **Counterparty and third party risks**

The management of exposure to default risks associated with issuers of corporate debt and financial instruments and in relation to reinsurance transactions is set out in note 31 to the financial statements. Other exposures to third party risks include:

- a significant level of financial failure among distributors; and
- failure of one or more external suppliers of administration and IT services (outsourced service providers).

These risks are managed through appropriate due diligence at the outset or renewal of business relationships and the monitoring the performance against key service levels or other metrics.

### **Reputation and contagion risks**

The reputation of companies with the Friends Provident group, or of the Group as a whole, can be affected by events that impact on organisations with which group companies have business relationships, by internal process failures and by the consequences of external events. The actions of the Group's ultimate parent company and its associates and partners can also have an influence on Friends Provident's reputation and its ability to attract new business. In particular, uncertainty about the nature and timing of potential future transactions by Resolution in pursuit of its stated consolidation and restructuring strategy within the UK life and pensions sector may impact the confidence of distributors in Friends Provident's UK franchise. The delivery of Friends Provident's strategy and effective communication with its key distribution partners remains central to our management of this risk, although the ultimate delivery of Resolution's strategy is outside the control of the Friends Provident Group plc board.

### **The timing and scale of the occurrence of insured events**

The nature of the business conducted by many Group companies involves the underwriting of events whose occurrence cannot be accurately predicted. For example, in the UK Friends Provident issues life assurance policies that provide protection in the event of death for those taking our mortgages for house purchase. The management of these insurance risks is described in Note 31 to the financial statements, but extreme events affecting mortality or morbidity may affect the companies' solvency, profitability and earnings.

### **Other assumptions**

In addition to pricing for mortality and morbidity risks, as part of the processes to determine the value of long term liabilities, Group companies make assumptions about other factors including lapse rates, interest rates and counterparty defaults. Assumptions are subject to rigorous review, with the use of stress testing of key parameters forming part of the processes used to calculate our capital holdings. However, extreme movements in financial markets and in the broader economic environment may require certain assumptions to be recalibrated, impacting the earnings and other financial metrics.

### **Future developments in retirement planning**

One of Friends Provident's key UK markets is the provision of pensions for groups of employees. The market for such schemes is influenced by a number of factors including government policy, social conditions and the general economic environment. In particular, the government's plans for a National Employment Savings Trust (previously called Personal Accounts) may have an impact for the Group's schemes and the levels of contributions into them. Economic factors also influence the decisions of employers and employees on contributions to such schemes and increases in unemployment will also have an impact on scheme membership levels and revenue generated from such arrangements.

### **Disclosure of information to the Company's auditor**

Each of the directors who held office at the date of approval of this directors' report confirms that, so far as he or she is aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**Statement of 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. 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 and financial performance (including cash generation and financial strength) is set out on pages 2 to 8. In addition, note 31 to the financial statements sets out in detail the Group's risk management objectives and policies for mitigating risks including liquidity risk.

After making enquiries, the directors are satisfied that the Company and the Group have adequate resources to continue to operate as a going concern for the foreseeable future and have prepared the financial statements on that basis.

**Auditor**

In accordance with section 516 of the Companies Act 2006, KPMG Audit plc resigned as auditor of the Company on 5 November 2009. The Company has appointed Ernst and Young LLP to take office as auditor of the Company in accordance with section 485 of the Companies Act 2006. Ernst and Young LLP has indicated its willingness to continue in office and, on the recommendation of the Audit Committee, a resolution to re-appoint Ernst and Young LLP as auditor of the Company will be proposed in General Meeting.

## **Corporate Governance Statement**

The Friends Provident Holdings (UK) Limited Board (FPH Board) has responsibility for the overall governance and management of the Group.

### **Risk management and internal control**

The Group seeks to take appropriate and managed risks in line with the board's risk appetite.

Risk appetite is an expression of the level of acceptable and/or unacceptable risk and is determined by the FPH Board and senior management. The Group's willingness to take on risk is set with reference to its capacity to bear risk. The FPH Board has set risk appetite for the Group as a whole, and has approved more detailed risk appetite statements for the individual businesses.

The categorisation of risk has changed during 2009. Risks are now categorised according a high-level classification covering the twenty principal areas of risk facing the business, including risks arising from the choice of a particular strategy or from external forces that might impair the Group's ability to realise its strategy, and as a result of changes in financial risk factors such as credit, insurance, liquidity and market risks. Other risks arise in the Group's internal processes and systems, through its people or from external events. The FPH Board aims to maintain an appropriate control environment to keep the exposure to risks in line with the agreed risk appetite.

### **Governance**

Operational responsibility within the Group rests with the Chief Executive Officer (CEO), being devolved through an executive structure with clearly delegated and appropriate levels of authority. The CEO has delegated to the Chief Financial Officer responsibility for the development of a risk management framework for the Group appropriate to the nature, scale and complexity of its business. Members of Group management are, therefore, accountable for the operation of the systems of internal control within the Group's core businesses. Business unit management is responsible for putting in place the ongoing management and monitoring disciplines for risks and activities under its control. The structure is designed to provide clear responsibilities and control for key areas of the Group's business, and includes 'whistleblowing' procedures, hosted by an independent third party, to enable staff to raise concerns in confidence. Through these mechanisms, the performance of the business is monitored, risks are identified in a timely manner, their financial implications assessed, control procedures re-evaluated and, where appropriate, corrective actions agreed and implemented. The Group's governance structures for risk management are based on three lines of defence. Primary accountability for managing risk lies with the business units, and with those specialist functions that are responsible for specific operational processes, such as Human Resources, IT and Facilities Management. A second line of defence is provided by specialist functions that undertake policy-setting and monitoring roles, such as Risk and Compliance and Legal. The third line of defence is provided by Group Internal Audit, which has responsibility for providing independent assurance over the risk management process and the internal controls environment. The risk committees within the Group have terms of reference that describe their roles in the identification, assessment, management and monitoring of risk.

### **The FPH Board:**

- is responsible for the risk management framework and for approving risk policy and risk appetite;
- has delegated to the Board Risk and Compliance Committee (BRC) authority to approve the Group's overall risk framework and its risk management policies, and to endorse the risk frameworks of the operating subsidiaries to the extent required by their local statutory obligations; and
- considers quarterly reports summarising the Group's key risks and the actions in place to control them, and receives a brief monthly update on the key risks and issues as part of its regular management information.

### **The Board Risk and Compliance Committee:**

- is a non-executive committee and has oversight of risk management across the Group, including the Financial Risk Committee and the Operational Risk Committee;
- reviews and approves detailed policies for the management of specific classes of risks; and
- considers quarterly reporting from the operating businesses.

### **The Financial Risk Committee and Operational Risk Committee:**

- are chaired by the Chief Financial Officer and the Managing Director, People and Change respectively;
- have oversight of the management of risks across the Group within their respective remits; and
- support the CEO and Friends Leadership Team in ensuring risk management is embedded in the business.

The Financial Risk Committee (FRC) oversees the management of financial and insurance risks of the Group. Within the international business, FPI and Lombard have risk committees comprising executive directors and other relevant senior managers that oversee their risk management processes for all risks and report into their respective boards as well as reporting into the FRC.

The FRC reviews and recommends strategies and policies for market, credit, liquidity and insurance risk management to the BRC. These are reviewed regularly by the FRC on at least an annual basis, to ensure they remain relevant to the changing demands of the business and regulatory environment.

The financial and insurance risk processes are aligned to the business planning process, with risk being identified and evaluated in relation to the achievement of business objectives. The management of financial and insurance risks is led by the Finance function with the Risk function providing oversight.

### **Audit committee**

Appointment to the Committee is made by the FPH Board on the recommendation of the Resolution Limited Nomination Committee in consultation with the Chairman of the Committee. The Committee comprises not less than three members, at least one of whom shall have recent and relevant financial experience.

The members of the Committee are David Allvey (Chairman), Gerhard Roggemann (Independent Director), Robin Phipps (Independent Director) and Jim Newman (Non-

executive Director). The Committee discharges its normal responsibilities, as allocated by its terms of reference, within a schedule of five meetings per year. Of the five scheduled meetings per year, four of those meetings, two at the beginning of each half-year, deal with matters of governance (for example, the effectiveness of internal controls and the external auditors) and the financial results of the Group for the half-year and full year. During the year the Committee may also deal with ad hoc internal control issues that the FPH Board has requested the Committee to investigate.

The Audit Committee has responsibility for the following areas:

- To monitor the integrity of the financial statements of FPH and the Company and any formal announcements relating to the financial performance of such companies.
- To review the effectiveness of systems of internal control and financial reporting.
- To review arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.
- To review the annual internal audit plan and reports issued by internal audit and monitor management's responsiveness thereto. The Committee is also responsible for reviewing the effectiveness of the internal audit function and approving the appointment and termination of appointment of the Director of Internal Audit.
- To approve the scope of the external audit and seek to ensure co-ordination with the activities of the internal audit function.
- To ensure that appropriate plans are in place for the audit at the start of each annual audit cycle.

The Audit and Risk Committee of Resolution Limited, the Company's ultimate holding company, reviews and monitors the independence of the Group's statutory auditor and the provision of additional services to Group companies.



Pixham End  
Dorking  
Surrey  
RH4 1QA

On behalf of the Board  
Diana Monger  
Company Secretary  
23 March 2010

Registration number 6861305

## **Statement of directors' responsibilities in respect of the annual report and accounts**

The directors are responsible for preparing the Directors' Report and group and parent company financial statements, in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law, they have prepared group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and the applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The group financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the Group; the Companies Act 2006 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**Statement of directors' responsibilities pursuant to Disclosure and Transparency Rule 4**

The directors confirm that, to the best of each person's knowledge:

(a) the Group and Company financial statements in this report, which have been prepared in accordance with IFRS and UK GAAP respectively, give a true and fair view of the assets, liabilities, financial position and results of the Company and of the Group taken as a whole; and

(b) the management report contained in this report includes a fair review of the development and performance of the business and the position of the Company and the Group taken as a whole, together with a description of the principal risks and uncertainties that they face.

The names and functions of all of the directors are listed on page 2.



On behalf of the Board  
Evelyn Bourke  
Chief Financial Officer  
23 March 2010

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRIENDS PROVIDENT GROUP PLC**

We have audited the group financial statements of Friends Provident Group plc for the year ended 31 December 2009 which comprise the consolidated income statement, consolidated statement of comprehensive income, the consolidated statement of IFRS based operating profit, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes 1 to 46. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statements set out on pages 17 to 18, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

### **Opinion on financial statements**

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2009 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

### **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

**Other matter**

We have reported separately on the parent company financial statements of Friends Provident Group plc for the year ended 31 December 2009.

*Ernst & Young LLP*

John Headley (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London  
23 March 2010

**Consolidated income statement on an IFRS basis  
For the year ended 31 December 2009**

	Notes	2009 £m	Restated (i) 2008 £m
<b>Revenue</b>			
Gross earned premiums	3	872	949
Premiums ceded to reinsurers	3	(98)	(100)
<b>Net earned premiums</b>	3	<b>774</b>	849
Fee and commission income and income from service activities		613	636
Investment return	4	5,183	(6,375)
<b>Total revenue</b>		<b>6,570</b>	(4,890)
<b>Claims, benefits and expenses</b>			
Gross claims and benefits paid	5	1,470	1,733
Amounts receivable from reinsurers	5	(194)	(191)
<b>Net claims and benefits paid</b>		<b>1,276</b>	1,542
Change in insurance contracts liabilities	28	(541)	(1,017)
Change in investment contracts liabilities	32	4,485	(5,671)
Transfer from fund for future appropriations		(128)	(80)
Movement in net assets attributable to unit-holders	36	136	(271)
<b>Movement in policyholder liabilities</b>		<b>3,952</b>	(7,039)
Acquisition expenses	6	484	594
Administrative and other expenses	7	532	480
Finance costs	11	119	121
<b>Total claims, benefits and expenses</b>		<b>6,363</b>	(4,302)
Share of profit of associates and joint venture	20	11	-
<b>Profit/(loss) before tax from continuing operations</b>		<b>218</b>	(588)
Policyholder tax	12	(67)	78
<b>Profit/(loss) before shareholder tax from continuing operations</b>		<b>151</b>	(510)
Total tax credit	12	50	173
Policyholder tax	12	67	(78)
<b>Shareholder tax</b>	12	<b>117</b>	95
<b>Profit/(loss) after tax from continuing operations</b>		<b>268</b>	(415)
Loss after tax from discontinued operations	13	(22)	(266)
<b>Profit/(loss) for the year</b>		<b>246</b>	(681)
Attributable to:			
Ordinary shareholders		195	(556)
Other equity holders		39	52
		234	(504)
Minority interest		12	(177)
<b>Profit/(loss) for the year</b>		<b>246</b>	(681)
<b>Earnings per share</b>			
		<b>2009</b>	Restated (i)
		<b>pence</b>	2008
			pence
Basic profit/(loss) per share		8.4	(23.9)
Diluted basic profit/(loss) per share		8.4	(23.9)
<b>Earnings per share from continuing operations</b>			
Basic profit/(loss) per share from continuing operations	15	9.3	(12.4)
Diluted basic profit/(loss) per share from continuing operations	15	9.3	(12.4)

(i) Accounting policy change (Note 1.3)

**Consolidated statement of comprehensive income on an IFRS basis  
For the year ended 31 December 2009**

	Ordinary shareholders	Other equity holders	Total equity holders of the parent	Minority interest	Total
	£m	£m	£m	£m	£m
<b>Profit for the year</b>	<b>195</b>	<b>39</b>	<b>234</b>	<b>12</b>	<b>246</b>
Actuarial (losses) on defined benefit schemes	(71)	-	(71)	(13)	(84)
Foreign exchange adjustments (i)	(65)	-	(65)	(14)	(79)
Revaluation of owner occupied properties	(1)	-	(1)	-	(1)
Shadow accounting (ii)	16	-	16	-	16
Aggregate tax effect of above items	9	-	9	4	13
<b>Other comprehensive loss, net of tax</b>	<b>(112)</b>	<b>-</b>	<b>(112)</b>	<b>(23)</b>	<b>(135)</b>
<b>Total comprehensive income/(loss), net of tax</b>	<b>83</b>	<b>39</b>	<b>122</b>	<b>(11)</b>	<b>111</b>

- (i) Foreign exchange adjustments relate to the translation of overseas subsidiaries.  
(ii) Shadow accounting includes £1m (2008:£10m) in respect of the revaluation of owner occupied properties and £15m (2008:£(40)m) in respect of foreign exchange adjustments on translation of overseas subsidiaries held by the With-Profits Fund of Friends Provident Life & Pensions Limited (FPLP).

For the year ended 31 December 2008 (restated (iii))

	Ordinary shareholders	Other equity holders	Total equity holders of the parent	Minority interest	Total
	£m	£m	£m	£m	£m
<b>(Loss)/profit for the year</b>	<b>(556)</b>	<b>52</b>	<b>(504)</b>	<b>(177)</b>	<b>(681)</b>
Actuarial gains/ on defined benefit schemes	46	-	46	1	47
Foreign exchange adjustments (i)	188	-	188	36	224
Revaluation of owner occupied properties	(10)	-	(10)	-	(10)
Shadow accounting (ii)	(30)	-	(30)	-	(30)
Aggregate tax effect of above items	7	-	7	-	7
<b>Other comprehensive income, net of tax</b>	<b>201</b>	<b>-</b>	<b>201</b>	<b>37</b>	<b>238</b>
<b>Total comprehensive (loss)/income, net of tax</b>	<b>(355)</b>	<b>52</b>	<b>(303)</b>	<b>(140)</b>	<b>(443)</b>

- (iii) Accounting policy change (note 1.3)

**Consolidated statement of IFRS based operating profit  
For the year ended 31 December 2009**

	Notes	2009 £m	2008 £m
<b>Profit/(loss) before tax from continuing operations (i)</b>		<b>218</b>	(588)
Policyholder tax	12	(67)	78
Returns on Group-controlled funds attributable to third parties		(16)	154
<b>Profit/(loss) before tax excluding return generated within policyholder funds from continuing operations</b>		<b>135</b>	(356)
Non-recurring items	3	86	51
Amortisation of acquired present value of in-force business	16	25	26
Amortisation of Life & Pensions acquired intangible assets	16	15	14
Impairment of goodwill	16	23	-
Impairment of other intangible assets	16	8	-
Interest payable on Step-up Tier one Insurance Capital Securities (STICS)	41	(39)	(52)
Short-term fluctuations in investment return	4	19	71
<b>IFRS based operating profit/(loss) before tax from continuing operations(i)</b>		<b>272</b>	(246)
Tax on operating profit/(loss)		99	90
<b>IFRS based operating profit/(loss) after tax attributable to ordinary shareholders of the parent from continuing operations</b>		<b>371</b>	(156)
<b>Earnings per share</b>			
		<b>2009 pence</b>	<b>2008 pence</b>
IFRS based operating profit/(loss) per share from continuing operations	15	<b>16.0</b>	(6.7)

(i) Included in profit/(loss) before tax from continuing operations and IFRS based operating profit/(loss) before tax are one-off items relating to basis changes which have increased the profit by £50m (2008: increased the loss by £61m). Further details of these items are set out in note 2(i).

The 2008 figures have been represented to exclude the results of the demerged asset management business which are presented as a discontinued operation.

IFRS based operating profit/(loss) is based on longer-term investment return and excludes: (i) policyholder tax, (ii) returns attributable to minority interests in policyholder funds, (iii) non-recurring items, (iv) amortisation and impairment of acquired intangible assets and present value of acquired in-force business; and is stated after deducting interest payable on STICS. Management consider that IFRS based operating profit better reflects the performance of the Group and focus on this measure of profit in its internal monitoring of the Group's IFRS results.

**Consolidated statement of financial position on an IFRS basis  
At 31 December 2009**

	Notes	2009 £m	Restated (i) 2008 £m
<b>Assets</b>			
Intangible assets	16	849	1,358
Property and equipment	17	47	66
Investment properties	18	1,546	1,493
Investments in associates and joint venture	20	51	47
Deferred tax assets	24	12	15
Financial assets	21	48,315	44,372
Deferred acquisition costs	22	1,321	1,223
Reinsurance assets	23	1,972	1,964
Current tax assets		4	4
Insurance and other receivables	25	481	743
Cash and cash equivalents	26	5,073	5,183
<b>Total assets</b>		<b>59,671</b>	<b>56,468</b>
<b>Liabilities</b>			
Insurance contracts	28	12,107	12,677
Fund for future appropriations		273	401
Financial liabilities			
- Investment contracts	32	40,507	35,275
- Loans and borrowings	33	569	729
- Amounts due to reinsurers	35	1,610	1,792
Net asset value attributable to unit-holders	36	668	668
Provisions	37	72	108
Deferred tax liabilities	24	21	108
Current tax liabilities		15	90
Insurance payables, other payables and deferred income	38	576	1,003
<b>Total liabilities</b>		<b>56,418</b>	<b>52,851</b>
<b>Equity attributable to equity holders of the parent</b>			
Attributable to ordinary shareholders:			
Share capital	39	117	234
Share premium	39	-	2,372
Other reserves	40	2,356	(169)
		2,473	2,437
Attributable to other equity holders	41	483	810
		2,956	3,247
<b>Minority interest</b>		<b>297</b>	<b>370</b>
<b>Total equity</b>		<b>3,253</b>	<b>3,617</b>
<b>Total equity and liabilities</b>		<b>59,671</b>	<b>56,468</b>

(i) Accounting policy change (note 1.3)

The financial statements were approved by the Board of directors on 23 March 2010.



**Evelyn Bourke**  
Chief Financial Officer

**Consolidated statement of changes in equity**  
**Year ended 31 December 2009**

	Share capital £m	Equity attributable to ordinary shareholders			Other equity £m	Total £m	Minority interest £m	Total £m
		Share premium £m	Other reserves £m					
<b>At 1 January 2009</b>	<b>234</b>	<b>2,372</b>	<b>(169)</b>		<b>810</b>	<b>3,247</b>	<b>370</b>	<b>3,617</b>
Profit for the year	-	-	195	39	234	12	246	
Other comprehensive loss	-	-	(112)	-	(112)	(23)	(135)	
Total comprehensive income/(loss)	-	-	83	39	122	(11)	111	
Dividends on equity shares	-	-	(91)	-	(91)	(30)	(121)	
Interest paid on STICS	-	-	-	(47)	(47)	-	(47)	
Appropriations of profit	-	-	(91)	(47)	(138)	(30)	(168)	
Tax relief on								
STICS interest	-	-	11	-	11	-	11	
Share based payments	-	-	15	-	15	3	18	
Change in participation in subsidiary	-	-	-	-	-	3	3	
STICS exchange (i)	-	-	113	(319)	(206)	-	(206)	
Group reorganisation (ii)	(117)	(2,372)	2,389	-	(100)	(38)	(138)	
Other	-	-	5	-	5	-	5	
<b>At 31 December 2009</b>	<b>117</b>	<b>-</b>	<b>2,356</b>	<b>483</b>	<b>2,956</b>	<b>297</b>	<b>3,253</b>	

(i) See note 41

(ii) See notes 13 and 39

**Year ended 31 December 2008 (Restated (i))**

	Share capital £m	Equity attributable to ordinary shareholders			Other equity £m	Total £m	Minority interest £m	Total £m
		Share premium £m	Other reserves £m					
<b>At 1 January 2008</b>	<b>234</b>	<b>2,372</b>	<b>346</b>		<b>810</b>	<b>3,762</b>	<b>562</b>	<b>4,324</b>
(Loss)/profit for the year	-	-	(556)	52	(504)	(177)	(681)	
Other comprehensive income	-	-	201	-	201	37	238	
Total comprehensive (loss)/income	-	-	(355)	52	(303)	(140)	(443)	
Dividends on equity shares	-	-	(153)	-	(153)	(39)	(192)	
Interest paid on STICS	-	-	-	(52)	(52)	-	(52)	
Appropriations of profit	-	-	(153)	(52)	(205)	(39)	(244)	
Tax relief on STICS interest	-	-	15	-	15	-	15	
Share based payments	-	-	11	-	11	6	17	
Change in participation in subsidiary	-	-	-	-	-	34	34	
Acquisition of subsidiaries (i)	-	-	(35)	-	(35)	(26)	(61)	
Disposal of subsidiaries (i)	-	-	2	-	2	(27)	(25)	
<b>At 31 December 2008</b>	<b>234</b>	<b>2,372</b>	<b>(169)</b>	<b>810</b>	<b>3,247</b>	<b>370</b>	<b>3,617</b>	

(i) Accounting policy change (note 1.3)

**Consolidated cash flow statement**  
**For the year ended 31 December 2009**

	2009 £m	2008 £m
<b>Operating activities</b>		
Profit/(loss) for the year	246	(681)
Adjusted for:		
Net realised and unrealised (gains)/losses on assets at fair value	(3,676)	8,696
Finance costs	128	140
Amortisation and impairment of intangible assets	103	365
Depreciation of property and equipment	7	10
Movement in deferred acquisition costs	(123)	(88)
Total tax credit	(53)	(205)
Purchase of shares and other variable yield securities	(24,959)	(25,080)
Sale of shares and other variable yield securities	23,129	24,512
Purchase of loans, debt securities and other fixed income securities	(24,725)	(21,340)
Sale of loans, debt securities and other fixed income securities	24,397	20,455
Purchase of investment properties	(67)	(13)
Sale of investment properties	79	283
Decrease in insurance contract liabilities	(588)	(932)
Increase/(decrease) in investment contract liabilities	7,005	(5,051)
Decrease in fund for future appropriations	(128)	(80)
Decrease in provisions	21	(24)
Net decrease in receivables and payables	(256)	(454)
<b>Pre-tax cash inflow from operating activities</b>	<b>540</b>	<b>513</b>
Tax paid	(1)	(39)
<b>Net cash inflow from operating activities</b>	<b>539</b>	<b>474</b>
<b>Investing activities</b>		
Acquisition of subsidiaries, net of cash acquired	(8)	132
Acquisition of associate	-	(33)
Reduction in participation in subsidiaries, net of cash disposed	(240)	(1)
Additions to internally generated intangible assets	(4)	(7)
Purchase of property and equipment (net)	1	(3)
<b>Net cash (outflow)/inflow from investing activities</b>	<b>(251)</b>	<b>88</b>
<b>Financing activities</b>		
Finance costs	(104)	(140)
STICS interest	(47)	(52)
Proceeds from issue of long-term debt	8	-
Repayment of long term debt	(4)	(80)
Net movement in other borrowings, net of expenses	(24)	11
Dividends paid to equity holders of the parent	(91)	(153)
Dividends paid to minority interest	(30)	(39)
<b>Net cash outflow from financing activities</b>	<b>(292)</b>	<b>(453)</b>
<b>(Decrease)/increase in cash and cash equivalents</b>	<b>(4)</b>	<b>109</b>
Balance at beginning of year	5,183	4,782
Exchange adjustments on the translation of foreign operations	(106)	292
<b>Balance at end of year</b>	<b>5,073</b>	<b>5,183</b>

## Notes to the consolidated accounts

### 1. Accounting policies

#### 1.1 Basis of preparation

Friends Provident Group plc (the Company) is a company domiciled in England and Wales. The financial statements of the Company for the year ended 31 December 2009 comprise the Company and its subsidiaries (together referred to as the Group) and the Group's interests in associates and jointly controlled entities.

The Company was incorporated on 27 March 2009 and became the holding company of Friends Provident plc on 15 June 2009 following a court-sanctioned reorganisation. On that date its shares were admitted to the Official List of the UKLA to enable trading on the London Stock Exchange. In accordance with International Financial Reporting Standard 3 Business combinations, this group reorganisation has been accounted for as a pooling of interests. Although the consolidated financial statements have been prepared in the name of the legal parent, the Company, they are in substance a continuation of the consolidated financial statements of the legal subsidiary, Friends Provident plc. The following accounting treatment has been applied in respect of this:

(i) At the date of the combination, the assets and liabilities of Friends Provident plc were recognised and measured in the consolidated financial statements at the pre-combination carrying amounts, without restatement to fair value.

(ii) The equity structure (share capital and premium) appearing in the consolidated financial statements reflects the equity structure of the Company.

(iii) Comparative numbers presented in the consolidated financial statements for the income statement are those reported in the consolidated financial statements of Friends Provident plc for the year ended 31 December 2008 and for the financial position are those reported in the consolidated financial statements of Friends Provident plc for the year ended 31 December 2008.

(iv) The disclosure requirements of IFRS 1 First-time adoption of International Financial Reporting Standards do not apply.

There has been no impact on profitability (apart from the costs of reorganisation) of the revised Group structure.

On 3 July 2009 the Group demerged its stake in F&C Asset Management PLC. In accordance with IFRS 5 Non current assets held for sale and discontinued operations, F&C is presented as a discontinued operation in these financial statements. As a result the consolidated income statement includes a single line item for the loss after tax from discontinued operations; the 2008 figures in the primary statements and in the notes to the primary statements figures have been revised to follow the 2009 presentation.

On 4 November 2009, Friends Provident Holdings (UK) Limited, a subsidiary of Resolution Limited acquired a 100% interest in the Company.

On 5 November the Company's shares ceased to be listed. However the Company has issued listed debt and for that reason the parts of the Companies Act relating to listed companies, International Financial Reporting Standards (IFRS) and the Listing Rules remain applicable, including the requirement to prepare IFRS consolidated financial statements. The presentation currency of the Group is Sterling. Unless otherwise stated the amounts shown in these financial statements are in millions of pounds sterling (£m).

The consolidated financial statements of the Group are prepared in accordance with EU adopted IFRS and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of property, investment properties, cash settled share based payment schemes and financial instruments at fair value through the income statement in accordance with the respective accounting policies contained herein. The financial statements also comply with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005 (as amended in December 2006) in so far as these requirements do not contradict IFRS requirements.

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

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

The Company presents individual financial statements prepared on a UK GAAP basis as permitted by sections 396 and 408 of the Companies Act 2006, adopting the exemption of omitting the profit and loss account and related notes conferred by section 408 of that Act. The Company financial statements, with its respective accounting policies, are presented on pages 129 to 133.

As explained in the directors' report, these financial statements have been prepared on the going concern basis.

The Group has applied all IFRS standards and interpretations adopted by the EU and effective at 31 December 2009. New standards, interpretations and amendments to existing standards adopted by the Group during the year are as follows:

**IFRS 2 Share based payment (amendments) Vesting conditions and cancellations**  
Amendments to IFRS 2 clarified the terms vesting conditions and cancellations. As a result of the amendments, cancellations by an individual are accounted for as an acceleration of the expense that would otherwise have been recognised over the remainder of the vesting period.

The majority of schemes vested in October 2009 prior to the acquisition by Resolution, resulting in an acceleration of the IFRS 2 charge. The impact of adopting the amendments to IFRS 2 has no material impact on the amounts reported.

**IFRS 7 Financial instruments: disclosures (amendments)**  
Amendments to IFRS 7 require enhanced disclosures relating to fair value measurements and liquidity risk. The additional disclosures in respect of fair value measurement are reported in note 21 Financial assets and provide additional information about the methods used and assumptions applied in determining fair values. The new liquidity risk disclosures are reported in note 31 Risk management objectives and policies for mitigating risks and provide a revised maturity analysis for derivative and non-derivative financial liabilities.

#### IFRS 8 Operating segments

IFRS 8 replaces IAS 14 Segment reporting and introduced new requirements for reporting segmental information. It requires information to be reported on the basis of internal financial information used by the Group to evaluate operating performance. The impact of adopting IFRS 8 is an increase in the number of reportable segments presented. The measures presented are unchanged from those presented under IAS 14. Comparative segment information has been re-presented in conformity with the transitional requirements of IFRS 8. Since the change in accounting policy only impacts presentation and disclosure aspects, there is no impact on profit.

#### IAS 1 Presentation of financial statements (revised)

The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present two statements.

#### Improvements to IFRSs (2008)

The majority of these amendments are effective from 1 January 2009 but have had no material effect on amounts reported.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

New standards, interpretations and amendments to existing standards endorsed by the EU but not currently adopted by the Group will be adopted when they become effective as follows:

#### IAS 39 Financial instruments: recognition and measurement - Eligible hedged items (amendment)

The amendment is effective for financial years beginning on or after 1 July 2009. The amendment clarifies which risks associated with a portion of the cash flows or fair value of a financial instrument an entity is permitted to designate as a hedge item.

IFRS 3 (Revised) Business combinations, IAS 27 (Revised) Consolidated and separate financial statements, IAS 28 (Revised) Investment in associates and IAS 31 (Revised) Interests in joint ventures.

The IASB issued the revised Business Combinations standard in January 2008, which will be effective for financial years beginning on or after 1 July 2009. The standard is to be applied prospectively. The standard introduces a number of changes in the accounting for business combinations which results in a greater impact to the income statement:

- Transaction costs are expensed as incurred;
- Subsequent changes in the value of contingent consideration are recorded in the income statement;
- Partial disposals involving loss of control will impact the income statement;
- Post-acquisition deferred tax assets are adjusted through the income statement.

The standard permits an entity to have a choice on a transaction-by-transaction basis on measuring the non-controlling interests at fair value or at the respective share of the total net assets.

At the same time as IFRS 3 was revised, the IASB amended IAS 27, IAS 28 and IAS 31. The standards are effective for financial years beginning on or after 1 July 2009. IAS 27 requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. IAS 28 requires that when a significant influence is lost, the cost of the retained investment is measured at fair value at the date that significant influence is lost. IAS 31 similarly requires any retained interest in an investment in a joint venture, following a transaction where joint control is lost, to be measured at fair value, and that this shall be used as deemed cost for subsequent accounting.

With the exception of future acquisitions under IFRS 3, the above standards and interpretations once implemented are not expected to materially impact the Group.

#### Improvements to IFRSs (2009)

The majority of these amendments are effective from 1 January 2010 but will have no material effect on amounts reported.

### **1.2 Use of estimates, assumptions and judgements**

The preparation of the financial statements requires the use of estimates, assumptions and judgements that affect the reported amounts of assets, liabilities and contingent liabilities at the balance sheet date, as well as affecting the reported income and expenses for the year. Although the estimates are based on management's best knowledge and judgement of information and financial data as at the date the financial statements are approved, the actual outcome may differ from these estimates. Further information on the use of estimates, assumptions and judgements is set out in note 2.

### **1.3 Changes in accounting policy**

#### **1.3.1 Presentation of tax relief on Step-up Tier One Insurance Capital Securities (STICS) interest**

The STICS issued by the Group are legally debt instruments however they are treated as equity in the IFRS financial statements of the Group. Historically, the tax credit arising on the STICS interest has been taken through the income statement.

Since first-time adoption of IFRS, emerging practice has generally applied a different interpretation of IAS 12 income taxes, and credited tax relief on similar instruments directly to equity. In 2009 the Group has decided to present the tax relief on STICS as being taken directly to equity. This is in the line with the guidance set out in IAS 12 which was amended following the amendments to IAS 1 effective from 1 January 2009.

The impact of this is that the items set out below in respect of 2008 and reported in the Group's 2008 R&A have been restated as follows, after the impact of representing the results of the Group's demerged asset management business as a discontinued operation:

- (i) The tax credit for the year has reduced by £15m to £173m.
- (ii) Loss after tax from continuing operations has increased by £15m to £415m.
- (iii) Loss after tax attributable to ordinary shareholders of the parent has increased by £15m to £556m.

- (iv) Basic and diluted loss per share has increased by 0.6p to 23.9p and basic loss from continuing operations has increased by 0.6p to 12.4p.
- (v) The statement of changes in equity includes an additional line to reflect the recognition of £15m tax relief directly in equity.

There is no impact on shareholders' funds or total equity.

### **1.3.2 Recognition of pension surplus**

During 2009 the group revisited its application of IFRIC 14 The limit on a defined benefit asset, minimum funding requirements and their interaction, addressing the circumstances under which a pension surplus should be recognised. It has been concluded that the Group's previous interpretation was not consistent with generally accepted practise and that the 2008 comparatives be restated.

The economic benefit available is recognised net of penal tax at a rate of 35%. The impact of the change in treatment is that the items set out below in respect of 2008, and reported in the Group's R&A, have been restated as follows:

- (i) recognition of a net pension surplus of £73m within Insurance and other receivables and a corresponding increase in other reserves
- (ii) Actuarial gains/(losses) on defined benefit schemes and related tax in the Consolidated statement of comprehensive income has increased by £73m.

The amendment to 2008 comparative information has no impact on profit for the year. A surplus of £4m was previously recognised at 31 December 2007 and is unaffected by the change in application.

## **1.4 Accounting policies**

The principal accounting policies set out below have been consistently applied to all years presented in these consolidated financial statements.

### **1.4.1 Business combinations**

The cost of a business combination is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the business combination. Identifiable assets acquired, including intangible assets arising on acquisition, and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the business combination date, irrespective of the extent of any minority interest. The excess of the cost of the business combination over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of the business combination is less than the fair value of the net assets acquired, the difference is recognised directly in the income statement.

The reorganisation of the Group has been treated as a pooling of interests in accordance with IFRS 3. No fair value adjustments arise. The share capital on the Group's consolidated balance sheet is that of the Company. The difference between the share capital and share premium of Friends Provident plc and the new share capital of Friends Provident Group plc is recognised in a merger reserve.

### **(a) Subsidiaries**

Subsidiaries are all entities over which the Group has the power, directly or indirectly, to govern the financial and operating policies so as to obtain economic benefits, generally

accompanying a shareholding of more than one half of the voting rights. Potential voting rights that presently are exercisable or convertible are also taken into account.

Open-ended investment companies and unit trusts in which the Group has a percentage holding in excess of 50% are consolidated as special purpose vehicles under SIC12 (the Group obtains the majority of the benefits). The units not owned by the Group are treated as a liability called 'net asset value attributable to unit holders'.

The consolidated financial statements incorporate the assets, liabilities, results and cash flows of the Company and its subsidiaries. The results of subsidiaries acquired or sold during the period are included in the consolidated results from the date of acquisition or up to the date of disposal. Intra-group balances and income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

Profits or losses arising from changes in holdings in subsidiaries that do not impact the Group's control over that subsidiary are recognised directly in equity.

#### **(b) Associates and joint ventures**

Associates are all entities over which the Group has significant influence but not control over the financial and operating policies, generally arising from holding between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any impairment loss) identified on acquisition.

Joint ventures are those entities where the terms of the contractual agreement ensure that the parties involved jointly control the entity, notwithstanding that the Group's share of the underlying assets and liabilities may be more than 50%. The Group recognises its interests in joint ventures using the equity method.

Under the equity method, an investment is included as a single line item in the consolidated balance sheet as the Group's share of the fair value of the investee undertaking's net assets plus goodwill, which equates to the cost of the investment plus the Group's share of post-acquisition reserves. The Group's share of post-tax profits or losses is presented as a single line item in the consolidated income statement, adjusted for the effect of any adjustments to fair values arising on acquisition.

### **1.4.2 Product classification**

#### **(a) Insurance contracts**

Contracts under which the Group accepts significant insurance risk from another party (the policyholder), by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder, are classified as insurance contracts. Under IFRS 4 Insurance contracts, insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of: a specified interest rate, security price, commodity price, foreign exchange rate, index of price or rates, a credit rating or credit index or other variable. Insurance contracts may also transfer some financial risk.

Once a policyholder contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are more than 5% greater than the benefits payable if the insured event did not occur.

### **(b) Investment contracts**

Policyholder contracts not considered insurance contracts under IFRS 4 are classified as investment contracts. Contracts classified as investment contracts are either unit-linked or contracts with Discretionary Participation Features (DPF). The latter are mainly unitised with-profits contracts.

A contract with DPF is a contractual right held by a policyholder to receive, as a supplement to guaranteed minimum payments, additional payments:

- that are likely to be a significant portion of the total contractual payments, and
- whose amount or timing is contractually at the discretion of the issuer and that are contractually based on:
  - the performance of a specified pool of contracts, or
  - a specified type of contract, or
  - realised and/or unrealised investment returns on a specified pool of assets held by the issuer, or
  - the profit or loss of the company that issues the contracts.

### **1.4.3 Segment reporting**

Under IFRS 8, operating and reportable segments are presented in a manner consistent with the internal reporting information provided to the chief operating decision maker, who has been identified as the Chief Executive Officer (CEO). The CEO is assisted in the performance of his duties by the Friends Leadership team (FLT) which consists of senior managers in the business.

An operating segment is a component of the Group that engages in business activities from which it earns revenues and incurs expenses. Minor operating segments are combined to derive the Group's reportable segments in accordance with the requirements of IFRS 8.

Revenue information for geographical segment reporting is based on customer location. Non-current assets for geographical segment reporting is based on the location of the assets.

### **1.4.4 Foreign currency translation**

#### **(a) Foreign currency transactions**

Transactions in foreign currencies are translated to the functional currency of each company in the Group at the foreign exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the exchange rate ruling at the balance sheet date, and any exchange differences arising are taken to the income statement. Non-monetary assets and liabilities measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not subsequently restated. Non-monetary assets and liabilities stated at fair value in a foreign currency are translated at the rate on the date the fair value was determined. When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in the income statement, any exchange component of that gain or loss is recognised in the income statement. Foreign exchange adjustments recognised in equity are reported in the Group's foreign currency translation reserve within retained earnings and reported in the statement of comprehensive income.

### **(b) Overseas subsidiaries and associates**

The assets and liabilities of overseas subsidiaries and associates, including goodwill and intangible assets attributable to the acquisition of the overseas subsidiary or associate, and fair value adjustments arising on consolidation, are translated to Sterling (the presentational currency of the Group) at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of overseas subsidiaries and associates are translated to Sterling at average foreign exchange rates for the year.

Foreign exchange differences arising on the translation to Sterling are classified as equity movements and recognised in the Group's foreign currency translation reserve and reported in the statement of comprehensive income. These exchange differences are recognised in the income statement in the period in which the overseas subsidiary or associate is disposed of.

### **1.4.5 Revenue recognition**

#### **(a) Premiums**

Premium income in respect of single premium insurance contracts, new generation group pensions business and pensions business not subject to contractual regular premiums, is accounted for when the premiums are received.

For all other insurance contracts, premium income is accounted for in the year in which it falls due.

#### **(b) Fee and commission income and income from service activities**

Investment contract policyholders are charged for policy administration services, investment management services and for surrenders. Investment management services comprise primarily fees and charges from unit-linked investment contracts issued by the Life & Pensions business. Fees earned on investment management contracts relate to the sale and management of retail investment products and from managing investments in the institutional market.

These fees and charges are recognised as revenue in the accounting period in which the services are rendered.

Front-end fees charged at the inception of certain investment contracts are recognised as income over the expected term of the contract on a straight-line basis with the amount not recognised at the end of the year deferred as a liability.

Regular fees charged to the policyholder periodically (monthly, quarterly or annually), are recognised on a straight-line basis over the period in which the service is rendered.

A number of contracts have performance fees based on an agreed level of performance in a set time period. Performance fees are recognised when the quantum of the fee can be estimated reliably, which is when the performance period ends, when this occurs on or before the reporting date, or where there is a period of less than six months remaining to the end of the performance period, and there is evidence at the reporting date which suggests that the current performance will be sustainable.

### **(c) Investment income**

All income received from investments is recognised in the income statement and includes dividends, interest, rental income, and the movement in financial assets and investment properties, at fair value through the income statement.

Dividend income from listed and unlisted securities is recognised as revenue when the right to receive payment is established. For listed securities this is the date the security is listed as ex-dividend.

Interest income is recognised in the income statement as it accrues, taking into account the relevant coupon rate, and applicable floating rate or, for loan assets at amortised cost, the effective interest rate method. Interest income includes the amortisation of any discount or premium.

Rental income from investment properties under operating leases is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease income.

Determination of gains and losses and the movement in financial assets and investment properties at fair value through the income statement are explained in their respective accounting policies.

### **1.4.6 Expense recognition**

#### **(a) Claims and benefits paid**

Insurance claims reflect the cost of all claims incurred during the year, including claims handling costs. Death claims and surrenders are recognised on the basis of notifications received. Maturities and annuity payments are recorded when due. Claims and benefits recorded are accrued to the policyholder and included within insurance and investment contracts liabilities, as appropriate.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any general administrative costs directly attributable to the claims function.

Reinsurance recoveries are accounted for in the same period as the related claim.

#### **(b) Finance costs**

The interest expense recognised in the income statement under finance costs, is calculated using the effective interest rate method. Interest accrued on variable rate interest bearing loans and borrowings is recognised under insurance payables, other payables and deferred income and not in the carrying value of interest bearing loans and borrowings.

#### **(c) Operating lease payments**

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives paid are recognised in the income statement over the period of the lease.

#### **(d) Investment properties related expenses**

Expenses with regards to investment properties are treated as administrative expenses and are recognised when incurred.

#### **1.4.7 Impairment**

Assets, other than goodwill, investment property and financial assets at fair value are reviewed at each reporting date to assess whether there are any circumstances that might indicate that they are impaired. If such circumstances exist, impairment testing is performed and any resulting impairment losses are charged to the income statement. The carrying value is adjusted to the recoverable amount or the present value of expected future cash flows discounted at the effective interest rate for loans and receivables at amortised cost. Goodwill is tested annually at 31 December for impairment or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined by comparing the carrying value with the recoverable amount of the asset, or in respect of goodwill, the cash generating unit to which the goodwill relates. The recoverable amount is the higher of fair value less costs to sell and value in use of the asset or cash generating unit.

Each cash generating unit to which goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes and is not larger than any of the Group's primary or secondary segments used for segment reporting.

An assessment is made at each reporting date whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

#### **1.4.8 Intangible assets**

##### **(a) Goodwill**

Goodwill arising on business combinations is the future economic benefit arising from assets that are not capable of being individually identified and separately recognised. Goodwill is not amortised but tested for impairment annually.

##### **(b) Present value of acquired in-force business (AVIF)**

On acquisition of a portfolio of insurance contracts and/or investment contracts, either directly or through the acquisition of a subsidiary undertaking, the net present value of the Group's interest in the expected pre-tax cash flows of the in-force business is capitalised in the balance sheet as an intangible asset. AVIF is amortised over the anticipated lives of the related contracts which typically vary between 5 and 35 years.

##### **(c) Investment management contracts**

Investment management contracts acquired separately are measured on initial recognition at cost. The cost of investment management contracts acquired in a business combination is the fair value as at the date of acquisition. Following initial recognition contracts are carried at cost less accumulated amortisation and any accumulated impairment losses. The useful

lives of investment management contracts are finite and the amounts recognised on acquisition are amortised against income on a straight-line basis over the estimated average contract term, depending on the nature of the contract. The remaining useful life is reviewed at each financial year-end. The estimated useful economic lives, have been assessed as follows:

	<b>Years</b>
Investment trusts	10
Insurance	10
Institutional	4
Retail	10
Property	7

All investment management contracts related to F&C which, as explained in note 34, was demerged from the Group on 3 July 2009.

#### **(d) Other intangible assets**

Customer relationships, distribution lists, brands and licences acquired are capitalised at cost, being the fair value of the consideration paid. Software is capitalised on the basis of the costs incurred to acquire and to bring into use. Direct costs of internally generated software are capitalised as intangible assets.

Other intangible assets have finite useful economic lives and are carried at cost less accumulated amortisation and impairment. Amortisation is calculated using the straight-line method to allocate the cost over the estimated useful economic lives of the intangible asset as follows:

	<b>Years</b>
Customer relationships	3 – 12
Distribution lists	7 – 15
Brands	10 – 12
Licences	3 – 5
Software	3

Subsequent expenditure on other intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

### **1.4.9 Property and equipment**

#### **(a) Owned assets**

Land and buildings are initially recognised at cost and subsequently measured at fair value. Revaluations are performed annually by independent valuers, who hold a recognised and relevant professional qualification and have recent experience in the location and category of properties being valued. Valuations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date. The fair value is the amount for which a property could be exchanged between knowledgeable and willing parties in an arm's length transaction.

Properties occupied by the Group are held at fair value on the basis of open market value at the date of revaluation. Revaluation surpluses, and their reversal, are recognised in equity. Revaluation losses, and their reversal, are recognised in the income statement.

Equipment is recognised at cost less accumulated depreciation and impairment losses.

## **(b) Depreciation**

Depreciation is charged so as to write off the cost of an asset net of the estimated residual value, using the straight-line method, over the estimated useful life of each part of an item of equipment, as follows:

	<b>Years</b>
Motor vehicles	3 – 4
Computer hardware and related software	1 – 4
Fixtures, fittings and office equipment	3 – 10

Residual values and useful lives are reviewed at each financial year end and adjusted if appropriate.

## **(c) Disposal and derecognition**

An item of property and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset is included in the income statement in the year the asset is derecognised.

Any revaluation reserve relating to the particular asset being disposed of or no longer in use is transferred to retained earnings.

### **1.4.10 Investment properties**

Investment properties comprise land and/or buildings that are not occupied by the Group and are held either to earn rental income or for capital appreciation, or for both.

In accordance with IAS 17 Leases, properties held by the Group under operating leases are classified as investment properties when the properties otherwise meet the definition of investment properties.

Investment property is initially included in the balance sheet at cost and subsequently measured at its fair value, which is supported by market evidence, based on annual valuations by independent valuers who hold a recognised and relevant professional qualification and have recent experience in the location and category of investment property being valued. Movements in the fair value of investment properties are taken to the income statement in the period in which they arise.

### **1.4.11 Financial assets**

The Group classifies its investments as either financial assets at fair value through the income statement or loans. Purchases and sales of financial assets are recognised on the date the Group commits to purchase or sell the asset.

A financial asset is derecognised when and only when the contractual right to receive cash flows expires or when the asset, together with substantially all the risks and rewards of ownership, has been transferred.

## **(a) Financial assets at fair value through the income statement**

Financial assets at fair value through the income statement comprise assets which are designated as such on initial recognition, and derivatives, which are classified as held for trading in accordance with IAS 39.

Financial assets are designated upon initial recognition at fair value through the income statement as they are managed individually or together on a fair value basis.

All financial assets at fair value through the income statement are measured at fair value. The fair value on initial recognition is generally the consideration given, excluding any transaction costs directly attributable to their acquisition. Movements in fair value are taken to the income statement as investment income in the period in which they arise.

### **(b) Loans**

Loans are financial assets with fixed or determinable payments that are not quoted in an active market. Loans are measured on initial recognition at the fair value of the consideration given plus incremental costs that are incurred on the acquisition of the investment. Subsequent to initial recognition, loans are measured at amortised cost using the effective interest rate method.

The amortised cost is the present value of estimated future cash flows discounted at the effective interest rate at the date of acquisition or origination of the loan.

### **1.4.12 Acquisition costs**

For both insurance contracts and investment contracts with DPF, acquisition costs comprise all direct and indirect costs arising from writing the contracts, which are incurred during a financial period. Acquisition costs are amortised over the life of the contracts where their recovery has not been reflected in the valuation of policyholder liabilities, but only to the extent that they are recoverable out of future margins. The rate of amortisation of acquisition costs on such contracts is proportional to the future margins emerging in respect of the related policies, over the life of those policies.

For investment contracts without DPF, and for Asset Management service contracts, acquisition costs comprise all incremental costs that are directly related to the writing of the contract, which are incurred during a financial period, and are amortised on a straight-line basis over the lifetime of the contract if they are recoverable out of future margins.

### **1.4.13 Reinsurance**

Amounts due to and from reinsurers are accounted for in accordance with the relevant reinsurance contract. Premiums ceded and claims reimbursed are individually presented on a gross basis.

Contracts that do not give rise to a significant transfer of insurance risk to the reinsurer are considered financial reinsurance and are accounted for and disclosed in a manner consistent with financial instruments.

### **1.4.14 Taxation**

The tax expense represents the sum of current year corporation tax, the movement in deferred tax and adjustments to prior periods' tax.

### **(a) Current tax**

Taxation is based on profits and income for the period as determined in accordance with the relevant tax legislation, together with adjustments to provisions for prior periods. Tax payable is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

The tax charge is analysed between tax in respect of income and investment return on the policyholders' interest in the with-profits and linked fund assets, representing policyholders' tax, with the balance being tax on equity holders' investment return and profits, representing shareholders' tax.

## **(b) Deferred tax**

Deferred tax is the tax expected to be payable or recoverable on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit. This is accounted for using the balance sheet liability method and the amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities. The tax rates used are the rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is recognised in the income statement for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in equity. In this case the gain or loss is shown net of the attributable deferred tax. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable future profits will be available against which deductible temporary differences can be utilised.

### **1.4.15 Insurance and other receivables**

Insurance and other receivables are recognised when due and measured on initial recognition at the fair value of the amount receivable plus incremental costs. Subsequent to initial recognition, these receivables are measured at amortised cost using the effective interest rate method.

### **1.4.16 Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdraft facilities.

### **1.4.17 Financial liabilities**

The Group classifies financial liabilities as either financial liabilities at fair value through the income statement or financial liabilities carried at amortised cost.

Financial liabilities at fair value through the income statement, such as investment contracts, are designated on initial recognition when one of the following criteria is satisfied:

- it eliminates or significantly reduces an accounting mismatch caused by financial assets and financial liabilities being measured on a different basis
- the financial liability contains or may contain an embedded derivative.

A financial liability is recognised when, and only when, the Group becomes a party to the contractual provisions of a financial instrument.

A financial liability is derecognised when, and only when, the obligation specified in the contract is discharged, or cancelled or expires.

### **1.4.18 Insurance contracts**

For UK operations the liabilities are calculated based on the relevant Financial Services Authority (FSA) rules contained in the Prudential Sourcebook for Insurers. Insurance contract liabilities are calculated on recognised actuarial principles, based on local regulatory requirements.

For the conventional with-profits policies in Friends Provident Life and Pensions Limited (FPLP), the liabilities to policyholders include both declared and constructive obligations for future bonuses not yet declared (excluding the shareholders' share of future bonuses) and

includes the cost of options and guarantees measured on a market-consistent basis. The basis of calculation does not recognise deferred acquisition costs (DAC), but allows for future profits of non-profit and unit-linked business written in the With-Profits Fund to be recognised. The calculation of liabilities to policyholders includes deduction for PVIF on the with-profits policyholders share of non-profit business written within the With-Profits Fund.

The calculation of the liabilities to policyholders in respect of conventional with-profits contracts in Friends Provident Life Assurance Limited (FPLA) includes an implicit provision for future regular bonuses, but not final bonuses, by means of a reduction in the valuation interest rate and an assessment of options and guarantees on a deterministic basis.

The calculation of liabilities to policyholders for non-profit contracts includes explicit allowance for future expenses and allows for lapses where appropriate.

The Group applies shadow accounting in relation to certain insurance contract liabilities, which are supported by owner occupied properties and overseas subsidiaries, on which unrealised gains and losses are recognised in equity. Where the liabilities have been affected by a change in the value of an underlying asset that has been accounted for in equity, the change in carrying amount of the liability is also recorded in equity.

The Group carries out an annual liability adequacy test on its insurance contract liabilities less related deferred acquisition costs and other related intangible assets to ensure that the carrying amount of its liabilities is sufficient in the light of estimated future cash flows. Where a shortfall is identified, an additional provision is made.

#### **1.4.19 Investment contracts**

Investment contracts are either unit-linked or contracts with DPF (mainly unitised with-profits contracts).

A unit-linked investment contract is recognised at fair value through the income statement. The fair value is calculated as the number of units allocated to policyholders in each of the unit-linked funds multiplied by the bid price of the assets in the fund at the balance sheet date. The fund assets and liabilities used to determine the unit prices at the balance sheet date are valued on a basis that is consistent with their measurement basis in the consolidated Group balance sheet, adjusted to take account of the effect on the liabilities of discounting for the time value of future tax on unrealised gains on assets held in the fund. Provision is made for renewal commissions at the inception of an investment contract as intermediaries are not required to perform any service once the policy is accepted.

Investment contracts with DPF held within the FPLP and FPLA with-profits funds (which are mainly unitised with-profits contracts) are measured on a basis that is consistent with a measurement basis for insurance contracts held within those funds.

#### **1.4.20 Fund for future appropriations (FFA)**

The FFA is presented as a liability and comprises all funds available for allocation, either to policyholders or to shareholders, the allocation of which has not been determined at the balance sheet date.

Within FPLP, the insurance and investment contracts liabilities allow for discretionary benefit allocations to the extent that they are allowed within current bonus practices. The FFA represents working capital and the value of future transfers to shareholders' from the With-Profits Fund in respect of discretionary bonuses for conventional with-profits business.

Within FPLA, the FFA represents the value of future regular and final bonus payments to policyholders.

#### **1.4.21 Interest bearing loans and borrowings**

Borrowings are recognised initially at fair value, which is generally the cash consideration received, net of transaction costs incurred, and subsequently stated at amortised cost. Any difference between the proceeds, net of transaction costs, and the redemption value is recognised in the income statement over the period of the borrowings, using the effective interest rate method.

#### **1.4.22 Provisions**

A provision is recognised when the Group has a present legal or constructive obligation, as a result of a past event, which is likely to result in an outflow of resources and where a reliable estimate of the amount of the obligation can be made. If the effect is material, the provision is determined by discounting the expected future cash flows at a pre-tax risk-free rate and, where appropriate, the risks specific to the liability.

The Group recognises a provision for onerous contracts when the expected benefits to be derived from the contracts are less than the related unavoidable costs.

#### **1.4.23 Insurance payables, other payables and deferred income**

Insurance and other payables are recognised when due and measured on initial recognition at the fair value of the consideration paid. Subsequent to initial recognition, payables are measured at amortised cost using the effective interest rate method.

#### **1.4.24 Employee benefits**

##### **(a) Pension obligations**

###### **(i) Defined benefit schemes**

Pension schemes are in operation for employees of certain subsidiary undertakings. The principal schemes, to which the majority of employees belong, are of the funded defined benefit type with uninsured assets. The schemes provide benefits based on final pensionable salary. The assets of the schemes are held in separate trustee administered funds.

The pension asset and liability recognised in the balance sheet is the present obligation of the employer, which is the estimated present value of future benefits that employees have earned in return for their services in the current and prior years, less the value of the plan assets in the schemes. The pension surplus is recognised to the extent it is recoverable through refunds or expected reductions in future contributions. The rate used to discount pension obligations is determined by reference to market yields at the end of the reporting period on high quality corporate bonds. A qualified actuary performs the calculation of the present value of the defined benefit obligation annually using the projected unit credit method.

The pension costs for the schemes are charged to the income statement and consist of current service cost, past service cost, interest cost on scheme liabilities, the effect of any settlements and curtailments, and the expected return on pension assets. Past service costs are recognised in the income statement on a straight-line basis over the period in which the increase in benefits vest.

The actuarial gains and losses, which arise from any new valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date, and any

restrictions to recognised surpluses, are taken to the statement of recognised income and expense for the period. The adjustment is shown net of deferred taxation.

(ii) Defined contribution schemes

Contributions made to these schemes are charged to the income statement as they become payable in accordance with the rules of the scheme.

(iii) Other long-term employee benefits

Other long-term employee benefits are recognised at the discounted present value of the defined benefit obligation at the balance sheet date. The obligation is calculated using the unit credit method. Movements in the value of the obligation are charged to the income statement.

(iv) Termination benefits

Termination benefits are recognised as a liability and an expense when the Group terminates the employment of an employee before the normal retirement date.

**(b) Share based payment schemes**

The Company and certain subsidiary undertakings offer share based payment schemes to employees of the Group, depending on eligibility.

The fair value of equity-settled share based payments is measured at the grant date and expensed on a straight-line basis over the vesting period in the income statement. A corresponding amount is credited to equity.

At each balance sheet date, the Group revises its estimate of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity. The fair value is measured using scenario based modelling techniques that take into account the terms and conditions upon which these options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest, except where forfeiture is only due to share prices not achieving the threshold for vesting.

The dilutive effect of all outstanding options is reflected in the computation of diluted earnings per share.

For cash-settled schemes, the fair value of the share based payment is measured at the grant date and expensed over the vesting period in the income statement with a corresponding credit to liabilities. The estimated fair value of cash-settled awards is re-measured at each reporting date until the payments are ultimately settled.

**1.4.25 Share capital and dividends**

Where either the Company or F&C has a holding in its own equity (classified as Treasury shares), the consideration paid is deducted from reserves. Where such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity attributable to the Company's equity holders, net of any directly attributable incremental transaction costs and the related tax effects.

Dividends are recognised as an appropriation on the date declared by the Group's directors or, if subject to approval, on the date approved by the shareholders.

## 2. Use of judgements, estimates and assumptions

The Group makes judgements in the application of critical accounting policies, that affect the reported amounts of assets and liabilities. The Group also makes key assumptions about the future and other sources of uncertainty. These are continually evaluated and based on historical experience and other factors, including expectations of future events that are considered to be reasonable under the circumstances.

### (a) Product classification

IFRS 4 requires contracts to be classified as either 'insurance contracts' or 'investment contracts' based on the significance of insurance risk present in the contract with consequential impacts on the accounting policies applied to the valuation of policyholder liabilities, deferral of acquisition costs and pattern of revenue recognition.

### (b) Liabilities arising from insurance contracts and investment contracts with DPF

Determination of the ultimate liabilities of insurance contracts or investment contracts with DPF arising is a critical accounting estimate. There are several sources of uncertainty that need to be considered in determining the key assumptions made in estimating the liabilities that the Group will ultimately pay on claims made and on maturity of the policies.

The most significant assumptions are:

- mortality, morbidity and persistency assumptions;
- for with-profits policies within FPLP, the stochastic model used to value liabilities is sensitive to risk-free rates, assumed asset volatilities and the assumed correlation between asset volatilities. Risk-free rates are set in accordance with current market gilt rates;
- valuation interest rate for annuities in payment - fixed interest assets, predominantly corporate bonds, are held to match the expected benefit outgo of the annuity portfolio. The excess yields on corporate bonds over that on gilts are called bond spreads and these reflect compensation for the higher risk of default (credit risk premium) and lower liquidity (illiquidity premium) compared to gilts. One of the key judgements is the assessment of how much of the spread is attributable to illiquidity premium;
- the methodology for determining the illiquidity premium assumed on backing assets in the derivation of valuation interest rates for annuities in payment has been changed from 50% of spreads on individual bonds (with an upper limit of 250 basis points), to an approach that derives the illiquidity premium by deducting an allowance for defaults (based on an analysis of historical defaults) from the total bond spread. This approach is consistent with current industry practice. The impact is an increase in profit before tax of £27m;
- other valuation interest rates have been calculated in the same way as in previous years, by reference to changes in consistent economic indices. The impact of all interest rate changes on liabilities is included within the impact of economic basis changes in note 28(a). The impact of these liability changes on surplus, is generally to offset some or all of the corresponding impact on the value of fixed interest assets backing the liabilities;
- for guaranteed annuity options (one of the principal guarantees written by the Group) the cost depends on assumptions such as the level of policy discontinuance and the tax-free cash take-up rate;
- changes in assumptions behind the valuation techniques for assets that are not quoted in active markets could have a significant impact on the value of assets that are backing insurance and investment contract liabilities.

The carrying value of insurance contract liabilities is £12,107m (2008: £12,677m) and investment contract liabilities with DPF is £3,974m (2008: £3,872m).

### **(c) Impairment testing**

The Group is required to perform an annual impairment test of goodwill. Other assets, excluding those assets held at fair value through the income statement, are reviewed where there is an indication of possible impairment. For most assets this requires the Group to estimate future cash flows and discount these amounts using a suitable rate which reflects the risk of those cash flows. In projecting cash flows, the most significant assumptions include:

- investment market conditions
- sales and margins
- expenses
- policy/client lapses
- discount rates
- terminal values

These assumptions are established using management's best estimate of the likely outcome.

There are five cash generating units for impairment testing: UK Life & Pensions, FPI, Lombard, and IFA Groups Sesame and Pantheon Financial.

Details of the testing for impairment performed during the year are contained in note 16.

### **(d) Fair value determination of financial instruments at fair value through the income statement**

Financial assets are designated at fair value as they are managed on a fair value basis. Financial liabilities such as investment contracts are designated at fair value to eliminate mismatch with corresponding assets which are managed on a fair value basis.

Fair values of financial instruments that are quoted in active markets are based on bid prices for the assets held. When independent prices are not available, fair values are determined by using valuation techniques which refer to market observable data. These include comparison with similar instruments when market observable prices are available.

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 generally 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.

Fair values of private equity investments are based on the revaluation of the underlying investments using International Private Equity and Venture Capital Valuation (IPEVC) guidelines. The valuations use earnings multiples reflecting similar multiples applying to quoted investments.

Methods considered when determining fair values of unlisted shares and other variable securities include discounted cash flow techniques and net asset valuation.

The value of derivative financial instruments is 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 balance sheet 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.

For units in unit trusts and shares in open ended investment companies, fair value is by reference to published bid values.

Participation in investment pools mainly relates to property investments. Property is independently valued in accordance with the Royal Institute of Chartered Surveyors' (RICS) guidelines on the basis of open market values as at each year end.

The carrying amount of financial assets at fair value through the income statement that are not based on quoted bid prices is £5,408m. These are mainly individual portfolios of assets held in unit-linked funds and therefore fair value movements do not impact shareholder profits. An analysis of financial assets by category is disclosed in note 21.

#### **(e) Staff pension schemes assumptions**

In assessing the pension benefit obligation, assumptions are made as to the life expectancy of all current, deferred and retired members, rates of increases of salaries and pensions, and interest and inflation rates. Material assumptions used and sensitivities are explained in detail in note 9. Estimations are made of the recoverability of any surplus, through expected refunds or reductions in contributions, and the surplus restricted accordingly.

The carrying value of the pension asset of the Group is £38m (2008: £57m), being a surplus in the FP pension scheme of £38m (2008: £73m) off set by a deficit of £16m in 2008 related to F&C schemes. The deficit in 2008 related to F&C schemes.

#### **(f) Share options and share based payments**

In assessing the cost of share options expected to vest, the key assumptions are future staff leaver numbers on the basis of past experience, and of the fair value of the options using assumptions including expected future levels of share price volatility and dividend yield.

The majority of schemes vested in October 2009 as a result of the acquisition by Resolution, resulting in an acceleration of the IFRS 2 charge.

The amount charged to the income statement in respect of share based payments is £21m (2008: £19m).

#### **(g) Deferred tax assets**

In assessing deferred tax assets, an estimate of probable future taxable profits is made, against which the temporary differences, being the carry forward of excess tax expenses, and tax losses are utilised. These involve management's best estimate based on past profit experience, adjusted for possible future deviations that management consider might occur.

The value of deferred tax assets recognised is detailed in note 24.

#### **(h) Fair value determination of investment properties and owner occupied properties**

Investment properties and properties occupied by the Group are measured at fair value at least annually at the balance sheet date. Fair values are measured by external independent valuers on the basis of open market value using methods set out in the 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.

#### **(i) Changes in accounting estimates**

The total impact of changes in accounting estimates in 2009 amounted to a £50m increase in profit, as follows:

- One-off basis changes: Expense assumptions  
Positive expense basis changes, largely as a result of the implementation of strategic review expense saving initiatives, offset by strengthening reserving for investment management fees and expenses on overseas business. The impact is to increase profit before tax by £23m.
- One-off basis changes: Lapses  
The profile of lapse assumptions on life protection business has been changed to reflect the most recently observed experience. The impact is to reduce profit before tax by £20m.
- One-off basis changes: Annuity valuation interest rate  
Assumption change for annuity business has resulted in increased surplus on conventional business. The impact is to increase profit before tax by £47m.

The total impact of changes in accounting estimates in 2008 amounted to a £61m increase in loss, as follows:

- One-off basis changes: Expense assumptions  
The liabilities to policyholders have been strengthened on Income Protection business to reflect the claims costs incurred. The impact is to reduce profit before tax by £39m.
- One-off basis changes: Lapses  
The profile of lapse assumptions on life protection business has been changed to reflect the most recently observed experience. The impact is to reduce profit before tax by £22m.

### **3. Segmental information**

#### **(a) Summary**

The Group presents segmental information based on internal financial information used by the Group to evaluate operating performance, in accordance with new requirements introduced by IFRS 8. The impact of IFRS 8 is an increase in the number of reportable segments presented, based principally on an operating measure of performance.

### **Operating segments**

The Group's management and internal reporting structure is based on the following operating segments:

- UK Life & Pensions
- Friends Provident International (FPI)
- Lombard
- Asset Management (including F&C's Managed Pension Fund business)
- All other includes the IFA Groups Sesame and Pantheon Financial, and associate undertaking AmLife Berhad

Corporate functions are not 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 presenting geographical segment information, on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets. The Group has defined two geographical areas:

- UK
- Rest of the World

**(b) Operating segment information****(i) IFRS based operating profit from continuing operations**

	UK Life & Pensions	FPI	Lombard	All other	Other Corporate	Total
Year ended 31 December 2009	£m	£m	£m	£m	£m	£m
Life result	234	(21)	15	11	-	239
Longer-term return on shareholder funds	26	2	(4)	-	-	24
Other income	1	-	-	4	4	9
<b>IFRS based operating profit/(loss) before tax from continuing operations</b>	<b>261</b>	<b>(19)</b>	<b>11</b>	<b>15</b>	<b>4</b>	<b>272</b>
Tax on IFRS based operating profit						99
<b>IFRS based operating profit after tax attributable to ordinary shareholders of the parent from continuing operations</b>						<b>371</b>
<b>Earnings per share</b>						
IFRS based operating earnings per share (pence)						<b>16.0</b>

	UK Life & Pensions	FPI	Lombard	All other	Other Corporate	Total
Year ended 31 December 2008	£m	£m	£m	£m	£m	£m
Life result	(291)	(17)	11	-	-	(297)
Longer-term return on shareholder funds	45	3	-	-	4	52
Other income	3	-	-	11	(15)	(1)
<b>IFRS based operating (loss)/profit before tax from continuing operations</b>	<b>(243)</b>	<b>(14)</b>	<b>11</b>	<b>11</b>	<b>(11)</b>	<b>(246)</b>
Tax on IFRS based operating loss						90
<b>IFRS based operating loss after tax attributable to ordinary shareholders of the parent from continuing operations</b>						<b>(156)</b>
<b>Earnings per share</b>						
IFRS based operating earnings per share (pence)						<b>(6.7)</b>

**(ii) Reconciliation of IFRS based operating profit before tax to profit before tax**

Year ended 31 December 2009	UK Life & Pensions £m	FPI £m	Lombard £m	Other		Total £m
				All other £m	Corporate £m	
<b>IFRS based operating profit/(loss) before tax</b>	<b>261</b>	<b>(19)</b>	<b>11</b>	<b>15</b>	<b>4</b>	<b>272</b>
Non-recurring items (i)	(50)	-	-	-	(36)	(86)
Amortisation of acquired present value of in-force business	(9)	(6)	(10)	-	-	(25)
Amortisation of acquired intangible assets	-	(1)	(9)	(5)	-	(15)
Impairment of goodwill	-	-	-	(23)	-	(23)
Impairment of other intangible assets	-	-	-	(8)	-	(8)
Interest payable on STICS	31	-	-	-	8	39
Short-term fluctuations in investment return	(4)	(2)	3	-	(16)	(19)
<b>Profit/(loss) before tax excluding return generated within policyholder funds</b>	<b>229</b>	<b>(28)</b>	<b>(5)</b>	<b>(21)</b>	<b>(40)</b>	<b>135</b>
Policyholder tax	67	-	-	-	-	67
Returns on Group-controlled funds attributable to third parties	16	-	-	-	-	16
<b>Profit/(loss) before tax</b>	<b>312</b>	<b>(28)</b>	<b>(5)</b>	<b>(21)</b>	<b>(40)</b>	<b>218</b>

(i) Non recurring items:

UK Life & Pensions items include £49m (2008: £31m) of strategic review costs.

Corporate items include £34m (2008: £9m) of costs in respect of the Group reorganisation and £2m (2008: £10m) of other project costs.

Year ended 31 December 2008	UK Life & Pensions £m	FPI £m	Lombard £m	Other		Total £m
				All other £m	Corporate £m	
<b>IFRS based operating (loss)/profit before tax</b>	<b>(243)</b>	<b>(14)</b>	<b>11</b>	<b>11</b>	<b>(11)</b>	<b>(246)</b>
Non-recurring items (i)	(31)	(1)	-	-	(19)	(51)
Amortisation of acquired present value of in-force business	(9)	(6)	(11)	-	-	(26)
Amortisation of acquired intangible assets	-	(1)	(8)	(5)	-	(14)
Interest payable on STICS	31	-	-	-	21	52
Short-term fluctuations in investment return	(64)	(3)	-	-	(4)	(71)
<b>(Loss)/profit before tax excluding return generated within policyholder funds</b>	<b>(316)</b>	<b>(25)</b>	<b>(8)</b>	<b>6</b>	<b>(13)</b>	<b>(356)</b>
Policyholder tax	(78)	-	-	-	-	(78)
Returns on Group-controlled funds attributable to third parties	(154)	-	-	-	-	(154)
<b>(Loss)/profit before tax</b>	<b>(548)</b>	<b>(25)</b>	<b>(8)</b>	<b>6</b>	<b>(13)</b>	<b>(588)</b>

(iii) Revenue and expenses

Year ended 31 December 2009	UK Life & Pensions £m	FPI £m	Lombard £m	Other		Elimination of inter- segment amounts (ii) £m	Total £m
				All other £m	Corporate £m		
Gross earned premiums on insurance and investment contracts	2,861	788	2,803	-	-	-	6,452
Investment contract premiums (i)	(2,001)	(776)	(2,803)	-	-	-	(5,580)
Gross earned premiums	860	12	-	-	-	-	872
Premiums ceded to reinsurers	(97)	(1)	-	-	-	-	(98)
<b>Net earned premiums</b>	<b>763</b>	<b>11</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>774</b>
Fee and commission income	128	209	102	180	-	(6)	613
Investment return:							
Interest income	775	8	90	-	-	(24)	849
Investment return: Other	2,820	387	1,102	2	23	-	4,334
<b>Total revenue</b>	<b>4,486</b>	<b>615</b>	<b>1,294</b>	<b>182</b>	<b>23</b>	<b>(30)</b>	<b>6,570</b>
Intersegment revenue	2	1	6	6	15	(30)	-
<b>Total external revenue</b>	<b>4,484</b>	<b>614</b>	<b>1,288</b>	<b>176</b>	<b>8</b>	<b>-</b>	<b>6,570</b>
Net claims and benefits paid	1,272	4	-	-	-	-	1,276
Movement in insurance and investment contract liabilities	2,299	517	1,128	-	-	-	3,944
Transfer from fund for future appropriations	(128)	-	-	-	-	-	(128)
Movement in net assets attributable to unit-holders	136	-	-	-	-	-	136
Acquisition expenses	207	85	58	136	(1)	(1)	484
Administrative and other expenses	272	34	109	78	51	(12)	532
Finance costs	116	3	4	-	13	(17)	119
<b>Total claims, benefits and expenses</b>	<b>4,174</b>	<b>643</b>	<b>1,299</b>	<b>214</b>	<b>63</b>	<b>(30)</b>	<b>6,363</b>
Intersegment expenses	20	1	3	-	6	(30)	-
<b>Total external claims, benefits and expenses</b>	<b>4,154</b>	<b>642</b>	<b>1,296</b>	<b>214</b>	<b>57</b>	<b>-</b>	<b>6,363</b>
Share of profits of associates and joint venture	-	-	-	11	-	-	11
<b>Profit / (loss) before tax from continuing operations</b>	<b>312</b>	<b>(28)</b>	<b>(5)</b>	<b>(21)</b>	<b>(40)</b>	<b>-</b>	<b>218</b>
Policyholder tax	(67)	-	-	-	-	-	(67)
Shareholder tax	113	-	3	6	(5)	-	117
<b>Segmental result after tax</b>	<b>358</b>	<b>(28)</b>	<b>(2)</b>	<b>(15)</b>	<b>(45)</b>	<b>-</b>	<b>268</b>

(i) Accounted for as deposits under IFRS

(ii) Eliminations include intersegment fee income and loan interest. Intersegment transactions are undertaken on an arms length basis.

Year ended 31 December 2008	Other						Elimination of inter-segment amounts (ii) £m	Total £m
	UK Life & Pensions £m	FPI £m	Lombard £m	All other £m	Corporate £m			
Gross earned premiums on insurance and investment contracts	3,074	841	2,329	-	-	-	6,244	
Investment contract premiums (i)	(2,143)	(823)	(2,329)	-	-	-	(5,295)	
Gross earned premiums	931	18	-	-	-	-	949	
Premiums ceded to reinsurers	(98)	(2)	-	-	-	-	(100)	
<b>Net earned premiums</b>	833	16	-	-	-	-	849	
Fee and commission income	147	196	87	210	-	(4)	636	
Investment return:								
Interest income	933	13	111	4	-	-	1,061	
Investment return: Other	(5,535)	(242)	(1,661)	1	28	(27)	(7,436)	
<b>Total revenue</b>	(3,622)	(17)	(1,463)	215	28	(31)	(4,890)	
Intersegment revenue	2	1	7	5	16	(31)	-	
<b>Total external revenue</b>	(3,624)	(18)	(1,470)	210	12	-	(4,890)	
Net claims and benefits paid	1,540	2	-	-	-	-	1,542	
Movement in insurance and investment contract liabilities	(5,015)	(69)	(1,604)	-	-	-	(6,688)	
Transfer from fund for future appropriations	(80)	-	-	-	-	-	(80)	
Movement in net assets attributable to unit-holders	(271)	-	-	-	-	-	(271)	
Acquisition expenses	350	42	43	160	(1)	-	594	
Administrative and other expenses	274	28	100	49	41	(12)	480	
Finance costs	128	5	6	-	1	(19)	121	
<b>Total claims, benefits and expenses</b>	(3,074)	8	(1,455)	209	41	(31)	(4,302)	
Intersegment expenses	16	2	3	-	10	(31)	-	
<b>Total external claims, benefits and expenses</b>	(3,090)	6	(1,458)	209	31	-	(4,302)	
Share of profits of associates and joint venture	-	-	-	-	-	-	-	
<b>(Loss)/profit before tax from continuing operations</b>	(548)	(25)	(8)	6	(13)	-	(588)	
Policyholder tax	78	-	-	-	-	-	78	
Shareholder tax	149	-	(8)	(2)	(44)	-	95	
<b>Segmental result after tax</b>	(321)	(25)	(16)	4	(57)	-	(415)	

(i) Accounted for as deposits under IFRS

(ii) Eliminations include intersegment fee income and loan interest. Intersegment transactions are undertaken on an arms length basis.

(iv) Products and Services

Year ended 31 December 2009	Protection £m	Investment £m	Annuities £m	Individual Pensions £m	Group Pensions £m	Other (i) £m	Total £m
Gross earned premiums	330	220	299	14	9	-	872
<b>Net earned premiums</b>	<b>236</b>	<b>218</b>	<b>298</b>	<b>13</b>	<b>9</b>	<b>-</b>	<b>774</b>
Fee and commission income from service activities	-	337	-	102	-	174	613
Total external revenue	236	555	298	115	9	174	1,387

(i) Other includes revenue streams from Sesame and Pantheon

Year ended 31 December 2008	Protection £m	Investment £m	Annuities £m	Individual Pensions £m	Group Pensions £m	Other (i) £m	Total £m
Gross earned premiums	346	246	318	30	9	-	949
Net earned premiums	249	244	318	29	9	-	849
Fee and commission income from service activities	-	332	-	98	-	206	636
Total external revenue	249	576	318	127	9	206	1,485

(v) Assets and liabilities

Year ended 31 December 2009	UK Life & Pensions £m	FPI £m	Lombard £m	Other All other (i) £m	Corporate £m	Elimination of inter- segment amounts £m	Total £m
Segment assets	38,652	5,525	15,263	148	576	(544)	59,620
Investment in associates and joint venture	8	-	-	43	-	-	51
<b>Total assets</b>	<b>38,660</b>	<b>5,525</b>	<b>15,263</b>	<b>191</b>	<b>576</b>	<b>(544)</b>	<b>59,671</b>
<b>Total liabilities</b>	<b>36,348</b>	<b>5,384</b>	<b>14,786</b>	<b>121</b>	<b>323</b>	<b>(544)</b>	<b>56,418</b>
Other segment information:							
Capital expenditure	67	-	5	-	2	-	74
Depreciation	-	-	2	-	5	-	7
Amortisation	9	7	24	29	2	-	71
Impairment (ii)	1	-	-	30	-	-	31

Year ended 31 December 2008	UK Life & Pensions £m	FPI £m	Lombard £m	Asset Mgt (iii) £m	Other All other £m	Corporate £m	Elimination of inter- segment amounts £m	Total £m
Segment assets	36,208	4,806	13,502	1,503	186	660	(444)	56,421
Investment in associates and joint venture	14	-	-	-	-	33	-	47
<b>Total assets</b>	<b>36,222</b>	<b>4,806</b>	<b>13,502</b>	<b>1,503</b>	<b>186</b>	<b>693</b>	<b>(444)</b>	<b>56,468</b>
<b>Total liabilities</b>	<b>34,146</b>	<b>4,663</b>	<b>12,989</b>	<b>1,326</b>	<b>133</b>	<b>38</b>	<b>(444)</b>	<b>52,851</b>
Other segment information:								
Capital expenditure	14	-	6	2	-	3	-	25
Depreciation	-	-	1	3	1	5	-	10
Amortisation	9	7	22	50	5	5	-	98
Impairment (ii)	18	-	3	264	-	-	-	285

(i) Includes amounts in respect of F&C for the period to 3 July 2009.

(ii) Comprises impairment on Asset Management goodwill £nil (2008: £216m), Asset Management investment management contracts £nil (2008: £48m), Pantheon goodwill £23m (2008: £nil) and other intangibles £8m (2008: £21m).

(iii) Asset Management amounts relate to F&C which was de-merged by the Group on 3 July 2009, see note 34 for further details.

### (c) Geographical segment information

Year ended 31 December 2009	UK £m	Rest of the World £m	Total £m
Gross earned premiums	860	12	872
Fee and commission income	349	264	613
Revenue from external customers	1,209	276	1,485
Investment return			5,183
Premiums ceded to reinsurers			(98)
<b>Total revenue</b>			<b>6,570</b>

Year ended 31 December 2008	UK £m	Rest of the World £m	Total £m
Gross earned premiums	936	13	949
Fee and commission income	399	237	636
Revenue from external customers	1,335	250	1,585
Investment return			(6,375)
Premiums ceded to reinsurers			(100)
Total revenue			(4,890)

## 4. Investment return

### (a) Net investment return

	2009 £m	2008 £m
Interest income:		
Assets at fair value through profit and loss	873	1,060
Other	3	6
Expected return on pension scheme assets net of interest cost	7	4
Dividend income	668	867
Rental income	112	129
Movement in fair value:		
Financial assets designated on initial recognition	3,993	(8,275)
Investment properties	67	(615)
Financial derivative instruments	(540)	449
<b>Total net investment return</b>	<b>5,183</b>	<b>(6,375)</b>

### (b) Longer-term investment return – operating profit

The longer-term investment return used in arriving at operating profit before tax is calculated in respect of equity and fixed interest investments of shareholder funds and surplus assets held within long-term funds, by applying the longer-term rate of return for each investment category to the quarterly weighted average of the corresponding assets, after adjusting for the effect of any short-term market movements. The longer-term rates of return are based on assumed gilt and cash returns, adjusted where appropriate to reflect the additional risks associated with the type of investment. The directors have determined the longer-term rates of investment return to be as follows:

	2009 %	2008 %
Equities	6.70	8.00
Government fixed interest	3.70	5.00
Other fixed interest	6.70	5.50

### (c) Sensitivity of longer-term investment return – operating profit

	2009 £m	2008 £m
Longer-term investment return:	24	52
After the impact of a 1% increase in the longer-term rates of investment return	38	72
After the impact of a 1% decrease in the longer-term rates of investment return	8	33

### (d) Comparison of longer-term and actual investment return – operating profit

	1 January 2009 to 31 December 2009 £m	1 January 2008 to 31 December 2008 £m	1 January 2005 to 31 December 2009 £m	1 January 2004 to 31 December 2008 £m
Actual investment return attributable to shareholders	4	(19)	136	245
Longer-term investment return	(23)	(52)	(241)	(304)
<b>Cumulative deficit of actual return over longer-term returns</b>	<b>(19)</b>	<b>(71)</b>	<b>(105)</b>	<b>(59)</b>

## 5. Net claims and benefits paid

Year ended 31 December 2009	Gross claims and benefits paid £m	Amounts receivable from reinsurers £m	Total net claims and benefits paid £m
Protection	152	(70)	82
Investment	705	(2)	703
Individual pensions	129	(1)	128
Group pensions	138	-	138
Annuities	346	(121)	225
<b>Total</b>	<b>1,470</b>	<b>(194)</b>	<b>1,276</b>

Year ended 31 December 2008	Gross claims and benefits paid £m	Amounts receivable from reinsurers £m	Total net claims and benefits paid £m
Protection	173	(67)	106
Investment	921	(2)	919
Individual pensions	162	-	162
Group pensions	150	-	150
Annuities	327	(122)	205
<b>Total</b>	<b>1,733</b>	<b>(191)</b>	<b>1,542</b>

## 6. Acquisition expenses

	2009	2008
	£m	£m
Commission	240	302
Other acquisition expenses	318	349
Deferral	(201)	(262)
Amortisation of DAC	126	187
Impairment of DAC	1	18
<b>Net acquisition expenses</b>	<b>484</b>	<b>594</b>

## 7. Administrative and other expenses

### (a) Analysis of administrative and other expenses

	2009	2008
	£m	£m
Amortisation of intangible assets	47	48
Impairment of intangible assets (i)	31	3
Employee remuneration	122	182
Share based payments: Equity-settled transactions	12	5
Auditors' remuneration	7	4
Investment expenses and charges	107	89
Investment property expenses	2	3
IT costs	19	6
Operating lease rentals: Land and buildings (ii)	4	3
Renewal commission	23	23
Office costs	15	17
Strategic review costs (iii)	49	42
Group reorganisation costs (iv)	42	-
Sundry administrative expenses	52	55
<b>Total administrative and other expenses</b>	<b>532</b>	<b>480</b>

(i) Includes impairment of goodwill of £23m (2008: £nil) see note 16.

(ii) Sub-lease rentals of £4m (2008: £3m) were received during the year.

(iii) Includes employee remuneration of £29m (2008: £15m)

(iv) Includes employee remuneration of £8m (2008: £nil)

### (b) Auditors' remuneration

At the Company's Annual General Meeting held on 21 May 2009, the shareholders approved the reappointment of KPMG Audit Plc as auditor to the Company and subsidiaries. On 5 November 2009 the Company appointed Ernst & Young LLP as auditors to the Company and the majority of its subsidiaries; details of the auditor and audit fees for those subsidiaries which are not audited by Ernst & Young LLP are set out in the following paragraphs.

The following tables give an analysis of the total fees excluding VAT in respect of services provided to the Group. Information concerning the auditors' appointment process is given in the directors' report on page 13.

**Fees for the year ended 31 December 2009**

	UK Life & Pensions £m	International Life & Pensions £m	Total £m
<b>Fees paid to Ernst &amp; Young</b>			
Audit of the Group financial statements	0.9	-	0.9
Subsidiary and pension scheme audit fees	0.7	0.3	1.0
Total audit fees	1.6	0.3	1.9
Other assurance pursuant to legislation and regulation	0.1	-	0.1
Services relating to information technology	-	-	-
Services relating to taxation	0.2	-	0.2
Services relating to corporate finance transactions	0.2	-	0.2
All other services	0.9	-	0.9
Total Ernst & Young fees	3.0	0.3	3.3
<b>Fees paid to KPMG</b>			
Audit of the Group financial statements	0.3	-	0.3
Subsidiary and pension scheme audit fees	0.2	-	0.2
Total audit fees	0.5	-	0.5
Other assurance pursuant to legislation and regulation	-	-	-
Services relating to information technology	0.6	-	0.6
Services relating to corporate finance transactions	1.0	-	1.0
All other services	1.1	-	1.1
Total KPMG fees	3.2	-	3.2
<b>Total audit fees</b>	<b>6.2</b>	<b>0.3</b>	<b>6.5</b>

The above table excludes fees paid by F&C to KPMG Audit plc in the period prior to de-merger which amounted to £0.7m (2008:£1.2m). Services of £1.3m relating to taxation, corporate finance transactions and other services provided by Ernst & Young LLP relate to the period prior to their appointment as auditors.

KPMG Audit Plc is the auditor of the principal pension scheme of the Group, the Friends Provident Pension Scheme (FPPS). Fees paid to KPMG Audit Plc in 2009 in respect of the audit of FPPS amounted to £nil (2008: £51,000). KPMG Audit Plc is the auditor of Sesame and was paid £0.2m in audit fees and £nil in other fees in 2009.

Deloitte and Touche LLP is the auditor of Pantheon Financial and was paid £0.04m (2008: £0.04m) in audit fees and £nil (2008: £nil) in other fees.

	UK Life & Pensions £m	International Life & Pensions £m	Total £m
<b>Fees for the year ended 31 December 2008</b>			
<b>Fees paid to KPMG</b>			
Statutory audit fees	0.7	0.2	0.9
Subsidiary & pension scheme audit fees	0.9	-	0.9
Total audit fees	1.6	0.2	1.8
Other assurance pursuant to legislation and regulation	0.6	-	0.6
Services relating to information technology	0.7	-	0.7
Services relating to corporate finance transactions	0.3	-	0.3
All other services	0.2	-	0.2
Total KPMG fees	3.4	0.2	3.6

## 8. Employee remuneration

### (a) Aggregate remuneration

The aggregate remuneration in respect of employees, including executive directors, was as follows:

	2009	2008
	£m	£m
Wages and salaries	174	179
Social security costs	12	13
Pension costs	19	27
Share based payments expenses	12	5
<b>Total remuneration</b>	<b>217</b>	<b>224</b>

### (b) Average number of employees

The average number of employees, including executive directors, employed by the Group was as follows:

	2009	2008
	Number	Number
UK Life & Pensions and Corporate	2,892	3,478
FPI	287	292
Lombard	455	441
Other	595	607
<b>Average number of employees</b>	<b>4,229</b>	<b>4,818</b>

### (c) Directors' emoluments

	2009	2008
	£	£
<b>Total</b>		
Aggregate emoluments	3,260,700	3,968,585
Aggregate amounts (excluding shares) receivable under long-term incentive schemes	-	-
Sums paid to third parties for directors' services	483,646	616,930
Compensation for loss of office	136,208	-
Company pension contributions to money purchase scheme	36,964	909,370

	2009	2008
	Number	Number
<b>Total</b>		
Number of directors to whom retirements benefits are accruing under money purchase schemes	2	2
Number of directors to whom retirement benefits are accruing under a defined benefit scheme	-	1
Number of directors who exercised share options	1	-
Number of directors in respect of whose qualifying services shares were received under long-term incentive schemes	2	-

	2009	2008
	£	£
<b>Highest paid director</b>		
Total amount of emoluments and amounts (excluding shares) receivable under long-term incentive schemes	1,311,201	1,179,754
Company pension contributions to money purchase scheme	15,873	6,370
Defined benefit pension scheme:		
Accrued pension at the end of year	-	-

## 9. Staff pension schemes

### (a) Introduction

The Group operates a defined benefit scheme: the Friends Provident Pension Scheme (FPPS), to which the majority of the Group's UK Life & Pensions employees belong. In addition, defined contribution schemes are operated by FP UK Life & Pensions, Friends Provident International Ltd, Pantheon Financial and Sesame Bankhall Group. Lombard does not operate a pension scheme.

### (b) Total schemes

The pension surplus and deficits are recognised in the statement of financial position net of penal tax at a rate of 35% and gross of deferred tax respectively.

	2009 £m	Restated (i) 2008 £m
<b>Pension surplus/(deficit) recognised in the statement of financial position</b>		
Surplus in the FPPS	38	73
Deficit in the F&C schemes (ii)	-	(16)
<b>Net pension asset/(liability)</b>	<b>38</b>	<b>57</b>
Recognised as follows:		
Insurance and other receivables	38	73
Provisions	-	(22)
Deferred tax liabilities	-	6
	<b>38</b>	<b>57</b>
<b>Analysis of net pension asset/(liability)</b>		
FPPS	38	73
F&C schemes (ii)	-	(16)
	<b>38</b>	<b>57</b>
<b>Amounts recognised in the income statement</b>		
FPPS	(7)	(19)
F&C schemes (ii)	-	(3)
	<b>(7)</b>	<b>(22)</b>
<b>Amounts recognised in the consolidated statement of comprehensive income</b>		
FPPS	(52)	53
F&C schemes (ii)	(19)	1
	<b>(71)</b>	<b>54</b>

(i) Accounting policy change (note 1.3)

(ii) As detailed in note 34, the Group's stake in F&C was demerged on 3 July 2009.

### (c) Friends Provident Pension Scheme

The FPPS is a UK defined benefit scheme to which the majority of the Group's UK Life & Pensions employees belong. The Scheme's assets, which are administered by three external investment managers including F&C, are held under the control of the Trustee and used to secure benefits for the members of the Scheme and their dependants in accordance with the Trust Deed and Rules.

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

### (i) Principal assumptions used by the Scheme Actuary

	2009 %	2008 %
Rate of increase in salaries*	1.50	3.50
Rate of increase in pensions in payment	<b>Relevant swap curve</b>	2.96
Discount rate for active and deferred members	5.93	5.82
Discount rate for pensioners	5.70	6.13

\*Plus allowance for salary scale increases

In 2009 and 2008, inflation rate assumptions have been based on the Bloomberg Zero Coupon RPI Swaps curve and the Citigroup zero coupon RPI swaps curve respectively.

### (ii) Mortality assumptions

Mortality assumptions for pensioners are based on the appropriate 2000 series mortality tables published by the Continuous Mortality Investigations (CMI) in 2006. In addition, allowance is made for future improvements in mortality according to each individual's year of birth through the use of the 'medium cohort' projections (with certain amendments) published by the CMI in 2002. The amendments are to allow for 75% of the medium cohort projections for females (with a minimum annual rate of improvement in future longevity of 0.75%), and 100% of medium cohort projections for males (with a minimum annual rate of improvement in future longevity of 1.00%). The mortality assumptions used are unchanged from 2008.

The mortality assumptions provide the following average life expectancies of future members retiring at the age of 60, and current pensioners.

	2009	2008
Expected age at death of future male pensioner	89	89
Expected age at death of future female pensioner	90	90
Expected age at death of current male pensioner	88	88
Expected age at death of current female pensioner	89	89

The present value of providing an annuity of £1 per annum for members aged 60, based on the above assumptions, is as follows:

Cost of annuities	2009 £	2008 £
Male annuity	22.02	20.85
Female annuity	21.56	20.21

These rates assume a monthly payments model with a discount rate of 5.93% (2008: 5.82%). The rates also assume two thirds of the members' benefit will be paid to the spouse on the death of the member. A guarantee is provided for pensioners who die within five years of retiring and pensions in excess of the Guaranteed Minimum Pension will increase in line with the LPI5% swap curve at 31 December 2009 (2008: 2.96% per annum).

	2009 % of total membership	2008 % of total membership
Active members	14	19
Deferred members	62	59
Pensioners	24	22
	<b>100</b>	<b>100</b>

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

<b>Assumption</b>	<b>Change in assumption</b>	<b>Impact on scheme liabilities</b>
Inflation	Increase/decrease by 0.5%	Increase/decrease by 8.4%
Salaries	Increase/decrease by 0.5%	Increase/decrease by 1.6%
Pensions	Increase/decrease by 0.5%	Increase/decrease by 5.9%
Discount rate	Increase/decrease by 0.5%	Decrease/increase by 10.2%
Rate of mortality	Increase/decrease by 1 year	Increase/decrease by 2.4%

### (iii) Changes in the present value of obligations of defined benefit scheme

	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Present value of obligations at 1 January</b>	<b>912</b>	971
Interest cost	<b>54</b>	54
Current service cost	<b>17</b>	21
Prior service credit	<b>(10)</b>	-
Contributions by plan participants	<b>1</b>	1
Actuarial losses/(gains)	<b>11</b>	(102)
Benefits paid	<b>(40)</b>	(35)
Termination benefits	<b>3</b>	2
Augmentation	<b>7</b>	-
Curtailements and settlements	<b>(2)</b>	-
<b>Present value of obligations at 31 December</b>	<b>953</b>	912

### (iv) Analysis of defined benefit obligations

	<b>2009</b>	2008
	<b>£m</b>	£m
Wholly or partly funded plans	<b>953</b>	912

The profile of the obligations is analysed as follows:

	<b>2009</b>	2008
	<b>£m</b>	£m
Active members	<b>213</b>	291
Deferred members	<b>361</b>	292
Pensioners	<b>379</b>	329
	<b>953</b>	912

### (v) Changes in present value of defined benefit plan assets

	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Fair value of plan assets at 1 January</b>	<b>1,025</b>	976
Expected return on plan assets	<b>61</b>	58
Actuarial losses	<b>(66)</b>	(17)
Employer contributions	<b>31</b>	42
Contributions by plan participants	<b>1</b>	1
Benefits paid	<b>(40)</b>	(35)
<b>Fair value of plan assets at 31 December</b>	<b>1,012</b>	1,025

Included within the fair value of plan assets at 31 December 2009 are investments in internal linked funds of £nil (2008: £62m).

### (vi) Assets in the defined benefit scheme and the expected rate of return

	Expected rate of return		Value	
	2009	2008	2009	2008
	%	%	£m	£m
Equities	<b>7.30</b>	6.74	<b>167</b>	180
Liability Driven Investment pools	<b>5.93</b>	5.82	<b>427</b>	591
Fixed interest (LDI in specie)	<b>5.93</b>	-	<b>71</b>	-
Insured assets	<b>5.70</b>	6.13	<b>300</b>	240
Cash	<b>3.80</b>	3.24	<b>47</b>	14
Total market value of assets			<b>1,012</b>	1,025
Present value of Scheme liabilities			<b>(953)</b>	(912)
Surplus in the Scheme			<b>59</b>	113

The expected return on net pension scheme assets is calculated using the assumptions and the market value of pension scheme assets as stated in the table above for the preceding year.

In May 2008, the FPPS entered into a bulk annuity arrangement with Aviva. The purchase of the annuity was partly funded by a £160m loan from a Group company. The loan is repayable over a maximum of 2 years and incurs interest at 3 months LIBOR +2%. £68m of the loan was outstanding at 31 December 2009 (2008: £82m). The insured assets shown above are net of this loan.

**(vii) Amounts recognised in the income statement in respect of defined benefit scheme**

	2009 £m	2008 £m
Interest cost	(54)	(54)
Current service costs	(17)	(21)
Prior service credit	10	-
Termination benefits	(3)	(2)
Expected return on plan assets	62	58
Augmentation	(7)	-
Curtailments	2	-
Total amounts recognised in the income statement	(7)	(19)
Actual return on plan assets	(5)	41

**(viii) Amounts recognised in the consolidated statement of comprehensive income in respect of defined benefit scheme**

	2009 £m	Restated (i) 2008 £m
Actuarial (losses)/gains on defined benefit schemes	(52)	53
(i) accounting policy change (note 1.3)		

**(ix) History of experience gains and losses of defined benefit scheme**

	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m
Present value of defined benefit obligation	(907)	(942)	(971)	(912)	(953)
Fair value of plan assets	848	911	976	1,025	1,012
Surplus/(deficit)	(59)	(31)	5	113	59
<b>Difference between the expected and actual return on scheme assets</b>					
Amounts	157	(21)	14	(17)	(67)
Percentage of closing scheme assets	19%	(2)%	1%	(2)%	(7)%
<b>Experience gains and losses on scheme liabilities</b>					
Amount	(7)	(4)	24	(17)	(5)
Percentage of the present value of the scheme liabilities	(1)%	-	(2)%	2%	(1)%
<b>Total amount recognised in the statement of comprehensive income before penal tax restriction</b>					
Amount	(9)	(12)	32	85	(77)
Percentage of the present value of the scheme liabilities	(1)%	(1)%	3%	9%	(8)%

### **(x) Future funding**

The most recently completed triennial actuarial valuation of FPPS was performed by an independent actuary and was carried out as at 30 September 2008. From 1 July 2007 the scheme had already been closed to new members. Existing member contributions are 6% in 2009 and 2010 for benefits with a pension age of 60, and 2% for benefits with a pension age of 65. The Group increased its contributions from 20% to 25% in 2009 and will pay an extra 1% in 2010 for pension age 60 members, as their rate has been held at 6% in 2010 (and did not increase to 7% as planned).

Under a review of the key employment benefits and following consultation, the Group has amended the provision of defined benefits under the FPPS from 1 January 2011 as follows:

- the future service accrual rate will reduce from one-sixtieth to one-eightieth for each year of pensionable service;
- the inflation limit on increases to pensions in deferment and payment will reduce from 5% to the statutory level of 2.5% for future service;
- final pensionable salary will be phased in to become a three year average for all pensionable service (with pensionable salary becoming fixed at 1 January each year). For past service, final pensionable salary will be not less than the rate of pensionable salary at 31 December 2010; and
- member contributions for pension age 60 benefits will be 7% and for pension age 65 benefits will be 2%.

The Group is scheduled to reduce its future service contribution to 15% from October 2011.

The FPPS reported a deficit of £65m as at 30 September 2009 on the scheme specific funding basis. The Trustee and the Group have agreed a Recovery Plan and determined that the anticipated return on assets and on new contributions during the recovery period is expected to be sufficient to eliminate the funding shortfall by the end of the recovery period set as 30 September 2014. The Recovery Plan has been underpinned by an agreement that the Group makes available up to £50m of additional contributions if the extra asset recovery anticipated over and above the standard return assumed in the valuation is less than expected. If triggered, the additional contributions would be spread by the Group over six years from 30 September 2011 at up to £8.3m a year.

A Statement of Funding Principles has been agreed by the Group and the Trustee. That statement provides the principles around assumption setting, in particular, choosing the discount rate, future price inflation, future pension increases, rates of mortality, future pay increases, employee turnover, pension commencement age, and typical partner or dependant information and assumes:

- the discounted value of the annuity contract will exactly match the discounted liabilities for pensioners insured under the contract;
- the strategic allocation to matched assets will normally be maintained at around 75% of non-insured assets and provide a return equal to the yield available on swaps contracts of a tenor that matches the liability cash flows;
- the strategic allocation to return seeking assets will normally be maintained at around 25% of non insured assets and provide a return that is 3% in excess of the return on the matched assets; and
- the discounted value of non insured liabilities will be broadly equal to swaps plus 0.75% in excess of the yields available on swaps contracts of the appropriate tenor.

In addition the Trustee has the following objectives for investments, as set out in the Statement of Investment Principles:

- to achieve and maintain a minimum funding level of 100% on a long-term ongoing basis and
- to agree the cost of providing the benefits and consult the Employer on any material changes that may be required to the agreed funding arrangements in light of experience.

Amounts paid to FPPS in the past 2 years, including an additional contribution of £20m in 2008, and expected future payments over the next 3 years are as follows:

	<b>£m</b>
FPPS (DB) contributions paid	
2008	42
2009	31
FPPS (DB) contributions expected to be paid	
2010	14
2011	13
2012	12

A defined contribution plan is in operation for new employees, to which the Principal Employer contributes 8% plus up to a further 5% to match contributions by employees.

### **(xi) Risk Management**

The Trustee has established a separate Risk and Investment Subcommittee (RISC) which is responsible for assisting the Trustee in investment policy and monitoring the Scheme's investments. The RISC seeks advice from the investment adviser and believes it has sufficient skills and expertise to make investment decisions based on this advice.

The Trustee sets general investment policy but delegates day to day responsibility for the selection of specific investments (other than investments in respect of members' voluntary contributions) to the Investment Manager.

The Trustee has set performance and risk targets for the Investment Manager on non insured assets. The performance objectives are long-term (5 years), however, the Trustee monitors the Investment Manager on a regular basis in order to ensure that it is on track to meet its long-term objectives.

#### Interest rate and inflation risk

The fund adopted a Liability Driven Investment (LDI) strategy in 2003 to reduce exposure to interest rate and inflation risk. This strategy has been carried out more recently through investing in a pooled LDI product managed by F&C, and through investing in an insured bulk annuity buy-in contract.

F&C's LDI product is designed to hedge the Fund against inflation and interest rate movements, based on the liability to pay the future benefits promised to members, and to provide an investment return similar to cash, benchmarked against three months LIBOR.

F&C's LDI product provides a flexible series of investment pools spread over a duration of the next 50 years to match the inflation and interest rate sensitivities based on this expected annual cash flow as it changes each year. These LDI pools are collateralised daily and are managed within a controlled leverage range by F&C; the LDI pools have a weekly investment valuation. The flexibility of F&C's LDI product will mean that the Scheme can review the liabilities periodically to ensure the interest rate and inflation sensitivities are well matched based on the latest cash flow data for non insured members.

The allocation to matched assets under the LDI strategy, including LDI pools, cash and fixed interest is 75% of the non insured assets.

The Trustee has also purchased a bulk annuity buy-in contract as a fully matching asset, mitigating a wider range of risks (market and longevity risk in addition to interest rate and inflation risk) on benefits reassured under the contract.

#### Market risk

The Trustee, with the full support of the Group, has agreed and implemented a strategic asset allocation to return seeking assets of 25% of the non insured fund.

#### Longevity risk

The Trustee, with the full support and involvement of the Group, invested 37% of the Scheme's assets in a bulk annuity contract with Aviva Annuity UK Limited as a buy-in investment in 2008 with a further 4% in 2009. The contract between the Trustee and Aviva reassures benefits for pensioners in payment up to 1 July 2009 and includes a facility for the Trustee to invest further tranches of benefits up to 30 June 2013.

The contract is an investment of the Trustee and includes additional security to that of a standard bulk annuity contract with an insurance company. The ownership of the Scheme's assets are being drip fed to Aviva over the duration of the contract. This additional protection has been negotiated by the Trustee to mitigate the risk of any decline in the financial strength of Aviva as the counterparty under the contract. This was a general requirement of the tender process for any counterparty to be selected. These assets have been set up under a ring fenced Trustee Investment Plan that is managed by Aviva and with the title to those assets secured in the Trustee's name through a safekeeping custody account set up with Citibank. These ring fenced assets would only be accessed by the Trustee in the event of Aviva failing to meet its obligations under this long term contract.

#### Currency risk

From December 2009 the Trustee has invested its return seeking assets through two new managers, Aberdeen Unit Trust Managers Limited and Walter Scott & Partners Limited in their global equity pooled funds. These managers take account of currency risks within their pooled fund vehicles.

#### Operational risk

The Investment Managers do not directly hold the Scheme's securities for non insured assets. These non insured assets are held in separate accounts with custodians, as appointed by the Investment Manager for pooled vehicles or by the Trustee for non pooled investments. Special arrangements noted above apply to insured assets under the Aviva contract.

### **(d) Other pension schemes**

The Group operates four defined contribution schemes: the schemes operated by Friends Provident, FPI, Pantheon Financial and Sesame Group. Contributions for the year were £2.2m (2008: £0.9m), £0.7m (2008: £0.6m), £0.2m (2008: £0.3m) and £0.7m (2008: £0.7m) respectively.

Lombard does not operate a staff pension scheme.

## **10. Share based payments**

## (a) Summary

The Group operated a number of share based payment schemes during the year. As part of the terms of the acquisition by Resolution, all awards and options under any of the Friends Provident Share based payments schemes (excluding the Lombard Incentive plans) vested and became exercisable before 5 November (the effective date of the acquisition). The following schemes lapsed due to failure to meet the required performance criteria:

- 75% of the Executive Long Term incentive Plan 2009 (1)
- Executive Long Term Incentive Plans 2007, 2008 and 2009 (2) and 2009 (3)

These will be accounted for in accordance with IFRS 2 as:

- Pre-acquisition scheme modifications for the ShareSave schemes, the deferred share awards and 25% of Executive Long Term incentive plan 2009 (1); and
- Scheme cancellations in respect of the Executive Long Term Incentive Plans, 2007, 2008, 2009 (2), 2009 (3) and 75% of Executive Long Term Plan 2009 (1).

The charge that has been recognised at vesting is, at a minimum, the unexpensed portion of the grant date fair value, accelerated to be charged in the shortened vesting period, irrespective of whether the schemes actually vested or not.

The number of options and awards issued by the schemes and outstanding at the year end, and the charge to the consolidated income statement in the year are as follows:

	2009		2008	
	Number	Charge £m	Number	Charge £m
Friends Provident	-	11	32,832,194	5
F&C	-	9	30,212,381	14
Lombard	-	1	-	-
	-	21	63,044,575	19

The charge to the income statement comprises £18m (2008: £17m) relating to equity-settled schemes and £3m (2008: £2m) relating to cash-settled schemes. In 2009 and 2008 all of the charge relating to cash-settled schemes, and in 2009 £6m (2008: £12m) of the charge relating to equity-settled schemes arose in F&C, and are reported in Loss after tax from discounted operations in the income statement.

The carrying amount of the liability arising from cash-settled schemes is £nil (2008: £3m).

The weighted average FP share price during 2009 was £0.82 (2008: £1.26).

## (b) Friends Provident Group plc

### (i) Description of the plans

There were a number of stock option and award schemes over Friends Provident shares active during the year, all of which were equity settled schemes. Certain schemes were open to all employees whilst others were open to executives only. Schemes operated by the Group included ShareSave schemes, Executive Share Options Schemes (ESOS), and Long Term Incentive Plan (LTIP). There was a range of performance and vesting conditions including conditions based on term of service, the financial performance of the Company, and other terms. ShareSave schemes vested on completion of continuous terms of service ranging from 3-5 years. The ESOS and LTIP schemes vested on completion of 3 years'

service and the achievement of certain financial performance measures by the Group, initially over a 3 year period.

Deferred share awards were issued to Trevor Matthews and Evelyn Bourke during 2009 as compensation for loss of long-term incentive arrangements with previous employers. The awards vested on completion of continuous terms of service of between 1 and 2 years; there were no performance conditions.

## (ii) Movements in the year

Movements of the option plans are as follows:

	Number of options	2009 Weighted average exercise price in pence	Number of options	2008 Weighted average exercise price in pence
Outstanding at start of year	29,361,823	95	30,490,036	129
Granted	283,646	5	16,782,639	65
Forfeited	(461,863)	90	(7,885,166)	119
Exercised	(2,418,693)	74	(225,998)	89
Expired	(26,764,913)	96	(9,799,688)	130
<b>Outstanding at end of year</b>	-	-	29,361,823	95
<b>Exercisable at end of year</b>	-	-	5,014,709	148

The fair value of services rendered in return for share options granted are measured by reference to the fair value of share options granted.

The estimate of the fair value of the services received is measured using binomial modelling techniques.

The fair values of the share options and grants made during the year are listed below, together with the assumptions used to calculate them.

	(TSR)	(IFRS EPS)	(ROEV)	(Strategic Review)	LTIP (1) (FP Franchise)
Award date	17 Mar 2009	17 Mar 2009	17 Mar 2009	17 Mar 2009	17 Mar 2009
Fair value (pence)	39.5	55.6	55.6	55.6	55.6
Exercise price	-	-	-	-	-
Share price	66.2	66.2	66.2	66.2	66.2
Volatility	30%	19%	19%	30%	30%
Dividend yield	4.75%	4.75%	4.75%	4.75%	4.75%
Average life	3 years	3 years	3 years	3 years	3 years
Risk-free rate	2.3%	2.3%	2.3%	2.3%	2.3%

	(TSR)	(IFRS EPS)	LTIP (2) (ROEV)
Award date	24 Mar 2009	23 Mar 2009	24 Mar 2009
Fair value (pence)	9.6	53.5	53.5
Exercise price	-	-	-
Share price	65.1	65.1	65.1
Volatility	36%	19%	19%
Dividend yield	4.75%	4.75%	4.75%
Average life	3 years	3 years	3 years
Risk-free rate	2%	2%	2%

	(TSR)	(IFRS EPS)	LTIP 2009 (3) (ROEV)	DSP (1)	DSP (2)
Award date	1 Sep 2009	1 Sep 2009	1 Sep 2009	17 Mar 2009	1 Sep 2009
Fair value (pence)	59.2	81.2	81.2	59.7	81.7
Exercise price	-	-	-	-	-
Share price	85.6	85.6	85.6	66.2	85.6
Volatility	36%	19%	19%	N/A	N/A
Dividend yield	4.75%	4.75%	4.75%	N/A	N/A
Average life	3 years	3 years	3 years	1 year	1 year
Risk-free rate	1.8%	1.8%	1.8%	N/A	N/A

## (c) F&C

### (i) Description of the plans

There were a number of active stock options and award schemes over F&C Asset Management plc shares active during the year, including equity settled and cash settled schemes, comprising schemes open to all employees and those which were restricted to executives only. There was a range of performance and vesting conditions including conditions based on term of service, the financial performance of the company, and other terms.

### (ii) Movements in the year

Movements of the option plans are as follows:

	Number of options	2009 Weighted average exercise price in pence	Number of options	2008 Weighted average exercise price in pence
Outstanding at start of year	2,836,536	212	4,219,241	207
Granted	-	-	-	-
Forfeited	(235,906)	165	(1,135,094)	214
Exercised	-	-	(247,611)	116
Expired	(81,106)	165	-	-
Demerger of F&C	(2,519,524)	218	-	-
<b>Outstanding at end of year</b>	-	-	2,836,536	212
<b>Exercisable at end of year</b>	-	-	1,973,300	235

The fair values of the share options and grants made during the year whilst F&C was a member of the Group have been calculated using the following assumptions:

Purchased Equity Plan	Purchased Equity Plan	
	Equity	Cash
Award date	2009	2009
Exercise price	52.9	11.6
Share price	64.5	64.5
Volatility	n/a	n/a
Dividend yield	4.68%	4.68%
Average life	51 months	51 months
Risk-free rate	n/a	n/a

## (d) Lombard Management Incentive Scheme

### (i) Description of the Plan

Lombard management have been incentivised through a scheme that entitles them to share in the growth in value of Lombard. The Plan lasts for 6 years, with 25% of value accruing on the third, fourth, fifth and sixth anniversary of the Plan, with an effective start date of 1 January 2009. The Plan gives rights to Resolution Limited shares.

The scheme is an equity-settled share based payment scheme and the grant date fair value, being the best estimate of the cost of the scheme, will be recognised over the vesting period. This results in a fair value of £10m being expensed over the six year term of scheme. The scheme has been valued based on probability weighted performance scenarios, based on varying levels of sales and market conditions.

## 11. Finance costs

	2009 £m	2008 £m
Subordinated loan interest	12	-
Debenture loan interest	15	23
Interest paid to reinsurers	86	91
Interest paid to credit institutions	6	7
<b>Total finance costs</b>	<b>119</b>	<b>121</b>

Interest expense is calculated using the effective interest rate method.

## 12. Taxation

### (a) Tax charged to the income statement

	2009 £m	2008 £m
<b>Current tax</b>		
UK corporation tax at 28% (2008: 28.5%)	22	36
Adjustments in respect of prior periods	(55)	(11)
Overseas taxation	7	7
<b>Total current tax (credit)/expense</b>	<b>(26)</b>	<b>32</b>
<b>Deferred tax</b>		
Origination and reversal of temporary differences	(65)	(208)
Adjustments in respects of prior periods	41	3
<b>Total deferred tax credit</b>	<b>(24)</b>	<b>(206)</b>
<b>Total tax credit</b>	<b>(50)</b>	<b>(173)</b>
Tax credit from continuing operations:		
Policyholder tax	67	(78)
Shareholder tax	(117)	(95)
<b>Total tax credit</b>	<b>(50)</b>	<b>(173)</b>
Tax credit from discontinued operations (note 13):		
Policyholder tax	-	-
Shareholder tax	(3)	(17)
	(3)	(17)
<b>Total tax credit</b>	<b>(53)</b>	<b>(190)</b>

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

## (b) Factors affecting tax charge for period

	2009			2008		
	Shareholder profit £m	Policyholder tax £m	Profit before tax £m	Shareholder loss £m	Policyholder tax £m	Loss before tax £m
<b>Profit/(loss) before tax from continuing operations</b>	<b>151</b>	<b>67</b>	<b>218</b>	(510)	(78)	(588)
Profit/(loss) before tax from continuing operations multiplied by the standard rate of corporation tax in the UK of 28% (2008: 28.5%)	42	19	61	(146)	(22)	(168)
Effects of:						
Non-taxable income	(20)	(19)	(39)	(2)	22	20
Deductions not allowable for tax purposes	11	-	11	68	-	68
Tax on reserving adjustments	-	-	-	28	-	28
Overseas tax	(16)	-	(16)	8	-	8
Adjustments in respect of prior periods	(23)	-	(23)	(9)	-	(9)
Tax relief on share based payments	2	-	2	-	-	-
Utilisation of excess expenses brought forward	(45)	-	(45)	47	-	47
Valuation of tax losses	(118)	-	(118)	(20)	-	(20)
Valuation of unrealised capital losses	53	-	53	(53)	-	(53)
Impairment of valuation of subsidiaries	-	-	-	(62)	-	(62)
Non-taxable with-profits minority interest	(3)	-	(3)	46	-	46
Policyholder tax	-	67	67	-	(78)	(78)
<b>Total tax (credit)/charge</b>	<b>(117)</b>	<b>67</b>	<b>(50)</b>	<b>(95)</b>	<b>(78)</b>	<b>(173)</b>

### 13. Discontinued operations

The Group demerged its stake in F&C on 3 July 2009 by means of a return of capital by the Company. Shareholder approval for this proposal was received on 12 June 2009 and on 2 July 2009, a Court hearing confirmed a reduction in the nominal value of each Friends Provident Group plc share from 20p to 5p resulting in a reduction of capital of £351m which facilitated the demerger of F&C by way of a return of capital. The reduction of capital from 20p to 5p per share reflected the return of the Company's holding in F&C that was demerged (a number of shares in F&C were held back and sold to recover costs) at market value, which was £158m, together with some additional capital being reduced to create £193m of additional distributable reserves. The relevant Court order was registered and the demerger and capital reduction became effective on 3 July 2009. In the Group accounts, F&C was demerged at net asset value, resulting in a reduction of equity of £100m (£118m net asset value less £18m value of shares retained).

The table below summarises the results of the discontinued operations and is stated after allowing for group eliminations.

<b>Results of discontinued operations</b>	<b>2009</b>	<b>2008</b>
	<b>£m</b>	<b>£m</b>
Total fee income (net of group eliminations)	<b>112</b>	204
Investment return	<b>15</b>	(204)
<b>Total revenue</b>	<b>127</b>	-
Movement in investment contract liabilities	<b>(8)</b>	213
Impairment of goodwill and asset management contracts	<b>-</b>	(264)
Other expenses	<b>(131)</b>	(232)
<b>Total expenses</b>	<b>(139)</b>	(283)
Loss before taxation and costs to sell	<b>(12)</b>	(283)
Costs to sell	<b>(13)</b>	-
Loss before taxation	<b>(25)</b>	(283)
Tax credit:		
On loss before costs to sell	<b>3</b>	17
<b>Loss from F&amp;C operations</b>	<b>(22)</b>	(266)

  

<b>Earnings per share</b>	<b>2009</b>	<b>2008</b>
	<b>pence</b>	<b>Pence</b>
Basic loss per share from discontinued operations	<b>(0.9)</b>	(11.5)
Diluted basic loss per share from discontinued operations	<b>(0.9)</b>	(11.5)

<b>Cash flow of discontinued operations</b>	<b>2009</b>	<b>2008</b>
	<b>£m</b>	<b>£m</b>
Operating cash flow	<b>(8)</b>	37
Investing cash flows	<b>6</b>	(22)
Financing cash flows	<b>(23)</b>	(50)
<b>Total cash flows from discontinued operations</b>	<b>(25)</b>	(35)

## 14. Appropriations of profit

### (a) Dividends paid on ordinary shares

Dividends paid during the year and recognised in reserves

	<b>2009</b>	<b>2008</b>
	<b>£m</b>	<b>£m</b>
Final dividend in respect of 2008 and paid in July 2009 of 2.6p per share (in respect of 2007 and paid in May 2008 of 5.3p per share)	<b>61</b>	123
Interim dividend in respect of 2009 and paid in October 2009 of 1.3p per share (in respect of 2008 and paid in November 2008 of 1.3p per share)	<b>30</b>	30
<b>Total dividends paid</b>	<b>91</b>	153

The final dividend of £61m above is equivalent to the previously contemplated final dividend of 2008 that was not recommended or declared by Friends Provident plc due to the need to complete the reorganisation to establish a new holding company for the Group. The distributable reserves of Friends Provident Group plc as at 31 December 2009 were £689m.

As required by IAS10 Events after the balance sheet date, dividends proposed after the balance sheet date are not accrued in these accounts. The Directors are recommending an interim dividend of £100m payable on 30 March 2010.

## (b) STICS interest

STICS interest paid during the year and recognised in reserves

	2009 £m	2008 £m
Interest on 2003 STICS at 6.875%		
Paid in May 2009 (May 2008)	10	10
Paid in November 2009 (November 2008)	7	11
Total 2003 STICS interest paid	17	21
Interest on 2005 STICS at 6.292%		
Paid in May 2009(i) and June 2009 (June 2008)	30	31
Total 2005 STICS interest paid	30	31
<b>Total STICS interest paid</b>	<b>47</b>	<b>52</b>

(i) Holders of 2005 STICS who opted to exchange their holding for Subordinated Guaranteed Notes on 21 May 2009 (see note 34) were paid accrued interest on that date.

Interest on the 2003 STICS is paid half yearly in May and November each year.  
Interest on the 2005 STICS is paid annually in June each year.

## 15. Earnings per share

### (a) Basic and operating earnings per share from continuing operations

Earnings per share have been calculated based on the profit/(loss) after tax and on the IFRS based operating profit/(loss) after tax, attributable to ordinary shareholders of the parent. The directors consider that the operating earnings per share figure gives a better indication of operating performance.

	2009 Earnings £m	2009 Per share pence	2008 Earnings £m	Restated 2008 Per share pence
<b>Profit/(loss) after tax attributable to ordinary shareholders of the parent from continuing operations</b>	<b>217</b>	<b>9.3</b>	(290)	(12.4)
Short-term fluctuations in investment return	19	0.8	71	3.0
Non-recurring items	86	3.7	51	2.2
Amortisation and impairment of acquired intangible assets	71	3.1	40	1.7
Minority interest on items excluded from operating profit/(loss)	(4)	(0.2)	(23)	(1.0)
Tax credit on items excluded from operating profit/(loss)	(18)	(0.7)	(5)	(0.2)
<b>IFRS based operating profit/(loss) after tax attributable to ordinary shareholders of the parent from continuing operations</b>	<b>371</b>	<b>16.0</b>	(156)	(6.7)

## (b) Diluted basic earnings per share from continuing operations

	2009 Earnings £m	2009 Weighted average number of ordinary shares millions	2009 Per share pence	Restated 2008 Earnings £m	2008 Weighted average number of ordinary shares millions	Restated 2008 Per share pence
Profit/(loss) after tax attributable to ordinary shareholders of the parent	217	2,326	9.3	(290)	2,323	(12.4)
Dilution (c)	-	-	-	-	-	-
Diluted profit/(loss) after tax attributable to ordinary shareholders of the parent	217	2,326	9.3	(290)	2,323	(12.4)

## (c) Dilution

There are no dilution factors at 31 December 2009. Options over 63,044,575 shares outstanding under the Group's various option schemes as at 31 December 2008 were not dilutive in 2008 because their impact on EPS would be to reduce the loss per share.

## 16. Intangible assets

Movements in intangible assets are as follows:

	Goodwill £m	Acquired VIF £m	Investment management contracts £m	Other £m	Total £m
<b>Cost</b>					
At 1 January 2008	733	499	585	267	2,084
Acquisition through business combinations	29	-	71	-	100
Other additions	-	-	-	8	8
Disposals	(16)	-	-	(1)	(17)
Adjustment to consideration	(6)	-	-	-	(6)
Foreign exchange adjustments	52	76	40	40	208
At 31 December 2008	792	575	696	314	2,377
Acquisition through business combinations (note 43)	16	-	-	5	21
Other additions	-	-	-	5	5
Demerger of F&C (note 13)	(357)	(8)	(684)	(5)	(1,054)
Disposals	(23)	-	-	(15)	(38)
Foreign exchange adjustments	(17)	(25)	(12)	(14)	(68)
<b>At 31 December 2009</b>	<b>411</b>	<b>542</b>	<b>-</b>	<b>290</b>	<b>1,243</b>
<b>Amortisation and impairment</b>					
At 1 January 2008	-	169	331	128	628
Amortisation charge for year	-	26	49	23	98
Impairment charge	216	-	48	3	267
Foreign exchange adjustments	-	15	1	10	26
At 31 December 2008	216	210	429	164	1,019
Demerger of F&C	(216)	(8)	(454)	(4)	(682)
Amortisation charge for year (i)	-	25	25	21	71
Impairment charge	23	-	-	8	31
Disposals	(23)	-	-	(13)	(36)
Foreign exchange adjustments	-	(5)	-	(4)	(9)
<b>At 31 December 2009</b>	<b>-</b>	<b>222</b>	<b>-</b>	<b>172</b>	<b>394</b>
<b>Carrying amounts</b>					
At 31 December 2008	576	365	267	150	1,358
<b>At 31 December 2009</b>	<b>411</b>	<b>320</b>	<b>-</b>	<b>118</b>	<b>849</b>

(i) Amortisation charge within Other in the above table includes £15m (2008: £14m) in respect of acquired intangible assets.

Goodwill is the only intangible asset which has an indefinite useful life. All other intangible assets are amortised over their estimated useful economic lives as set out in note 1.4.8. The average remaining useful lives for each category of asset are: acquired VIF 14 years and other intangibles 7 years.

The main reduction in intangible assets in the year arises from the demerger of F&C.

All identifiable intangible assets are reviewed at each reporting date to assess whether there are any circumstances that might indicate that they are impaired. If such circumstances exist, impairment testing is performed and any resulting impairment losses are charged to the income statement. Goodwill is tested annually at 31 December for impairment or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

### **Impairment**

As a result of the impairment testing undertaken as at 31 December 2009, an impairment charge of £31m (2008: £267m) has been recognised. Goodwill initially recognised on the acquisition of Pantheon has been impaired by £23m (2008: £nil) and other intangible assets have been impaired by £8m (2008: £3m). In 2008, Asset Management investment management contracts were impaired by £48m and Asset Management goodwill was impaired by £216m.

### **Goodwill impairment testing**

Friends Provident's annual impairment test in respect of goodwill allocated to each cash generating unit (CGU) is performed as at 31 December each year. Each CGU to which goodwill is allocated represents the lowest level within the Group at which goodwill is maintained for internal management purposes.

Impairment is determined by assessing the recoverable amount of the CGU to which the goodwill relates. The recoverable amount is the higher of the CGU's (i) fair value less costs to sell and (ii) value in use.

The recoverable amount for goodwill that has been allocated to each CGU is the value in use at 31 December 2009. In 2008 the recoverable amount was the value in use except for the Asset Management CGU where the recoverable amount was deemed to be its fair value less costs to sell.

The value in use for each life and pensions CGU has been taken to be the value of in-force business (VIF) at 31 December 2009 calculated under market-consistent embedded value (MCEV) principles plus 3 years' value of new business (VNB) from the Group's business plan that was approved in November 2009. The year-end VIF figure is adjusted to take account of the significant differences between the net assets in the MCEV balance sheet and the net assets in the IFRS balance sheet to ensure no double counting. The calculations discount future cash projections and reflect the long-term nature of the business. Forecast sales take into account sales initiatives as well as past experience and market conditions.

For each Life & Pensions CGU, the pre-tax discount rate is based on the market observable cost of capital for the cash flows expected to be generated by the insurance and investment contracts. An equity cash flow is valued using an equity discount rate and a bond cash flow is valued using a bond discount rate. The cash flow projections take into account all

expected future cash flows of insurance and investment contracts in-force at 31 December 2009 together with forecast cash flows from new business written in the next three years. Equity investment return assumptions reflect the specific mix of equities that are held or expected to be held over the period. For the purpose of determining the terminal value, the volume of in-force contracts is not assumed to grow after 2011 with new contracts replacing those contracts that mature, lapse or cease on a claim.

In determining the future cash flows, it has been assumed that there will be mild growth in the UK economy from 2011 equating to a 1% pa growth in GDP and a consequent improvement in sales of new contracts.

For other CGUs, the value in use has been calculated from individual business plans by discounting the estimated future cash flows.

In determining the above key assumptions, the directors have considered relevant market observable data as well as in-house and external views in the light of the current economic conditions.

At 31 December 2009 aggregate goodwill of £192m (2008: £192m) had been allocated to UK Life & Pensions, £196m (2008: £213m) to Lombard and £23m (2008: £30m) had been allocated to CGUs which were not considered individually significant. 2008 also included £141m allocated to Asset Management.

### Cash Generating Units

An analysis of intangible assets by significant CGU is set out below:

	31 December 2009			31 December 2008		
	Cost £m	Amortisation and impairment £m	Net book value £m	Cost £m	Amortisation and impairment £m	Net book value £m
UK Life & Pensions (i)	464	214	250	474	212	262
Lombard (ii)	643	128	515	695	115	580
Asset Management (iii)	-	-	-	1,059	650	409
Other CGUs	136	52	84	149	42	107
<b>Total</b>	<b>1,243</b>	<b>394</b>	<b>849</b>	<b>2,377</b>	<b>1,019</b>	<b>1,358</b>

#### (i) UK Life & Pensions

An analysis of the intangible assets in respect of UK Life & Pensions is as follows:

	31 December 2009			31 December 2008		
	Cost £m	Amortisation and impairment £m	Net book value £m	Cost £m	Amortisation and impairment £m	Net book value £m
Goodwill	192	-	192	192	-	192
Acquired VIF	176	120	56	184	119	65
Other	96	94	2	98	93	5
<b>Total</b>	<b>464</b>	<b>214</b>	<b>250</b>	<b>474</b>	<b>212</b>	<b>262</b>

The total net book value of intangible assets amounts to £250m (2008: £262m) and mainly arises from the acquisition of the London and Manchester Group in 1998. Since the acquisition, the Life & Pensions businesses of Friends Provident and London and Manchester have been fully integrated and are managed on a unified basis.

The effective pre-tax risk discount rate calculated on the basis set out above is 9.0% (2008: 9.4%). Other key assumptions specific to the UK Life & Pensions value in use are:

- Equity investment returns of 7.1% per annum
- Bond spreads have been assumed to hold at 300 basis points (based on A grade bonds)
- Annuity valuation interest rates allow for an illiquidity premium of 100 basis points
- Lapse assumptions have generally been strengthened from current experience to reflect anticipated increases in the future

The outcome of the impairment assessment is that it is considered highly unlikely that an impairment of goodwill in respect of UK Life & Pensions would arise given that its value in use is significantly higher than the carrying value of goodwill. There is also no indication of impairment in respect of any other intangible assets.

The value in use has been assessed for sensitivity of the key assumptions as follows: (i) the recession continues through 2010 and into 2011 with a corresponding impact on new sales; (ii) reduction of 15% in equity values followed by a 7% increase pa; (iii) bond spreads of 400bps. On the basis of this combined downside scenario, the value in use is still higher than the goodwill attributed to the CGU.

## (ii) Lombard

An analysis of the intangible assets in respect of Lombard is as follows:

	31 December 2009			31 December 2008		
	Cost £m	Amortisation and impairment £m	Net book value £m	Cost £m	Amortisation and impairment £m	Net book value £m
Goodwill	196	-	196	213	-	213
Acquired VIF	289	68	221	314	63	251
Other	158	60	98	168	52	116
<b>Total</b>	<b>643</b>	<b>128</b>	<b>515</b>	<b>695</b>	<b>115</b>	<b>580</b>

The total net book value of intangible assets amounts to £515m (2008: £580m) and arises from the acquisition of Lombard in 2005. The reduction in intangible assets in 2009 mainly arises as a result of appreciation of Sterling against the Euro.

The effective pre-tax risk discount rate calculated on the basis set out above is 6.5% (2008: 6.7%). Other key assumptions in respect of the Lombard value in use are:

- Equity investment returns of 7.4% per annum and overall return on linked funds of 5.3% per annum
- Lapse assumptions have generally been strengthened from current experience to reflect anticipated increases in the future

The outcome of the impairment assessment is that the value in use is in excess of its carrying value and that there is no impairment of goodwill in Lombard. With the exception of a £nil impairment (2008: £3m) of internally developed software that is no longer in use, there is no indication of impairment in respect of any other intangible assets.

The value in use has been assessed for sensitivity of the key assumptions as follows: (i) recession to continue through 2010 and into 2011 with a corresponding impact on sales of new investment contracts; (ii) reduction of 15% in equity values followed by a 7% increase

pa; (iii) 10% increase in lapse rates over current experience. On the basis of this combined downside scenario, the value in use is still higher than the goodwill attributed to the CGU.

### (iii) Asset Management

The Asset Management CGU consisted of F&C Asset Management plc in which the Group's share holding was 52%. The Group's interest in F&C was demerged on 3 July 2009.

At 31 December 2008, the total net book value of intangible assets amounted to £409m and largely arose from the merger between ISIS Asset Management and F&C in 2004. The fair value less costs to sell of the Asset Management CGU was determined as the bid price of the F&C shares at 31 December 2008 which resulted in a fair value of £149m and a goodwill impairment charge of £216m reducing goodwill to £141m.

## 17. Property and equipment

	Owner occupied properties			Fixtures, fittings and office equipment	
	at valuation	Motor vehicles	Computer equipment	£m	Total £m
	£m	£m	£m	£m	
<b>Cost</b>					
At 1 January 2008	55	2	49	23	129
Foreign exchange adjustments	-	-	3	1	4
Other additions	-	-	3	1	4
Disposals	(1)	-	(1)	-	(2)
Revaluations	(10)	-	-	-	(10)
At 31 December 2008	44	2	54	25	125
Foreign exchange adjustments	-	-	(1)	-	(1)
Acquisition through business combinations	-	-	8	1	9
Demerger of F&C	-	(1)	(8)	(15)	(24)
Other additions	-	-	1	1	2
Disposals	(4)	(1)	(2)	(1)	(8)
Revaluations	(1)	-	-	-	(1)
<b>At 31 December 2009</b>	<b>39</b>	<b>-</b>	<b>52</b>	<b>11</b>	<b>102</b>
<b>Depreciation</b>					
At 1 January 2008	-	1	35	12	48
Foreign exchange adjustments	-	-	2	1	3
Acquisition through business combinations	-	-	-	-	-
Depreciation charge for year	-	1	7	2	10
Disposals	-	(1)	-	(1)	(2)
At 31 December 2008	-	1	44	14	59
Foreign exchange adjustments	-	-	(1)	-	(1)
Acquisition through business combinations	-	-	7	1	8
Demerger of F&C	-	-	(7)	(8)	(15)
Depreciation charge for year	-	-	5	2	7
Disposals	-	(1)	(2)	-	(3)
<b>At 31 December 2009</b>	<b>-</b>	<b>-</b>	<b>46</b>	<b>9</b>	<b>55</b>
<b>Carrying amounts</b>					
At 31 December 2008	44	1	10	11	66
At 31 December 2009	<b>39</b>	<b>-</b>	<b>6</b>	<b>2</b>	<b>47</b>

If owner occupied properties were measured on a cost basis, the carrying amount would be £25m (2008: £29m).

## 18. Investment properties

	2009 £m	2008 £m
<b>At 1 January</b>	<b>1,493</b>	2,371
Purchases	67	13
Disposals	(101)	(334)
Fair value adjustments	89	(564)
Foreign exchange adjustments	(2)	7
<b>At 31 December</b>	<b>1,546</b>	1,493

Of the total, £1,040m (2008: £918m) is held in with-profits funds and £506m (2008: £575m) in unit-linked funds.

## 19. Principal Group undertakings

Principal subsidiary undertakings of the Group as at 31 December 2009 are shown below.

Unless otherwise stated, they are undertakings incorporated in England and Wales and have only one class of issued ordinary shares. The voting rights are equal to the percentage holdings unless otherwise stated. Other subsidiaries do not materially affect the results of the Group.

Subsidiary undertaking	Activity	% held
<b>Corporate</b>		
Friends Provident Limited (Formerly Friends Provident plc)*	Holding company	100
<b>UK Life &amp; Pensions</b>		
Friends Provident Life and Pensions Limited	Insurance	100
Friends Provident Life Assurance Limited	Insurance	100
Friends Provident Pensions Limited	Insurance	100
Friends Provident Reinsurance Services Limited	Reinsurance	100
Friends Provident Management Services Limited	Management services	100
F&C Commercial Property Trust plc (iii)	Property company	50.32
<b>Friends Provident International Limited (i)</b>	Insurance	100
<b>Lombard International Assurance SA (ii)</b>	Insurance	99.39
<b>Other:</b>		
Pantheon Financial Limited	IFA distribution business	100
Sesame Bankhall Group Limited	IFA distribution business	100

\*Held directly by Friends Provident Group plc (all other companies are held indirectly).

- (i) Incorporated in the Isle of Man
- (ii) Incorporated in Luxembourg
- (iii) Incorporated in Guernsey

## 20. Investments in associate and joint venture

### (a) Associate

	2009 £m	2008 £m
<b>Carrying amount of investment</b>	<b>43</b>	<b>33</b>

On 28 November 2008 the Group acquired a 30% interest in AmLife Insurance Berhad, a Malaysian based life assurance business, for RM170m (£31m) plus acquisition costs of £2m.

The total assets, liabilities, revenues and losses of the Group's associate undertaking is as follows:

	2009 £m	2008 £m
Current assets	62	96
Non-current assets	168	101
Current liabilities	(34)	(33)
Non-current liabilities	(122)	(124)
Net assets	74	40
Revenue	119	-
Profit before tax	37	-

### (b) Joint venture

	2009 £m	2008 £m
<b>Carrying amount of investment</b>	<b>8</b>	<b>14</b>

This investment is in Tenet Group Limited, an IFA firm which comprises two IFA networks, and a compliance network and intermediary operating in the mortgage and general insurance sectors. The Group's interest in the ordinary share capital of Tenet Group Limited is 21.023% (2008: 21.1%). The Group's share of assets, liabilities, revenue and profit is as follows:

	2009 £m	2008 £m
Current assets	9	8
Non-current assets	3	3
Current liabilities	(2)	(2)
Non-current liabilities	(2)	(2)
Net assets	8	7
Revenue	16	19
Profit before tax	-	-

## 21. Financial assets

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

	2009 £m	2008 £m
Fair value through the income statement (note 21(a))	48,235	44,275
Loans at amortised cost (note 21 (f))	80	97
<b>Total financial assets</b>	<b>48,315</b>	<b>44,372</b>

### (a) Analysis of financial assets at fair value through the income statement

At 31 December 2009	With- profits £m	Unit- linked £m	Non-linked		Shareholder £m	Total £m
			Annuities £m	Other £m		
Shares and other variable yield securities	2,568	27,693	-	103	8	30,372
Debt securities and other fixed- income securities:						
Government securities	3,654	1,803	424	256	173	6,310
Corporate bonds (including ABS)	4,442	3,471	2,200	501	357	10,971
Derivative financial instruments	176	8	-	3	(6)	181
Deposits with credit institutions	-	375	-	24	2	401
	10,840	33,350	2,624	887	534	48,235

At 31 December 2008	With- profits £m	Unit- linked £m	Non-linked		Shareholder £m	Total £m
			Annuities £m	Other £m		
Shares and other variable yield securities income securities	2,584	23,486	-	75	4	26,149
Debt securities and other fixed- income securities:						
Government securities	4,059	1,950	355	282	100	6,746
Corporate bonds (including ABS)	4,077	3,005	2,187	613	421	10,303
Derivative financial instruments	549	9	-	8	10	576
Deposits with credit institutions	-	494	-	7	-	501
	11,269	28,944	2,542	985	535	44,275

The above unit-linked column includes £584m of financial assets (£352m of shares and £232m of corporate bonds) relating to the minority interests in the OIECs that have been consolidated as the Group holding is 50% or more.

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

The majority of financial assets held are readily realisable, however, included in the carrying amounts above, £44,852m (2008: £41,125m) is expected to be realised more than 12 months after the balance sheet date in line with the expected maturity of insurance/investment contract liabilities.

Asset Backed Securities (excluding those held by the linked funds) amount to £1,167m (2008: £1,191m) as set out in note 31(c).

### (b) Determination of fair Value Hierarchy

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

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

Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (ie, as prices) or indirectly (ie, derived from prices). This category

generally includes assets that are priced based on models using market observable inputs. Examples include certificates of deposit and derivatives.

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

The majority of the Group's assets held at fair value are valued based on quoted market information or market observable data. Approximately 11% (3% excluding unit-linked) are based on valuation techniques where significant observable market data is not available or the price is not observable from current market transactions. However, the fair value measurement objective of these assets remains the same, that is, an exit price from the perspective of the Group.

The revised requirements of IFRS 7 also require financial liabilities at fair value to be categorised into the above Level 1, 2 or 3 hierarchies. Financial liabilities at fair value include unit-linked contracts, amounts due to reinsurers, net asset value attributable to unit-holders (minority interest in the OEICs that are consolidated) and derivative financial instruments. The classifications take into account the types of inputs used to determine the fair value measurements. For unit-linked funds this has been undertaken on a fund by fund basis. For the net asset value attributable to unit holders, this has been analysed in the same proportion as the underlying consolidated investments categorisation.

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

31 December 2009	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
<b>Financial assets held at fair value</b>								
Shares and other variable yield securities	25,445	207	4,720	30,372	2,283	-	396	2,679
Debt securities and other fixed income securities:								
Government securities	6,297	13	-	6,310	4,507	-	-	4,507
Corporate bonds (including ABS)	5,996	4,287	688	10,971	5,195	2,215	90	7,500
Derivative Financial Instruments	-	181	-	181	-	173	-	173
Deposits with credit institutions	343	58	-	401	-	26	-	26
<b>Total financial assets held at fair value</b>	<b>38,081</b>	<b>4,746</b>	<b>5,408</b>	<b>48,235</b>	<b>11,985</b>	<b>2,414</b>	<b>486</b>	<b>14,885</b>
<b>Financial liabilities held at fair value</b>								
Unit-linked investment contracts	-	36,410	-	36,410	-	-	-	-
Amounts due to reinsurers	-	1,610	-	1,610	-	1,610	-	1,610
Net asset value attributable to unit-holders	-	668	-	668	-	-	-	-
Derivative financial instruments	-	54	-	54	-	54	-	54
<b>Total financial liabilities held at fair value</b>	<b>-</b>	<b>38,742</b>	<b>-</b>	<b>38,742</b>	<b>-</b>	<b>1,664</b>	<b>-</b>	<b>1,664</b>

### (c) Transfers between Level 1 and Level 2

During the period, debt securities amounting to £193m were transferred from Level 1 to Level 2 and £117m were transferred from Level 2 to Level 1. These movements arise from changes in credit ratings and availability of current prices. There were no significant transfers between Level 1 and Level 2 for other financial assets.

### (d) Financial instruments

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

	At 1 January 2009 £m	Total gains/ (losses) in income statement £m	Purchases £m	Sales £m	Transfers from level 1 and level 2 £m	At 31 Dec 2009 £m	Total gains or losses for the period included in profit or loss for assets held at 31 December 2009 £m
<b>Financial assets held at fair value</b>							
Shares and other variable yield securities	4,158	84	484	(389)	383	4,720	77
Corporate bonds (including ABS)	766	(110)	43	(23)	12	688	(106)
<b>Total financial assets held at fair value</b>	<b>4,924</b>	<b>(26)</b>	<b>527</b>	<b>(412)</b>	<b>395</b>	<b>5,408</b>	<b>(29)</b>

Transfers into Level 3 arise due to prices no longer being readily available in an active market.

### (e) Level 3 sensitivity analysis

	Carrying amount £m	31 December 2009 Effect of reasonably possible alternative assumptions £m
Unit-linked investments	4,922	-
Shares and other variable yield securities	396	79
Corporate bonds (including ABS)	90	9
	<b>5,408</b>	<b>88</b>

For unit-linked assets, the policyholder bears the investment risk and any change in asset values is matched by a broadly equivalent change in liability. Consequently there is no significant net impact on shareholder profit from changes to underlying assumptions used to value these assets.

For shares and other variable yield securities, although the values are based on the latest information available, this information is not up to date and the current prices could reasonably be expected to be higher or lower by approximately 20%.

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

## (f) Loans

	2009 £m	2008 £m
Mortgage loans	3	4
Other loans	77	93
<b>Total loans</b>	<b>80</b>	<b>97</b>

Other loans include £68m (2008: £82m) due from the Friends Provident Pension Scheme (see note 9). The fair value of loans is considered to be the same as their carrying value.

## (g) Unit-linked net assets

The amounts included in the balance sheet in respect of net assets held within unit-linked funds are as follows:

	2009 £m	2008 £m
Investment properties	506	575
Shares and other variable yield securities	27,341	23,085
Debt securities and other fixed-income securities	5,042	4,756
Derivative financial instruments	8	9
Deposits with credit institutions	375	494
Other receivables	120	262
Cash and cash equivalents	3,126	2,571
<b>Total assets</b>	<b>36,518</b>	<b>31,752</b>
Other payables	(141)	(200)
<b>Total unit-linked net assets</b>	<b>36,377</b>	<b>31,552</b>

The impact of consolidating OEICs in which the Group has a holding in excess of 50% has been excluded from the analysis of unit-linked net assets.

## 22. Deferred acquisition costs

	Insurance contracts £m	Investment contracts £m	Total £m
<b>Year ended 31 December 2009</b>			
<b>At 1 January</b>	<b>14</b>	<b>1,209</b>	<b>1,223</b>
Demerger of F&C	-	(10)	(10)
Incurred and deferred in the year	1	201	202
Amortisation charge to the income statement	(1)	(127)	(128)
Impaired	(2)	1	(1)
Other movements (i)	-	35	35
<b>At 31 December</b>	<b>12</b>	<b>1,309</b>	<b>1,321</b>

(i) Other movements relate to foreign exchange movements and enhanced unit allocations.

Included in the carrying values above is £1,229m (2008: £1,004m) which is expected to be recovered more than 12 months after the balance sheet date. Acquisition expenses that do not meet the criteria for deferral are expensed directly as incurred.

	Insurance contracts £m	Investment contracts £m	Total £m
<b>Year ended 31 December 2008</b>			
<b>At 1 January</b>	<b>133</b>	<b>960</b>	<b>1,093</b>
Incurred and deferred in the year	1	264	265
Amortisation charge to the income statement	(119)	(70)	(189)
Impaired	(1)	(17)	(18)
Other movements	-	72	72
<b>At 31 December</b>	<b>14</b>	<b>1,209</b>	<b>1,223</b>

## 23. Reinsurance assets

	Insurance contracts £m	Investment contracts £m	Total £m
<b>Year ended 31 December 2009</b>			
<b>At 1 January</b>	<b>1,964</b>	-	<b>1,964</b>
Premiums	97	-	97
Claims	(194)	-	(194)
Unwind of discount rate	81	-	81
Other movements	24	-	24
<b>At 31 December</b>	<b>1,972</b>	-	<b>1,972</b>

No significant gain or loss arose on reinsurance contracts incepted in either 2009 or 2008.

	Insurance contracts £m	Investment contracts £m	Total £m
<b>Year ended 31 December 2008</b>			
<b>At 1 January</b>	<b>1,918</b>	97	<b>2,015</b>
Premiums	100	-	100
Claims	(191)	-	(191)
Unwind of discount rate	60	-	60
Other movements	77	-	77
Reclassified as financial assets	-	(97)	(97)
<b>At 31 December</b>	<b>1,964</b>	-	<b>1,964</b>

Included in the carrying totals above is £1,408m (2008: £2,154m) which is expected to be recovered more than 12 months after the balance sheet date.

Amounts expected to be recovered more than 12 months after the balance sheet date exceed the carrying value when the expectation is that premiums will exceed claims in the short-term.

Reinsurance assets are valued using the same methods and bases as those used to value the underlying liabilities that are being reinsured.

## 24. Deferred tax assets and liabilities

### (a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	2009			2008		
	Assets £m	Liabilities £m	Net £m	Assets £m	Liabilities £m	Net £m
Property and equipment	40	-	40	53	-	53
Intangible assets	-	(30)	(30)	-	(199)	(199)
Purchased value of in-force business	-	(76)	(76)	-	-	-
Unrealised gains on investments	-	(12)	(12)	50	-	50
Employee benefits	1	-	1	19	-	19
Deferred acquisition costs	-	(50)	(50)	-	(19)	(19)
Tax value of recognised tax losses	91	-	91	7	-	7
Short-term temporary differences	27	-	27	18	-	18
Unremitted profits of subsidiary	-	-	-	-	(22)	(22)
<b>Net deferred tax assets/(liabilities)</b>	<b>159</b>	<b>(168)</b>	<b>(9)</b>	<b>147</b>	<b>(240)</b>	<b>(93)</b>

Of the deferred tax assets above, £12m (2008: £15m) cannot be offset against deferred tax liabilities and is presented gross on the statement of financial position.

## (b) Movement in temporary differences during the year

	1 January 2009 £m	Recognised in income £m	Recognised in equity £m	Recognised in other comprehensive income £m	De-merger of F&C £m	31 December 2009 £m
Property and equipment	53	(9)	-	-	(4)	40
Intangible assets	(113)	7	-	-	76	(30)
Purchased value of in-force business	(86)	10	-	-	-	(76)
Unrealised gains on investments	50	(63)	-	-	1	(12)
Employee benefits	19	(9)	-	13	(22)	1
Deferred acquisition costs	(19)	(31)	-	-	-	(50)
Tax value of recognised tax losses	7	84	-	-	-	91
Short-term temporary differences	18	13	-	-	(4)	27
Unremitted profits of subsidiary	(22)	22	-	-	-	-
<b>Net deferred tax (liabilities)/assets</b>	<b>(93)</b>	<b>24</b>	<b>-</b>	<b>13</b>	<b>47</b>	<b>(9)</b>

	1 January 2008 £m	Recognised in income £m	Recognised in equity £m	Recognised in other comprehensive income £m	Acquired in year £m	31 December 2008 £m
Property and equipment	46	7	-	-	-	53
Intangible assets	(161)	23	(41)	-	(20)	(199)
Unrealised gains on investments	(161)	211	-	-	-	50
Employee benefits	20	(8)	-	7	-	19
Deferred acquisition costs	(10)	(13)	4	-	-	(19)
Tax value of recognised tax losses	11	(4)	-	-	-	7
Short-term temporary differences	5	13	-	-	-	18
Unremitted profits of subsidiary	(24)	2	-	-	-	(22)
<b>Net deferred tax (liabilities)/assets</b>	<b>(274)</b>	<b>231</b>	<b>(37)</b>	<b>7</b>	<b>(20)</b>	<b>(93)</b>

Of the amount recognised in income £nil (2008: £26m) relates to discontinued operations.

## (c) Unrecognised deferred tax assets and liabilities

Deferred tax assets of £96m (2008: £128m) have not been recognised as it is not probable that there will be sufficient suitable profits emerging in future periods against which to relieve them.

## 25. Insurance and other receivables

	2009 £m	2008 £m
Receivables arising out of direct insurance operations:		
Policyholders	24	31
Agents, brokers and intermediaries	39	51
Investment income receivables	56	83
Investments sold for subsequent settlement	39	85
Prepayments and accrued income	246	313
Surplus on FPPS	38	73
Other receivables	39	107
<b>Total insurance and other receivables</b>	<b>481</b>	<b>743</b>

With the exception of the surplus on FPPS all insurance and other receivables are expected to be recovered within 12 months. The carrying value of each item approximates fair value.

## 26. Cash and cash equivalents

	2009 £m	2008 £m
Bank and cash balances	2,207	1,798
Short-term deposits	2,866	3,385
<b>Total cash and cash equivalents</b>	<b>5,073</b>	<b>5,183</b>

## 27. Terms and conditions of insurance and investment contracts

The main types of insurance and investment contracts that the Group currently has in force are:

### (i) Life

Protection business (other than whole life products) – these insurance contracts consist mainly of regular premium term assurance, critical illness and income protection products, which pay out a fixed amount (the sum assured) on ill health or death. The premium rate is usually guaranteed for the lifetime of the contract. For most policies this payout will be a single amount, whereas income protection products provide a regular income upon incapacity either for the length of illness or to the end of the contract if earlier, depending on the specific policyholder terms. Most contracts have no surrender value.

Endowments and whole life products – these insurance contracts both provide benefits upon death or, in the case of endowments, at a preset maturity date if earlier. These policies often have a surrender value, particularly in the later years of the contract. The amount payable on death is subject to a guaranteed minimum amount. The maturity value usually depends on the investment performance of the underlying assets. For with-profits business, it is underpinned by a minimum guarantee, which may be increased by the addition of bonuses.

Single premium bonds and regular premium savings contracts – these are unit-linked or unitised with-profits investment contracts that have no maturity date. On death, the amount paid is 100%-105% of the value of the units. On surrender the value of units is paid, sometimes in the first few years less a surrender penalty. For with-profits contracts a final bonus may be payable on death or surrender, or if markets are depressed a market value reduction may be applied to surrender values.

### (ii) Pensions

Individual and group pensions – these contracts generally provide a cash sum at retirement. If death occurs before retirement, they generally return the value of the fund accumulated or in some cases premiums paid are returned. Contracts with guaranteed cash and annuity options (see below) are defined as insurance contracts but in the absence of these guarantees products are normally defined as investment contracts.

Annuities in payment – these insurance contracts are typically single premium products, which provide for a regular payment to the policyholder whilst they and/or their spouse are still alive. Payments are generally either fixed or increased each year at a specified rate or in line with the rate of inflation. Most contracts guarantee an income for a minimum period usually of five years, irrespective of death.

### (iii) Guarantees and options

The main guarantees and options included within the Group's insurance contracts, the majority of which arise within FPLP's With-Profits Fund, are as follows:

Guaranteed cash and annuity options – most conventional deferred annuity contracts have benefit options expressed in terms of cash and annuity payments with a guaranteed conversion rate, allowing the policyholder the option of taking the more valuable of the two at retirement.

Guarantees in respect of bonus additions – bonuses added to with-profits policies increase the guaranteed minimum benefit that policyholders are entitled to at maturity. These are set at a level that takes account of expected market fluctuations, such that the cost of the guarantee is generally met by the investment performance of the assets backing the policyholder liability. However in circumstances where there has been a significant fall in investment markets, the guaranteed maturity benefits may exceed asset shares and these guarantees become valuable to the policyholder.

Guaranteed surrender bases – certain older products have a guaranteed basis for calculating surrender values. In all these cases the basis includes an element of final bonus which can be reduced or taken away. The guaranteed basis typically applies over a period of 15 years but in most cases policies are approaching the end of this period. The effect of the guaranteed surrender basis is to extend the guarantee in respect of bonus additions so that they apply over an extended period and not just at the maturity date.

## 28. Insurance contracts

### (a) Changes in insurance contracts liabilities

The following table shows the movements in insurance contracts liabilities in the year:

	2009 £m	2008 £m
<b>At 1 January</b>	<b>12,677</b>	13,607
Increase in liability from premiums	<b>786</b>	949
Release of liability due to recorded claims	<b>(1,477)</b>	(1,733)
Unwinding of discount	<b>216</b>	190
Change in assumptions:		
Economic	<b>(156)</b>	62
Non-economic	<b>(59)</b>	61
Other movements including net investment return	<b>120</b>	(459)
<b>At 31 December</b>	<b>12,107</b>	12,677

Included in the carrying amount above, £10,271m (2008: £11,526m) is expected to be settled more than 12 months after the balance sheet date.

A liability adequacy test was carried out at policy level and resulted in no additional provision in either 2009 or 2008.

It should be noted that changes in the economic assumptions are typically largely offset by corresponding changes in the financial assets backing the liabilities. In addition, assumption changes on with-profits contracts will result in changes in the FFA, and not in retained earnings.

The main items within non-economic assumption changes in 2009 and 2008 relate to one-off items as set out in note 2(i).

## **(b) Method used for reserving for both insurance contracts and investment contracts with DPF**

The liability for insurance contracts and investment contracts with DPF is calculated on the basis of recognised actuarial methods having due regard to actuarial principles and best practice. The methodology takes into account risks and uncertainties of the particular classes of long-term business written.

Calculations are generally made on an individual policy basis, however in addition there are some global provisions which are calculated using statistical or mathematical methods. The results are expected to be approximately the same as if the individual insurance/investment contract liability was calculated for each contract.

The methodology for the calculation of liabilities is set out in more detail in notes 1.4.18 and 1.4.19.

## **(c) Process used for assumptions**

### **(i) Economic assumptions**

Details regarding the economic assumptions used in the stochastic model for the valuation of with-profits policyholder liabilities are set out in note 29.

For other insurance liabilities and unitised with-profits contracts within the FPLA fund, economic assumptions are the same as those used for reporting to the FSA under the regulatory peak. Economic assumptions are adjusted from year to year by reference to changes in consistent economic indices or yields on the underlying portfolio. The principal assumption is the valuation interest rate, being the rate at which projected policy cash flows are discounted.

### **(ii) Non-economic assumptions**

The provision for insurance contracts and investment contracts with DPF liabilities is sensitive to the principal assumptions in respect of mortality, morbidity and maintenance expenses (except for net premium valuations), persistency and guaranteed annuity option take-up rates, although the relative sensitivity will vary depending on the insurance or investment contract.

Long-term estimates of future mortality and morbidity assumptions are based on standard tables wherever possible but adjusted to reflect the Group's own experience. Expense assumptions are based on recent experience. Experience investigations for mortality, morbidity, persistency, guaranteed annuity option take-up rates and maintenance expenses are performed at least annually. Where industry analysis indicates that changes in expected future mortality/morbidity or other assumptions factor patterns mean that claim costs are likely to rise in the future, then this is taken into account in the liability calculation. No benefit is taken where industry analysis indicates that future trends are likely to reduce claim costs in the future. Improving mortality has been assumed when valuing annuities and deteriorating morbidity has been assumed when valuing critical illness business. Assumptions, for policies other than with-profits, are generally intended to be a prudent estimate of future experience.

**(d) Valuation interest rates for policies other than conventional with-profits business in FPLP**

Class of business	31 December	With-profits	31 December	Non-profit
	2009	31 December	2009	31 December
	%	2008	%	2008
<b>Life</b>				
Endowment and whole-of-life	2.8	2.5	3.0	2.7
Protection	-	-	3.0	2.7
<b>Pension</b>				
Annuities in payment	-	-	4.33 – 5.21	3.4-4.52
Individual and group pensions	3.6	3.2	3.8	3.4
Protection	-	-	3.8	3.4
<b>Income protection</b>	-	-	3.3	2.9

As explained in note 29, FPLP's with-profits business is valued in accordance with the FSA's realistic reporting regime.

Where products can have positive or negative liabilities the interest rate used is 2.5% or 5.4% (2008: 2.2% or 4.7%) depending on which is more onerous.

**(e) Mortality, morbidity and lapse rates**

Insurance contract liabilities allow for mortality and morbidity risk by making assumptions about the proportion of policyholders who die or become sick. Allowance for future mortality has been made using the following percentages of the standard published tables below:

	2009	2008
Term assurances:		
Smoker	93% TMS00(5)	93% TMS00(5)
	88% TFS00(5)	88% TFS00(5)
Non-smoker	93% TMN00(5)	93% TMN00(5)
	86% TFN00(5)	86% TFN00(5)
Critical illness	CIBT02(i)	CIBT02(i)
Other life assurances	120% AM/FC00ult	120% AM/FC00ult
Unitised policies (life / other)	130% AM/FC00ult / 110% AM/FC00ult	130% AM/FC00ult / 110% AM/FC00ult
Pension policies	65% AMCO0ult / 55% AFC00ult	65% AMCO0ult / 55% AFC00ult
Individual income protection	60% AM/F80ult	60% AM/F80ult
Individual pension annuities in payment	RM/FV00 (ii)	RM/FV00 (ii)
Group pension annuities in payment	PCMA/PCFA00 (ii)	PCMA/PCFA00 (ii)

- (i) The percentages of the table used differ by sex and smoker status.
- (ii) Age-related percentages of the mortality tables are used. Future improvements in mortality are based on the following percentages of the average of CMI's Medium Cohort and Long Cohort:  
Males – 100% subject to a minimum improvement of 1.5% per annum.  
Females – 75% subject to a minimum improvement of 1.25% per annum.

Individual income protection sickness and recovery rates are based on percentages of the CMI 12 (male and female) published tables. Rates differentiate by smoker status, deferred period and occupational class.

Critical illness morbidity rates are based on percentages of the published CIBT02 table. The percentages used vary by sex and smoker status. In addition, future deterioration in

morbidity is allowed for by assuming claim rates increase by 1.25% per annum and 1.50% per annum for males and females respectively.

Lapse rates for protection business are based on recent experience with a prudent margin.

**(f) Apportionment of surplus between shareholders and with-profits policyholders**  
Shareholders are entitled to 100% of surplus emerging from companies within the Group, with the exception of surplus emerging in the two with-profits Funds.

(i) The Group's main With-Profits Fund is within FPLP, and is open to new business. The Fund is run on a mutual basis and managed so that over time the working capital is sufficient to provide most of the risk capital but not to exceed the risk capital margin. The entitlements of shareholders to share in surplus differ for policies written before and after demutualisation on 9 July 2001.

In respect of pre-demutualisation conventional with-profits policies, shareholders are entitled to one ninth of the cost of bonuses added to policies. In respect of pre-demutualisation non-profit and unitised business (excluding the investment element), shareholders are entitled to 60% of the surplus arising.

Post-demutualisation with-profits policyholders are only entitled to surplus from the return on their investments; other sources of surplus are wholly owned by shareholders including policies written by FPLA and Friends Provident Pensions Limited, where the investment element is reinsured to the FPLP With-Profits Fund.

(ii) The With-Profits Fund of FPLA is closed to new business. The Fund's policyholders are entitled to all the surplus of that fund. In addition, FPLA has a closed unitised with-profits fund. Shareholders are entitled to all profits from the unitised with-profit fund other than investment profits, which are wholly owned by with-profits policyholders. The investment element of the contract is wholly reinsured to the FPLP With-Profits Fund.

The effect of this fund structure is that investment risk, in respect of assets backing with-profits policies, is largely borne by policyholders; shareholders bear 10% of the investment risk from conventional with-profits policies. Expense risk is borne by the shareholders, other than in the FPLA Closed Fund. Until 2009, the FPLP With-Profits Fund is charged a fixed amount for managing policies, adjusted by an inflation index, irrespective of actual costs. The charges will be reviewed with effect from the end of 2009 to reflect market rates at the time. Other forms of risk are shared between shareholders and policyholders as described above.

## 29. FPLP's With-Profits Balance Sheet

FPLP's with-profits business can be summarised as follows:

	2009 £m	2008 £m
Total net assets	12,040	12,753
Less non-profit liabilities including long-term insurance capital requirements	(2,414)	(2,509)
Total regulatory assets	9,626	10,244
Additional assets arising on realistic basis	209	316
<b>Total with-profits assets</b>	<b>9,835</b>	<b>10,560</b>
Policyholder liabilities:		
Asset shares	8,076	8,114
Financial guarantees (net of charges)	386	623
Options (guaranteed annuities)	427	575
Other liabilities	789	957
<b>Total with-profits liabilities</b>	<b>9,678</b>	<b>10,269</b>
<b>Excess of assets over liabilities</b>	<b>157</b>	<b>291</b>

At 31 December 2009, the surplus of assets over liabilities initially amounted to £560m (2008: £338m) with a Risk Capital Margin (RCM) of £157m (2008: £291m), the surplus assets have subsequently been reduced by £403m (2008: £47m) via a reduction in future policyholder guarantee charges and enhancing future payouts. This leaves the working capital at £157m (2008: £291m) fully covering the RCM. After adding back the shareholders' share of future bonuses totalling £42m (2008: £43m) and deducting adjustments to estimate double counting of other assets of £nil (2008: £2m), the excess in accordance with FRS 27 amounted to £199m (2008: £332m).

The main element of the liabilities is the asset shares of with-profits business. This represents the premiums received to date together with the investment return earned less expenses and charges. This is mainly calculated on an individual policy basis using historic information and in line with the company's Principles and Practises of Financial Management (PPFM). Asset shares are closely matched since they move with the value of the underlying assets.

Policyholder liabilities (including operation and guarantees) are then valued using a market-consistent stochastic model. Other liabilities include current liabilities, creditors, tax provisions, and the value of future transfers to shareholders.

The realistic balance sheet also allowed for future profits of non-profit business written in the With-Profits fund to be included as an asset, in addition to the regulatory assets.

Options and guarantees are features of life assurance and pensions contracts that confer potentially valuable benefits to policyholders. They are not unique to with-profits funds and can arise in non-participating funds. They can expose an insurance company to two types of risk: insurance (such as mortality/morbidity) and financial (such as market prices/interest rates). The value of an option or guarantee comprises two elements: the intrinsic value and the time value. The intrinsic value is the amount that would be payable if the option or guarantee was exercised immediately. The time value is the additional value that reflects the possibility of the intrinsic value increasing in future, before the expiry of the option or guarantee. Under FSA rules all options and guarantees must be valued and included in policyholder liabilities. For funds within the FSA's realistic capital methodology, options and guarantees are valued on a market-consistent stochastic basis that takes into account both the time value and the intrinsic value of the options and guarantees.

The majority of the Group's life and pensions options and guarantees are within FPLP's With-Profits Fund. These are valued stochastically and included in the liabilities. There are two main types of guarantees and options in the FPLP With-Profits Fund: maturity guarantees and guaranteed annuity options. Maturity guarantees are in respect of conventional with-profits business and unitised with-profits business and represent the sum assured and reversionary bonuses declared to date. The cost of these guarantees, allowing for future reversionary bonuses, net of charges, has been calculated at £386m (2008: £623m). For certain with-profits pension policies issued, there are options guaranteeing the rates at which annuities can be purchased. The cost of these guarantees has been calculated at £427m (2008: £575m).

The cost of with-profits guarantees is most sensitive to the assumed volatility of future returns on asset shares, the level of future interest rates and the rates of discontinuance on these policies.

The guarantee cost in respect of guaranteed annuity options is most sensitive to the level of future interest rates, assumed rates of discontinuance and early retirement and the assumptions relating to exercise of the tax free cash option on these policies. Further details on these assumptions are provided below.

The cost of the with-profits guarantees is assessed using a market-consistent stochastic model (using The Smith Model (TSM) Plus as the scenario generator) and is calculated using 6,300 simulations. The model has been calibrated using the gilt risk-free curve assuming interest rates of between 0.7% and 4.7% pa (2008: between 1.2% and 5.0% pa) and implied volatilities in the market as shown in the table below.

#### Swaption implied volatilities

Option Term	31 December 2009 Swap Term				31 December 2008 Swap Term			
	10 years	15 years	20 years	25 years	10 years	15 years	20 years	25 years
UK Sterling								
10 years	15%	15%	14%	14%	17%	16%	16%	16%
15 years	16%	15%	14%	14%	17%	17%	16%	16%
20 years	16%	15%	14%	13%	18%	18%	17%	16%
25 years	16%	14%	13%	12%	20%	19%	17%	17%

For equity capital return and property total return implied volatilities are shown in the table below

Option Term	31 December 2009		31 December 2008	
	Equities	Property	Equities	Property
5 years	25%	16%	32%	17%
10 years	27%	17%	35%	19%
15 years	29%	18%	37%	21%

The cost of guarantees also depends on management actions that would be taken under various scenarios. The regular bonus rate is set each year such that, by maturity, guaranteed benefits are targeted as a prescribed fraction of the total asset share, leaving the remaining portion of the asset share to be paid as a final bonus. This management action is in line with the company's PPFM and is programmed into the model.

The guarantee cost in respect of guaranteed annuity options is assessed using a market-consistent stochastic model and values both the current level of the guaranteed annuity rate benefit (allowing for future improvements in annuitant mortality) and the time value due to uncertainty in future interest rates. The guarantee cost in each scenario is the value of the

excess annuity benefit provided by the options, relative to an annuity purchased in the open market. In estimating the future open market annuity rate, the model allows for stochastic variation in interest rates and for future mortality improvements. The stochastic interest rate assumption reflects that implied by current market interest rate derivative prices. Future annuitant mortality has been derived from the premium basis at which annuities can be purchased from Friends Provident Pensions Limited, which allows for future mortality improvements.

The guaranteed annuity options cost also depends upon other factors such as policy discontinuance and the take up rate for the options. The factors are based on recent experience adjusted to reflect industry benchmarks and to anticipate trends in policyholder behaviour. A summary of the key assumptions is as follows:

Policy discontinuances: lapse, early retirement and paid-up rates vary by policy type and period and have been based on recent experience.

Policy lapses for pensions are generally in the range of 1% to 4.5% pa (2008: 1% to 4.5% pa) with policy lapses for life business in the range of 3% to 10% pa (14% pa for mortgage endowment and 20% pa for with-profit bond policies) (2008: 3% to 10% pa (14% pa for mortgage endowment policies and 20% pa for with-profit bond policies)). Paid-up rates for pensions are generally in the range of 4% to 17% pa (2008: 4% to 17% pa) with life policies generally in the region of 0.5% to 2% pa (2008: 0.5% to 2% pa). Early retirement rates vary by age band and policy type.

Tax free cash option: where a guaranteed annuity option is more valuable than the cash equivalent it is assumed that 18% to 27% of the benefit of the option is taken tax-free depending on the type of business (2008: 18% to 27%). This is based on recent experience.

There are also guarantees and options in respect of some of the other life assurance business within the Group, but these are not considered to be material to the Group's future cash flows. In addition, they have largely been matched with suitable assets and there is no material exposure to market or interest rate changes. Provisions have been established using deterministic scenarios based on prudent assumptions.

## **30. Capital**

### **(a) Overview**

The Group's Life & Pensions business manages its capital on both economic capital and regulatory bases.

The economic capital model helps in setting the Group's financial risk appetite and in actively managing financial risk. The economic capital model compares total available capital resources, calculated on a realistic basis, with the risk capital required to cover unexpected losses.

The Group complies with all regulatory capital requirements; these include the Insurance Groups Directive (IGD) and individual company regulatory requirements.

IGD looks at capital from a group shareholder perspective and is a prudent measure in that surplus capital not immediately available to shareholders, such as surplus capital in the long-term funds, is excluded from the calculation.

The Life & Pensions capital statement, drawn up in accordance with FRS 27, illustrates the financial strength of the Life & Pensions business and is set out in section (b) below. Total available capital resources are calculated on a realistic basis for the FPLP With-Profits Fund and on a regulatory basis for all other funds.

A reconciliation of IFRS Equity, Life & Pensions capital resources per the Capital Statement and Group Capital on an IGD basis is set out below.

	Capital resources £m	Capital requirements £m	2009 Surplus £m	Capital resources £m	Capital requirements £m	2008 Surplus £m
<b>IFRS</b>						
Equity attributable to equity holders of the parent	2,956	-	2,956	3,247	-	3,247
Subordinated debt	11	-	11	14	-	14
Fund for future appropriations	273	-	273	401	-	401
Entity resources excluded from Capital Statement (i)(vi)	25	-	25	(359)	-	(359)
Regulatory prudence – Inadmissible assets and valuation differences (ii)	(1,333)	-	(1,333)	(1,306)	-	(1,306)
<b>Life &amp; Pensions Capital Statement</b>	<b>1,932</b>	<b>681</b>	<b>1,251</b>	1,997	771	1,226
FPLP With-Profits Fund resources calculated on a regulatory basis (iii)	1,136	818	318	390	296	94*
Long-term fund surplus (iv)	(436)	-	(436)	(388)	-	(388)*
Entities excluded from capital statement (v)	(108)	16	(124)	(56)	68	(124)
Other	12	(2)	14	13	(10)	23
<b>Estimated group IGD surplus (v)(vi)</b>	<b>2,536</b>	<b>1,513</b>	<b>1,023</b>	1,956	1,125	831

\* Re-presented based on the FPLP regulatory return submitted on 29 July 2009.

(i) Corporate centre and IFA distribution businesses.

(ii) Largely goodwill, intangible assets and DAC less actuarial funding (for which credit cannot be taken on an IFRS basis).

(iii) FPLP With-Profits Fund resources are calculated on a realistic basis under IFRS and a regulatory basis under the IGD.

(iv) Long-term fund surplus capital over and above capital requirements is excluded from capital resources on an IGD basis.

(v) Estimated Group IGD surplus includes Corporate centre and IFA distribution businesses. The 2009 movement is largely driven by the demerger of F&C which increased the surplus by £0.2bn, the payment of dividends and STICs interest of £0.15bn and transfers from long-term funds of £0.21bn.

(vi) Includes Asset Management in 2008.

## (b) Capital statement

The capital statement in respect of the Group's Life & Pensions business is set out below. This statement shows an analysis of the available capital resources calculated on a realistic basis for the FPLP With-Profits Fund and calculated on a regulatory basis for all other funds. It also shows the regulatory capital requirements and, in total, the overall surplus capital

over regulatory requirements. In addition the statement provides an analysis of policyholders' liabilities.

At 31 December 2009

	UK with- profits (FPLP) £m	UK with- profits (FPLA) £m	UK non- participating funds £m	Overseas Life & Pensions funds £m	Life & Pensions shareholders' funds £m	Total Life & Pensions business £m
<b>Shareholders' funds</b>						
Outside fund	-	-	-	-	877	877
Inside fund	-	-	994	125	-	1,119
	-	-	994	125	877	1,996
<b>Other qualifying capital</b>						
Subordinated debt	-	-	-	11	-	11
Preference shares	-	-	-	-	300	300
FFA	199	74	-	-	-	273
	199	74	994	136	1,177	2,580
<b>Regulatory adjustments</b>						
Assets	-	-	(497)	(732)	(13)	(1,242)
Liabilities	-	-	(16)	675	(23)	636
Shareholders' share of future bonuses	(42)	-	-	-	-	(42)
<b>Available capital resources</b>	157	74	481	79	1,141	1,932
<b>Capital requirement</b>						
UK realistic basis	157	-	-	-	-	157
Other regulatory bases	-	32	417	75	-	524
	157	32	417	75	-	681
<b>Overall surplus capital over regulatory requirements</b>						1,251
<b>Analysis of policyholders' liabilities</b>						
With-profits	9,151	181	-	-	-	9,332
Unit-linked	-	-	17,606	19,689	-	37,295
Non-participating	2,289	48	3,645	5	-	5,987
<b>Total</b>	<b>11,440</b>	<b>229</b>	<b>21,251</b>	<b>19,694</b>	<b>-</b>	<b>52,614</b>

**At 31 December 2008**

	UK with- profits (FPLP) £m	UK with- profits (FPLA) £m	UK non- participating funds £m	Overseas Life & Pensions funds £m	Life & Pensions shareholders funds £m	Total Life & Pensions business £m
<b>Shareholders' funds</b>						
Outside fund	-	-	-	-	661	661
Inside fund	-	-	940	94	-	1,034
	-	-	940	94	661	1,695
<b>Other qualifying capital</b>						
Subordinated debt	-	-	-	14	-	14
Preference shares	-	-	-	-	300	300
FFA	334	67	-	-	-	401
	334	67	940	108	961	2,410
<b>Regulatory adjustments</b>						
Assets	-	-	(357)	(642)	(13)	(1,012)
Liabilities	-	(3)	57	594	(6)	642
Shareholders' share of future bonuses	(43)	-	-	-	-	(43)
<b>Available capital resources</b>	291	64	640	60	942	1,997
<b>Capital requirement</b>						
UK realistic basis	291	-	-	-	-	291
Other regulatory bases	-	16	412	52	-	480
	291	16	412	52	-	771
<b>Overall surplus capital over regulatory requirements</b>						1,226
<b>Analysis of policyholders' liabilities</b>						
With-profits	9,541	181	-	-	-	9,722
Unit-linked	-	-	15,167	16,989	-	32,156
Non-participating	2,437	46	3,586	5	-	6,074
<b>Total</b>	11,978	227	18,753	16,994	-	47,952

**(i) Summary**

As can be seen from the above table, the total available capital resources of the Group's Life & Pensions business amounts to £1,932m (2008: £1,997m), its regulatory capital requirements amount to £681m (2008: £771m) resulting in a surplus of available capital resources over regulatory capital of £1,251m (2008: £1,226m).

Set out below are details of how the available capital resources have been calculated, the restrictions that are in existence over the available capital resources, the basis of calculating the regulatory capital requirements and an explanation for the change in the available capital.

**(ii) Basis of calculating available capital resources in Life & Pensions business**

The available capital of the two UK with-profits funds has been determined in accordance with FSA regulations and includes the FFA. The FFA represents the estimated surplus in the funds that has not been allocated and is available to meet regulatory and other solvency requirements of the funds. Adjustments have been made to restate all assets and liabilities onto the basis used to determine regulatory requirements.

The majority of the Group's life and pensions options and guarantees are within FPLP's With-Profits Fund and details are set out in note 29. These are valued on a market-consistent stochastic basis.

Options and guarantees outside FPLP's With-Profits Fund are not considered to be material to the Group's future cash flows. In addition they have largely been matched with suitable assets and there is no material risk to market or interest rate changes. Provisions have been established using deterministic scenarios based on prudent assumptions.

The With-Profits Fund in FPLP has available capital of £157m (2008: £291m) and has been calculated in accordance with the FSA's realistic capital regulations. In accordance with accounting rules, the realistic liabilities only represent amounts relating to policyholders and do not include the shareholders' share of future bonuses. However, the shareholders' share is treated as a deduction from capital that is available to meet regulatory requirements and shown as a separate adjustment in the capital statement.

The available capital in the closed with-profits fund in FPLA amounts to £74m (2008: £64m). This has been calculated in accordance with the FSA's regulatory capital requirements.

The available capital in the Group's UK non-participating businesses has been determined in accordance with FSA regulations and amounts to £481m (2008: £640m). Adjustments have been made to restate all assets and liabilities on to a regulatory basis. The regulatory adjustment to assets mainly consists of eliminating deferred acquisition costs. The regulatory adjustment to liabilities mainly represents the additional regulatory capital arising as a result of the securitisation of a defined book of pre-demutualisation business in December 2004 and including Sterling reserves of investment policies.

The available capital in the Group's overseas businesses written by FPI, Lombard and the associate undertaking (AmLife) has been determined in accordance with local requirements and amounts to £79m (2008: £60m). FPI is based in the Isle of Man, Lombard is based in Luxembourg and AmLife is based in Malaysia. The analysis of available capital is £13m FPI, £37m Lombard and £29m AmLife (2008: £14m FPI, £34m Lombard and £12m AmLife). Adjustments have been made to restate all assets and liabilities onto local regulatory bases.

The shareholders' funds supporting the Life and Pensions business, but held outside the Life & Pensions funds are shown separately in the capital statement. It is the Group's policy to ensure that each subsidiary is adequately capitalised to support its life businesses and to exceed regulatory capital requirements. The amount of shareholders' funds available is £1,141m (2008: £942m).

### **(iii) Restrictions on available capital resources in Life & Pensions business**

The available capital is subject to certain restrictions as to its availability to meet capital requirements elsewhere in the Group. In particular, no transfers from long-term funds can take place without an up to date actuarial valuation. The main restrictions on capital are set out below.

UK With-Profits Fund in FPLP: the available surplus held in the FPLP With-Profits Fund can only be applied to meet the requirements of the fund itself or be distributed to with-profits policyholders and shareholders. Shareholders are entitled to an amount not exceeding one-ninth of the amount distributed to policyholders in the form of bonuses on conventional with-profits policies. Non-profit business written in the FPLP With-Profits Fund has been

securitised and surpluses are initially used to repay £380m of floating rate loan notes issued by the Group. At the end of 2009 £123m of these loan notes are outstanding. Any subsequent surplus may be distributed 40% to FPLP's With-Profits Fund and 60% to shareholders. Arising from this arrangement, the FPLP Non-Profit fund has loaned £72m (2008: £72m) to FPLP's With-Profits Fund. The FPLP Non-Profit fund has also provided a contingent loan of £62m (2008: £59m) inclusive of accrued interest (with a facility for a further £38m) to the FPLP With-Profits Fund which is repayable out of future surpluses in the With-Profits Fund, subject to certain restrictions.

UK With-Profits Fund in FPLA: the available surplus held in the closed With-Profits Fund of FPLA can only be distributed to policyholders.

UK non-participating overseas life funds: for non-participating business, any liquid surplus can be distributed to shareholders subject to meeting the requirements of the business.

It remains the intention of management to ensure that there is adequate capital to exceed the regulatory requirements of the Group's life and pensions businesses, to meet any net new business strain and to support the Group's overall credit ratings. FPLP has guaranteed the £210m STICS issued in 2003 and the £268m STICS issued in 2005 by the parent company. FPLP has also guaranteed the £162m subordinated debt issued by Friends Provident Group plc in May 2009.

#### **(iv) Basis of calculating capital requirements for Life & Pensions business**

Each Life and Pensions company has to hold sufficient capital to meet its regulatory capital requirements.

For the FPLP With-Profits Fund, the capital requirement is the risk capital margin (RCM) which amounts to £157m (2008: £291m). This is calculated on a defined set of adverse scenarios prescribed by the FSA (the market risk scenarios tested are what would happen if property prices fall by 12.5% (2008: 12.5%), equity prices fall by 20% (2008: 20%), corporate bond prices fall by 7.60% (2008: 8.43%), fixed interest yields fall 0.78% (2008: rise 0.6%) and persistency increases by 32.5% (2008: 32.5%)). The RCM is based on the asset mix at the year-end and takes into account hedging strategies and certain other actions management would take in the event of particular adverse market conditions.

Under the realistic capital methodology, the capital requirement is the higher of the 'twin peaks' test of the realistic peak and the regulatory peak. The With-Profits Insurance Capital Component (WPICC) which adjusts the regulatory peak surplus to the realistic peak surplus, is then reduced by the value of future transfers to shareholders, being £318m (2008: £94m). These are liabilities of the With-Profits Fund in the realistic peak, but are not admissible assets of the FPLP funds to which they are payable.

	<b>2009</b>	<b>Realistic</b>		<b>2009</b>	<b>Regulatory</b>
	<b>£m</b>	<b>2008</b>		<b>£m</b>	<b>2008</b>
		<b>£m</b>			<b>£m</b>
Available capital	157	291	Surplus	1,293	681
Risk capital margin	(157)	(291)	Long term Insurance Capital requirements	(362)	(405)
Realistic peak	-	-	Regulatory peak surplus	931	276
			With Profits Insurance Capital Component	(613)	(182)*
			Regulatory excess Capital (i)	318	94*

\* Re-stated based on the FPLP regulatory return submitted on 29 July 2009.

(i) Represented by value of future internal transfers.

The capital cover to meet the regulatory solvency requirement of FPLP's With-Profits Fund is provided from FPLP's Non-Profit Fund and shareholders' fund, to the extent it is not met from the With-Profits Fund itself.

For the FPLA closed With-Profits Fund, the capital requirement has been calculated on a regulatory basis in accordance with FSA regulations at £32m (2008: £16m).

For UK non-participating funds, the relevant capital requirement is the capital resources requirement determined in accordance with FSA regulations. This, in total, amounts to £417m (2008: £412m).

For overseas business, local regulatory capital requirements are determined and these amount to £75m (2008: £52m). This is analysed as £12m (2008: £10m) for FPI, £39m (2008: £35m) for Lombard and £24m (2008: £7m) for AmLife.

### (v) Movement in available capital

At 31 December 2009 total available Life & Pensions capital resources had decreased by £65m to £1,932m, as shown below.

	UK with- profits (FPLP) £m	UK with- profits (FPLA) £m	UK non- participating funds £m	Overseas Life & Pensions funds £m	Life & Pensions shareholders' funds £m	Total Life & Pensions business £m
<b>At 1 January 2009</b>	<b>291</b>	<b>64</b>	<b>640</b>	<b>60</b>	<b>942</b>	<b>1,997</b>
New business strain	-	-	(136)	(131)	-	(267)
Surplus in year (i)	(126)	10	179	150	44	257
Principal assumption changes (ii):						
- Expense	-	-	35	-	-	35
- Mortality / morbidity	-	-	(5)	-	-	(5)
- Persistency	-	-	(21)	-	-	(21)
Transfers	(8)	-	(211)	-	219	-
Dividend and STICS interest	-	-	-	-	(46)	(46)
Acquisitions	-	-	-	-	(18)	(18)
<b>At 31 December 2009</b>	<b>157</b>	<b>74</b>	<b>481</b>	<b>79</b>	<b>1,141</b>	<b>1,932</b>

(i) All tax items are included within Surplus in year.

(ii) Principal assumption changes on an IFRS basis are disclosed in note 2(i)

	UK with- profits (FPLP) £m	UK with- profits (FPLA) £m	UK non- participating funds £m	Overseas Life & Pensions funds £m	Life & Pensions shareholders' funds £m	Total Life & Pensions business £m
At 1 January 2008	246	141	662	48	1,151	2,248
New business strain	-	-	(192)	(121)	-	(313)
Surplus in year (i)	45	(77)	114	106	23	211
Principal assumption changes (ii):						
- Expense	-	-	(52)	2	-	(50)
- Persistency	-	-	(22)	-	-	(22)
Transfers	-	-	130	13	(135)	8
Dividend and STICS interest	-	-	-	-	(97)	(97)
Acquisitions	-	-	-	12	-	12
At 31 December 2008	291	64	640	60	942	1,997

## **31. Risk management objectives and policies for mitigating risks**

### **Overview**

The Group is exposed to market risk, credit risk and liquidity risk from its use of financial instruments and to these risks and insurance risk through the issuing of insurance contracts. This note presents information about the Group's exposure to each of the above risks and the Group's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board has overall responsibility for the Group's risk management framework and for approving risk policy and risk appetite. The Group's risk management framework is aligned with the RSL risk management framework. The RSL Board have approved a set of risk management policies within which the Group operates.

The Board Risk and Compliance Committee (BRC) has been established to oversee the risk management across the Group, including the Financial Risk Committee ("FRC") and the Operational Risk Committee ("ORC"). The BRC reviews and recommends for approval of the Board detailed policies for the management of specific classes of risks; and considers quarterly reporting from the operating businesses.

The FRC, which includes The Chief Executive Officer and other relevant senior managers, oversees the management of financial and insurance risks of the Group. Within the international business, FPI and Lombard have risk committees comprising executive directors and other relevant senior managers that oversee their risk management processes for all risks and report into their respective boards as well as reporting into the FRC.

The FRC will review and recommend to the BRC strategies and policies for market, credit, liquidity and insurance risk management. All risk management policies are reviewed regularly by the relevant committee on at least an annual basis, to ensure they remain relevant to the changing demands of the business and regulatory environment.

The financial and insurance risk processes are aligned to the business planning process, with risk being identified and evaluated in relation to the achievement of business objectives. The management of financial and insurance risks is led by the Finance function with the Risk function providing oversight. Risks within business change activities are identified and evaluated by senior management both in relation to delivery and in terms of the effect on the business as a whole.

Business unit management is responsible for putting in place the ongoing management and monitoring disciplines for risks and activities under its control. Through these mechanisms, risks are identified in a timely manner, their financial implications assessed, control procedures re-evaluated and, where appropriate, actions agreed and implemented.

The Audit Committee (AC) oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The AC is supported in its oversight role by Internal Audit, which undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the AC.

## (a) Quantitative risk exposure

The Group's quantitative exposure to a range of financial, insurance and other risks is illustrated in the MCEV sensitivity analysis below, where the impacts of reasonably possible changes in risk variables are disclosed. The basis of preparation and limitations of the MCEV methodology are provided in note 1, basis of preparation of the MCEV supplementary information within Resolution Limited's Annual Report & Accounts.

### Life and Pensions

The table below shows the sensitivity of the embedded value and the contribution from new business to changes in assumptions at year end 2009, split by UK and International. The sensitivities shown reflect movements in Life and Pensions MCEV and corporate net assets only.

For each sensitivity other future experience assumptions remain unchanged, except where changes in economic conditions directly affect them. The assumptions underlying the statutory reserving calculations remain unchanged in all sensitivities. Sensitivities shown in a single direction have broadly symmetrical impacts.

	Notes	Change in embedded value (net of tax)			Change in new business contribution (gross of tax)		
		UK £m	Int £m	Total £m	UK £m	Int £m	Total £m
<b>2009 Sensitivities</b>							
Base MCEV / VNB (per Resolution Limited's Annual Report & Accounts)		2,113	915	3,028	26	107	133
<b>Market risk</b>							
1% increase in equity and property expected returns	(i)	N/A	N/A	N/A	N/A	N/A	N/A
1% increase in reference rates, with corresponding change in fixed-interest asset values		(54)	(15)	(69)	(2)	(3)	(5)
1% reduction in reference rates, with corresponding change in fixed-interest asset values		64	8	72	2	2	4
Removal of illiquidity premium		(129)	-	(129)	(22)	-	(22)
10% decrease in market values of equity and property assets	(ii)	(54)	(41)	(95)	N/A	N/A	N/A
10% adverse movement in Sterling/overseas exchange rate	(iii)	(10)	(63)	(73)	N/A	N/A	N/A
25% increase in equity and property implied volatility		(9)	-	(9)	N/A	N/A	N/A
25% increase in swaption implied volatility		(3)	-	(3)	N/A	N/A	N/A
100 bps increase in corporate bond spreads		(115)	(10)	(125)	(8)	-	(8)
100 bps decrease in corporate bond spreads		96	9	105	8	-	8
<b>Insurance and other risk</b>							
5% reduction in annuitant mortality:							
Before reinsurance		(35)	-	(35)	(2)	-	(2)
After reinsurance		(23)	-	(23)	(2)	-	(2)
5% reduction in mortality and morbidity (excluding annuities):							
Before reinsurance		48	4	52	10	1	11
After reinsurance		16	4	20	3	1	4
1% increase in risk discount rates	(iv)	(102)	(61)	(163)	(14)	(14)	(28)
Reduction in capital requirement to regulatory minimum	(v)	N/A	N/A	25	2	-	2
10% reduction in administrative expenses		50	14	64	4	4	8
10% reduction in lapses		27	46	73	5	8	13
10% reduction in paid-up rates		12	5	17	4	2	6

- (i) As a market-consistent approach is used, equity and property expected returns only affect the derived risk discount rates and not the embedded value or contribution to profits from new business.
- (ii) The movement in embedded value from a reduction in market values comprises a £3m (2008: £4m) fall in the value of shareholders' invested net assets and a £93m

(2008: £86m) reduction in the value of in-force Life and Pensions business. Conversely, the effect of an increase in market values comprises a £3m (2008:£4m) rise in the value of shareholders' invested net assets and a £93m (2008:£94m) increase in the value of in-force Life & Pensions business.

- (iii) Currency risk is expressed in terms of total overseas exposure; the principal currencies the Group is exposed to are the Euro and US Dollar.
- (iv) Although not directly relevant under a market-consistent valuation where the risk discount rate is a derived disclosure only, this shows the impact of a change in the average derived risk discount rate, to enable adjustments to be made to reflect differing views of risk.
- (v) Required capital is set at the greater of regulatory capital and requirements arising from internal capital management policies. In aggregate the required capital is higher than the regulatory requirement by £350m (2008: £400m). This sensitivity shows the impact on embedded value of using the lower regulatory capital requirements.

#### 2008 Sensitivities

	Notes	Change in embedded value (net of tax)			Change in new business contribution (gross of tax)		
		UK £m	Int £m	Total £m	UK £m	Int £m	Total £m
Base MCEV / VNB (per Resolution Limited's Annual Report & Accounts)		1,679	744	2,423	28	111	139
<b>Market risk</b>							
1% increase in equity and property expected returns	(i)	N/A	N/A	N/A	N/A	N/A	N/A
1% increase in risk-free rates, with corresponding change in fixed-interest asset values		(107)	(16)	(123)	(3)	(3)	(6)
1% reduction in risk-free rates, with corresponding change in fixed-interest asset values		103	14	117	3	3	6
10% decrease in market values of equity and property assets	(ii)	(56)	(34)	(90)			
10% reduction in Sterling/overseas exchange rate	(iii)	(15)	(54)	(69)	N/A	N/A	N/A
<b>Insurance and other risk</b>							
5% reduction in annuitant mortality:							
Before reinsurance		(46)	-	(46)	(2)	-	(2)
After reinsurance		(29)	-	(29)	(2)	-	(2)
5% reduction in mortality and morbidity (excluding annuities):							
Before reinsurance		49	4	53	9	1	10
After reinsurance		14	4	18	2	1	3
1% increase in risk discount rates	(iv)	(105)	(49)	(154)	(18)	(17)	(35)
Reduction in capital requirement to regulatory minimum	(v)	N/A	N/A	16	N/A	N/A	N/A
10% reduction in administrative expenses		52	16	68	6	5	11
10% reduction in lapses		15	39	54	8	10	18
10% reduction in paid-up rates		14	3	17	7	2	9

A summary of how each risk is mitigated is provided below with, where appropriate, additional quantitative information on the exposure to that risk.

#### (b) Market risk

Market risk is the risk of loss arising from a change in the values of, or the income from, assets or in interest or exchange rates. A risk of loss also arises from volatility in asset prices, interest rates, or exchange rates. Market Risk includes the following five elements:

- Equity Risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in equity prices or income
- Foreign exchange risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in exchange rates
- Interest rate risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in interest rates

- Property risk – the risk of fluctuations in fair value or future cash flows of a financial instrument arising from a change of or volatility in real estate values or income

Market risk arises on guarantees and options offered on certain of the Group's products. As described within the section on policyholder liabilities (see note 28), the Group is exposed to guarantees on bonus additions that become more valuable as investment values fall. In addition, the Group is exposed to guaranteed cash and annuity options on certain pension policies that become more valuable as interest rates fall.

The Group manages market risk attaching to assets backing specific policyholder liabilities and to assets held to deliver income and gains for the shareholder. Within the unit-linked funds and with profit funds, the Group manages market risk so as to provide a return in line with the expectations of policyholders. The principal objective for shareholder assets is to manage them so that they meet the capital requirements of the Group, and support its future strategic and operational objectives.

The Board sets appetite for market risk for each of the different asset classes. Consideration is given to the objectives of the asset pools to which they relate and the nature of the liabilities backed by those assets. The Financial Risk Committee, in consultation with management and the Risk function, recommends appropriate risk appetite statements to the Board and reviews risk appetite on a regular basis.

For assets backing non-linked policyholder liabilities, market risk is managed by matching, where possible, the duration and profile of assets to the policyholder liabilities they are backing. This helps manage market risk to the extent that changes in the values of assets are matched by a corresponding movement in the values of liabilities.

Shareholders' earnings are further exposed to market risk to the extent that the income from policyholder funds is based on the value of financial assets held within those unit-linked or with-profits funds.

The following summarises the key actions undertaken by the Group to manage all aspects of market risk:

The Investment Committee oversees investment policy and strategy, which the Group actions primarily through the use of investment fund mandates. Day-to-day implementation of investment policy and strategy is managed predominantly by F&C in line with these approved mandates.

Mandates are set for each fund within each of the insurance legal entities within the Group taking account of the relevant factors outlined above. Unit-linked funds are managed in line with their underlying objectives as set out in policyholder contracts. The mandates seek to limit exposure to market risk by using some or all of the following mechanisms:

- a maximum proportion of the fund that can be held in equities,
- restrictions on the maximum holding in any one company
- defined asset allocations between UK and overseas equity exposure in specific regions,
- restrictions on the variation of the duration of the portfolio of bonds from the benchmark duration,
- restrictions on exposure to structured credit investments.

F&C managed funds may hold equity derivatives to facilitate efficient portfolio management as outlined in the relevant fund mandates. Currency forwards and other derivatives may

also be held to manage currency risk, but only if permitted by individual fund mandates. The Group may seek to reduce investment risk by holding equity derivatives (without disproportionately increasing other types of risk).

Non-F&C managed unit linked funds may use derivatives for the purposes of efficient portfolio management and risk reduction in accordance with policy holder contracts and marketing literature relevant to the funds.

In addition to the mandates, the Group undertakes a programme of asset/liability management. For example, in order to manage the impact of interest changes on profit, corporate bonds and gilts are held to match the duration and profile and cash flows of annuity and permanent health insurance policies.

In order to manage the exposure arising from guarantees and options, the Group has purchased a number of derivatives, including interest rate swaps, equity put options, currency forwards, inflation swaps, interest rate swaptions, and equity futures to manage exposures to movements in equity prices or interest rates. Hedge accounting has not been applied to these derivatives, as movements in the fair value of these instruments will be offset by the movement in the valuation of the liability. As noted, the majority of these guarantees arise within FPLP's With-Profit Fund and so any net fair value movement will be reflected in the FFA rather than within shareholders' funds.

The following provides additional information on the exposure to equity and property risk, foreign exchange risk and interest rate risk:

(i) Equity and property risk

Equity and property risk, as defined above, are accepted in accordance with agreed risk appetite in order to achieve the desired level of return from policyholder assets.

Asset allocation within the With Profits Fund is actively managed. During 2009 steady improvement in the investment return of our With Profits Fund has enabled us to remove Market Value Reductions (MVRs) on all pension contracts taken out after 2001 and on all life contracts. MVR rates on all other contracts have been reduced to an average of 2%. At 31 December 2009 the proportion of equities and property backing asset shares was close to 26% (2008: 15%). These actions are in line with Friends Provident's commitment to fair treatment of all its customers and the published Principles and Practices of Financial Management underlying the fund.

For with-profit and unit-linked policies, the policyholders bear the majority of the investment risk and any change in asset values is matched by a broadly equivalent change in the realistic liability. However, charges which are expressed as a percentage of fund values are impacted by movements in equity and property prices and therefore falling values still have an adverse effect on shareholders. Throughout 2009 there has been no exposure to equity risk within shareholders funds.

The management of equity investments for FPL&P (the UK Life and Pensions business) in the UK is largely undertaken on behalf of FPL&P by F&C. Following the demerger of F&C, the process of managing the relationship has become increasingly formalised. The interaction between the Group and F&C is governed by investment management agreements, service level agreements and investment mandates. In its decision-making on equity investments, F&C will assess the extent of equity risk required or allowed by the fund as set out in the fund objectives and relative to defined performance benchmarks. The management of

equity investments by non-F&C fund managers will be performed in accordance with the objectives of the fund as set out in policy contracts and marketing literature.

(ii) Foreign exchange risk

The Group is exposed to foreign exchange risk through its investment in foreign operations, fee income derived from financial instruments denominated in currencies other than its measurement currency (pounds sterling), and revenues receivable in foreign currency. The net exposure to foreign exchange risk through investment in overseas equities is currently small, and exposure through debt securities is limited due to restrictions through limits placed by Investment mandates. Consequently, the Group is exposed to the risk that the exchange rate of its measurement currency relative to other currencies may change in a manner that has an adverse effect on the value of the Group's financial assets and liabilities. This risk is accepted, in accordance with the agreed risk appetite, as being consequential upon the Group following its agreed investment strategy.

For unit-linked contracts, currency risk is borne by the policyholder. As noted above, the shareholders are subject to currency risk only to the extent that income from policyholder funds is based on the value of the financial assets held in those funds. The liability for non-linked insurance contracts in currencies other than sterling is immaterial.

(iii) Interest rate risk

The Group is exposed to fair value interest rate risk where changes to interest rates result in changes to fair values rather than cash flows, for example fixed interest rate loans and assets. Conversely, floating rate loans expose the Group to cash flow interest rate risk. The Group holds both:

- Receiver interest rate swaps (where fixed payments are received in return for floating payments being paid) – increases to interest rates increase cash flows payable and reduce fair value.
- Payer interest rate swaps (where floating payments are received in return for fixed payments being paid) – reductions to interest rates reduce cash flows receivable and reduce fair value.

However, both types of swaps are in place in order to mirror the effect of interest rates on the liabilities and so the net effect of interest rate changes is minimal.

Bond related performance benchmarks within fund mandates are set so that asset profiles broadly match liability profiles. This minimises interest rate risk.

Day to day investment decisions around the management of interest rate risk and its impact on the value of FPL&Ps investments are largely undertaken on behalf of FPL&P by F&C, within the boundaries set by fund mandates. In its decision making on gilt and corporate bond investments, F&C will assess the extent of interest rate risk allowed by the fund as set out in the fund objectives and relative to the defined performance benchmarks.

FPL&P may also be exposed to interest rate risk on its strategic investments, or any debt issuance. As part of any proposal for strategic investment or debt capital raising, the interest rate risk to which FPL&P is exposed will be given careful consideration as one of the factors impacting on the final recommendation. Ultimate approval for any strategic investments or debt raising rests with the Resolution Limited Board.

**(c) Credit risk**

Credit risk is the risk of loss due to the default of a company, individual or country. Credit risk includes the following seven elements:

- Investment credit risk – financial loss arising from a change in the value of an investment due to a rating downgrade, default, or widening of credit spreads. Changes in credit spreads are also affected by the liquidity of the stock, but since the liquidity is usually closely related to credit risk, the risk is managed as credit risk
- Derivative counterparty risk – financial loss arising from a derivative counterparty's default, or the deterioration of the derivative counterparty's financial position
- Reinsurance counterparty risk – financial loss arising from a reinsurer's default, or the deterioration of the reinsurer's financial position
- Deposit risk – financial loss arising from a deposit institution's default, or the deterioration of the deposit institution's financial position
- Loan risk – financial loss arising from a debtor's inability to repay all, or part, of its loan obligations to the Group or the deterioration of the debtor's financial position
- Country risk – financial loss arising from economic agents in a sovereign foreign country, including its government, being unable or unwilling to fulfil their international obligations due to a shortage of foreign exchange or another common reason such as currency inconvertibility
- Settlement risk – financial loss arising from the failure or substantial delay of an expected settlement in a transfer system to take place, due to the party other than FPL&P defaulting/not delivering on its settlement obligations.

The Life & Pensions business will take on investment credit risk and loan risk when it is deemed financially beneficial to do so in support of financial objectives.

The Group is exposed to investment credit risk on its investment portfolio, primarily from investments in corporate bonds. Creditworthiness assessment for new and existing investments is largely undertaken on behalf of the Group by F&C. In their decision making, F&C will assess the extent of investment credit risk allowed by each fund as set out in the fund mandates and relative to defined performance benchmarks.

The majority of the Group's corporate bond portfolio is highly rated (see table on page 109).

Derivatives purchased over the counter have the potential to expose the Group to substantial credit risk but this risk is significantly reduced through collateral arrangements with counterparties. The Asset Liability Management function is responsible for recommending derivative strategies to the Board, and putting into place the appropriate internal management processes. FPL&P will endeavour only to transact over-the-counter derivatives with highly rated counterparties.

The Group is exposed to reinsurance counterparty risk of three different types:

- as a result of debts arising from claims made by FPL&P but not yet paid by the reinsurer
- from reinsurance premium payments made to the reinsurer in advance, and
- as a result of reserves held by the reinsurer which would have to be met by FPL&P in the event of default.

In addition, there is potential for the Group's credit risk exposure to increase significantly under adverse insurance risk events, e.g. if FPL&P received a large number of claims for which it needed to recover amounts from its reinsurers. In order to mitigate reinsurance counterparty risk, FPL&P will give due consideration to the credit quality of a reinsurer before incepting a reinsurance treaty. To facilitate this process, a list of acceptable reinsurers is maintained within Life & Pensions Finance.

FPL&P is exposed to credit risk on the balances deposited with banks in the form of cash, certificates of deposit and money market instruments. Money market instruments issued by parties other than banks such as commercial paper are also covered under this heading. The primary risk is borrower quality; this is mitigated by limiting holding in any one issuer to 5%.

In certain, limited circumstances, Lombard is exposed to deposit risk:

- of custodian banks relating to unit-linked policy-holder cash positions, and
- for cash amounts held on behalf of unit-linked policyholders for premium proceeds with respect to policies not yet issued, and withdrawal/surrenders/death claim proceeds not yet paid to beneficiaries

FPL&P is exposed to loan risk in several different areas, the most material of which are:

- loans to IFAs as part of strategic investments
- other strategic loans
- loans to appointed representatives
- loans to brokers
- agency debt (including debt arising as a result of clawback of commission)
- policyholder debt
- rental income due

In general, these quantitative credit exposures are relatively low but they can bear relatively high likelihoods of default.

FPL&P is exposed to country risk in a number of key areas, the most significant of which is bonds issued by foreign governments in non-domestic currency. The mandates that govern all F&C managed funds restrict the purchase of foreign government bonds to only those that exceed a minimum level of credit worthiness.

The management of country risk on the creditworthiness of our investments is largely undertaken on behalf of FPL&P by F&C.

Settlement risk is a form of credit risk that arises at the settlement of a transaction, as a result of a counterparty failing to perform its obligations to FPL&P. FPL&P is exposed to settlement risk in the following key areas:

- bank transfers, including foreign exchange transactions
- the purchase or sale of investments
- the purchase or sale of property
- the purchase, sale or expiry of exchange-traded derivatives or the transfer of periodic payments under these contracts
- the settlement of derivative contracts

## Objectives in managing credit risk

To mitigate credit risk:

- Investment mandates for many funds will have a prescribed minimum credit rating of bonds that may be held. Investing in a diverse portfolio reduces the impact from individual companies defaulting.
- Counterparty limits are set for investments, cash deposits, foreign exchange trade exposure and stock lending.
- All over the counter derivative transactions are covered by collateral, with minor exceptions.
- The Group regularly reviews the financial security of its reinsurers.

The exposure to individual counterparties is limited to specific percentages of total non-linked assets in the long term fund, based on regulatory categorisation of counterparties. These are typically less than 3% of non-linked assets.

Concentrations of credit risk might exist where the Group has significant exposure to a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions.

In relation to deposit risk of custodian banks, Lombard will, wherever possible, hold positions via diversified monetary collective funds, which are not at Lombard's risk. The residual risk is mitigated in most circumstances via clients acceptance of such risk in policy general conditions, and via the diversification of risk across Lombard's more than 130 custodian banks.

In relation to Lombard's deposit risk for cash amounts held on behalf of unit-linked policyholders, the risk is mitigated via the diversification of risk across Lombard's more than 130 custodian banks, and the management policy of holding any longer term balances in highly rated and/or state-backed custodian banks.

An indication of the Group's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The Group is most exposed to credit risk on debt and other fixed income securities, derivative financial instruments, deposits with credit institutions, reinsurance arrangements and cash and cash equivalents. Debt and other fixed income securities mainly comprise government bonds and corporate bonds. Given the nature of the Group's investments in government bonds the credit risk associated with these is considered small and the Group therefore focuses on monitoring the quality of its corporate bonds.

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 tables below as the credit risk on these assets is borne by the policyholders rather than the shareholders.

At 31 December 2009	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Corporate bonds	1,247	2,256	1,774	450	84	249	273	6,333
Asset backed securities	501	254	198	85	6	42	81	1,167
Derivative financial instruments	-	(6)	-	-	-	-	179	173
Reinsurance assets	-	1,973	-	-	-	-	-	1,973
Deposits with credit institutions	4	12	9	-	-	-	-	25
Cash and cash equivalents	1,092	49	541	-	-	-	167	1,849
<b>Total</b>	<b>2,844</b>	<b>4,538</b>	<b>2,522</b>	<b>535</b>	<b>90</b>	<b>291</b>	<b>700</b>	<b>11,520</b>
<b>%</b>	<b>25%</b>	<b>38%</b>	<b>22%</b>	<b>5%</b>	<b>1%</b>	<b>3%</b>	<b>6%</b>	<b>100%</b>

At 31 December 2008	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Not rated £m	Total £m
Corporate bonds	1,195	2,514	1,858	453	6	3	68	6,097
Asset backed securities	488	295	337	49	5	-	17	1,191
Derivative financial instruments	-	4	560	-	-	-	-	564
Reinsurance assets	-	1,964	-	-	-	-	-	1,964
Deposits with credit institutions	-	3	4	-	-	-	-	7
Cash and cash equivalents	1,137	898	394	-	-	-	72	2,501
<b>Total</b>	<b>2,820</b>	<b>5,678</b>	<b>3,153</b>	<b>502</b>	<b>11</b>	<b>3</b>	<b>157</b>	<b>12,324</b>
<b>%</b>	<b>23%</b>	<b>46%</b>	<b>26%</b>	<b>4%</b>	<b>-</b>	<b>-</b>	<b>1%</b>	<b>100%</b>

The following tables show the amounts of insurance receivables and loans that were impaired and the amounts of insurance receivables and loans that were not impaired but either past due or not at the end of the year. No other financial assets were either past due or impaired at the end of the year. Assets held in unit-linked funds have been excluded from the tables.

31 December 2009	Insurance receivables	Loans
Financial assets that are neither past due nor impaired	85.7%	100%
Financial assets that are past due:		
0 – 3 months past due	6.4%	-
3 – 6 months past due	0.3%	-
6 – 12 months past due	0.3%	-
Impaired financial assets for which provision is made	7.3%	-
<b>Total before provision for impairment (£m)</b>	<b>343</b>	<b>80</b>
31 December 2008	Insurance receivables	Loans
Financial assets that are neither past due nor impaired	88.4%	100.0%
Financial assets that are past due:		
0 – 3 months past due	5.0%	-
3 – 6 months past due	0.6%	-
6 – 12 months past due	0.8%	-
Impaired financial assets for which provision is made	5.2%	-
<b>Total before provision for impairment (£m)</b>	<b>481</b>	<b>98</b>

For the majority of over-the-counter derivative transactions undertaken by FPL&P, collateral is received from the counterparty if the sum of all contracts held with the counterparty are in-the-money (ie is an asset of FPL&P). The Group has a legal right to this collateral if the counterparty does not meet its obligations but has no economic benefit from holding the assets and the counterparty may substitute at any time the collateral delivered with another asset of the same value and quality. It is repayable if the contract terminates or the contract's fair value falls. Contractual agreements between the Group and each counterparty exist to protect the interests of each party, taking into consideration minimum threshold, asset class of collateral pledged and the frequency of valuation. At 31 December

2009 the fair value of such collateral held was £177m (2008: £440m). No collateral received from the counterparty has been sold or repledged.

Reinsurance assets include an amount of £1,715m which relates to a reinsurance agreement with Swiss Re, as set out in note 35. The asset is secured by a collateral arrangement offering protection should any counterparty supporting the Reinsurance Agreement default. An Investment Management Agreement exists between the Group and Swiss Reinsurance Company Ltd (Swiss Re) to govern the suitability of collateral assets. As at 31 December 2009 the value of such collateral was £1,614m. The value of the loan note and underlying collateral is reviewed annually to ensure that the future payments received from the loan note are similar to the best estimate liability cash flows. As a result of this years' review a payment of approximately £40m will be made by the reinsurer to increase the value of the loan note and collateral. It is expected that this will take place in April 2010.

#### **(d) Liquidity risk**

Liquidity risk is the risk that an entity, although solvent, either does not have sufficient financial resources available to it in order to meet its obligations when they fall due, or can secure them only at excessive cost.

The Group faces two key types of liquidity risk:

- shareholder liquidity risk (liquidity within funds managed for the benefit of shareholders, including shareholders' interests in long-term funds) and
- policyholder liquidity risk (liquidity within funds managed for the benefit of policyholders).

The overall objective of shareholder liquidity risk management is to ensure there are sufficient funds available to meet the cash flow needs of the business. The overall objective of policyholder liquidity risk is to ensure that sufficient liquid funds are available to meet cash flow requirements under all but the most extreme scenarios (the exception being the property funds where a six month notice period is required for switches and withdrawals).

The Group will meet shareholder liquidity needs arising in a number of key areas. For example:

- the ability to support the liquidity requirements arising from new business
- the capacity to maintain dividend payments / loan repayments and interest etc
- the ability to cope with the liquidity implications of strategic initiatives, such as merger and acquisition activity
- the capacity to provide financial support across the Group
- the ability to fund its day-to-day cash flow requirements

The overall objective of shareholder liquidity risk management is to ensure that there is sufficient liquidity over short (up to one year) and medium time horizons to meet the needs of the business.

For policyholder funds, liquidity needs arise from a number of potential areas, including:

- a short-term mismatch between cash flows arising from assets and cash flow requirements of liabilities
- having to realise assets to meet liabilities during stressed market conditions
- investments in illiquid assets such as property and private placement debt

- higher than expected level of lapses/surrenders caused by economic shock, adverse reputational issues or other events
- higher than expected payments of claims on insurance contracts
- the implementation of temporary restrictions for the withdrawal of funds, as recently applied by extending the notice periods of switches and withdrawals from Property Funds.

Exposure to policyholder liquidity risk can be split between non-linked and linked funds. As a general rule, the Group is more likely to be significantly impacted by policyholder liquidity risk on non-linked funds, as opposed to linked funds where policyholder benefits are expressed directly as units held in an underlying fund though this may not always be the case.

The overall objective of policyholder liquidity risk management is to ensure that sufficient liquid funds are available to meet cash flow requirements under all but the most extreme scenarios.

Liquidity risk is managed in the following way:

- Forecasts are prepared regularly to predict required liquidity levels over both the short and medium term.
- A credit facility with a syndicate of banks exists to enable cash to be raised in a relatively short time-span as detailed below.
- Credit risk of cash deposits is managed by applying counterparty limits and imposing restrictions over the credit ratings of third parties with whom cash is deposited.
- Assets of a suitable maturity and marketability are held to meet policyholder liabilities as they fall due.
- Limits are set on the level of investment in securities that are not readily realisable. These are typically restricted to 5% of non-linked assets.

The Company benefits from a £300 million multi-currency revolving credit facility with Barclays Capital, Citigroup Global Markets Limited, HSBC Bank Plc and The Royal Bank of Scotland Plc, with HSBC Bank Plc as agent, entered into on 26 April 2006 (as amended). If a third party, who does not presently have control of the Company, acquires such control, the Company must notify the agent immediately. In this circumstance, the lenders are not obliged to fund utilisation and may notify the agent to cancel their commitments under the facility. This would have the effect of rendering all of their loans immediately repayable. As at the date of this report, the facility remains undrawn.

Where contracts have a surrender value (ie the policy is theoretically payable on demand) the following table shows the current surrender value in the within one year or payable on demand column. Otherwise it indicates the undiscounted expected contractual net cash flows in respect of financial and insurance liabilities.

Year ended 31 December 2009	Carrying value £m	Contractual undiscounted cash flows		
		Within 1 year or payable on demand £m	1-5 years £m	More than 5 years £m
<b>Non-derivative financial liabilities</b>				
Insurance contracts	12,107	6,828	1,062	5,673
Investment contracts	40,495	40,575	-	-
Loans and borrowings:				
Principal	590	164	30	396
Interest	-	48	127	132
Due to reinsurers	1,610	120	470	2,052
Net asset value attributable to unit-holders	668	668	-	-
Insurance payables and other Payables	440	419	2	19
<b>Derivative financial liabilities</b>				
Interest rate swaps	19	-	-	19
Inflation rate swaps	3	1	2	-
Futures backing equities	22	22	-	-
Forward currency contracts	11	11	-	-

At 31 December 2008	Carrying value £m	Contractual undiscounted cash flows		
		Within 1 year or payable on demand £m	1-5 years £m	More than 5 years £m
<b>Financial liabilities</b>				
Insurance contracts	12,677	7,895	866	5,169
Investment contracts	35,275	36,215	-	60
Loans and borrowings:				
Principal	729	71	58	600
Interest	-	36	135	92
Due to reinsurers	1,792	125	477	2,101
Net asset value attributable to unit-holders	668	668	-	-
Insurance payables and other payables	872	633	60	179

Amounts expected to be settled from the fund for future appropriation are excluded from the analysis above as there is no contractual obligation to settle the liability. Of the carrying amount on the balance sheet in respect of the FFA, £253m (2008: £385m) is expected to be settled more than 12 months after the balance sheet date.

The Group has issued fixed rate subordinated loan notes repayable in 2016, with the option of extending the term to 2026 (at a floating rate). This has provided the Group with long-term flexible funding at a fixed rate of interest.

#### **(e) Policy cash flow risk (including insurance risk)**

Policy cash flow risk consists of the following four main areas:

Insurance risks:

- mortality risk – risk of loss arising due to policyholder deaths experience being different from expectations; or for annuities, risk of annuitants living longer than expected (called annuity longevity risk);
- morbidity risk – risk of loss arising due to policyholder health experience being different from expectations.

Other risks:

- policyholder decision risk – risk of loss arising from experience of actual policyholder behaviour (eg lapses, option take-up) being different from expectations;
- expense risk – risk of loss due to expense experience being different from expectations.

The Life & Pensions business actively pursues mortality risk (other than annuitant mortality risk) and morbidity risk in those areas where it believes it has a competitive advantage in managing these risks to generate shareholder value (without compromising the interests of policyholders, and the need to treat customers fairly). Annuitant mortality risk, policyholder decision risk and expense risk are taken on when it is deemed financially beneficial for the organisation to do so, or where the taking of these risks is in support of the Group's strategic objectives.

Underpinning the Group's management of policy cash flow risk is:

- adherence to an approved underwriting policy that takes into account the level of risk that the Group is prepared to accept;
- controls around the development of products and their pricing;
- regular analysis of actual mortality, morbidity and lapse experience which feeds into the development of products and policies. If the analysis changes expectations of future liability cash flows, periodic adjustments are made to asset cash flows to maintain the asset liability match.

Risks in excess of agreed underwriting limits may be reinsured. The Group's objective is to purchase reinsurance in the most cost-effective manner from reinsurers whose creditworthiness is deemed appropriate.

Substantially all insurance contracts, and the majority of the combined insurance and investment contract portfolio, are written in the UK and so results are sensitive to changes in the UK insurance market and tax regime. Otherwise the Group sells a diverse range of products to a diverse group of people.

Note 27 describes the main insurance contracts written by the Group and the basis of setting assumptions in measuring insurance liabilities which will take into account the risks above. The following sections describe how policy cash flow risks are managed.

(i) Mortality and morbidity risk

Life assurance

Most insurance policies other than annuities and deferred annuity policies include life assurance. When pricing policies, an assumption is made as to the likelihood of death and this assumption is reviewed as part of the annual valuation of policies. To the extent that actual mortality experience is worse than that anticipated in pricing (and subsequently in the insurance liability valuation) a loss will be made. The risk is greater for those policies such as term assurance where the maturity or surrender benefit is small in relation to the death benefit. Other policies which have a savings element, such as endowment assurance have significant liabilities relating to the maturity benefit, particularly as the policy approaches maturity. Contractual terms for unit-linked and unitised with-profits products include provision for increases in mortality charges.

### Critical illness

The Group writes a number of critical illness policies that pay out in the event of a policyholder's ill health. As for life assurance, the amount payable on ill health can be significantly higher than the amount payable if the policy is surrendered.

### Income protection

The two main risks related to income protection are an increase in the frequency of claims (the inception rate) and an increase in the average length of the claim (a reduction in recovery rate). Most income protection policies are regular premium with the premium and cover fixed at inception. Some group policies allow premiums to be reviewed but the premium rates are usually guaranteed for three years.

### Annuities

If annuitants live longer than expected on average, profits will reduce. In most cases the annuity is guaranteed payable for a fixed term and many policies are written so that when the first life dies the benefit continues, often at a reduced level. These features tend to reduce the volatility of results to random fluctuations in experience but not the impact of a general increase in longevity.

Deferred annuities are subject to a similar risk from the impact of longevity, the only difference being that the risk of adverse impact is greater given that the annuity is payable further into the future. However, most of these policies are with-profits and the impact would be offset by a reduction in the FFA, with relatively little resulting impact on shareholder profits.

The annuity risk of the Group was significantly reduced through a reinsurance agreement with Swiss Re put in place in April 2007. The agreement covers annuity contracts written between July 2001 and December 2006 within Friends Provident Pensions Limited. The policies are valued at £1,610m at 31 December 2009.

### (ii) Policyholder decision risk

Persistency experience varies over time as well as from one type of contract to another. Factors that will cause lapse rates to vary over time include changes in investment performance of the assets underlying the contract where appropriate, regulatory changes that make alternative products more attractive, customer perceptions of the insurance industry in general and the Group in particular, and the general economic environment.

The valuation of the Group's guarantees and options is described in note 28. As stated in that note, the cost of guaranteed annuity options is dependent on decisions made by policyholders such as policy discontinuance and tax-free cash take-up. These assumptions are set by reference to recent experience.

### (iii) Expense risk

Though under IFRS 4 expense risk is not a component of insurance risk, it is an important policy cash flow risk in the context of insurance and investment contracts.

The whole of the impact of changes in expense levels is borne by shareholders with the following exceptions. In 2009 the charges made to the FPLP With-Profits Fund for managing policies were reviewed to reflect market rates at the time. Pre-demutualisation with-profits policyholders will bear the impact of any resulting changes to charges. Also FPLA closed fund with-profits policyholders bear the full expense risk for the fund.

Contractual terms for unit-linked and unitised with-profits products include provision for increases in charges. Certain expenses (such as fees/commissions) are fixed at the time a contract is written.

### 32. Investment contracts

#### Movement in investment contracts liabilities

	2009 £m	2008 £m
<b>At 1 January</b>	<b>35,275</b>	37,266
Demerger of F&C	(734)	-
Premiums	5,493	5,592
Claims	(2,801)	(3,510)
Investment return, annual management charges and other expenses	4,313	(7,131)
Foreign exchange adjustments	(1,039)	3,058
<b>At 31 December</b>	<b>40,507</b>	35,275
Analysed as follows:		
Unit-linked contracts	36,410	31,341
Policies with DPF	3,974	3,872
Other	123	62
<b>Total investment contracts liabilities</b>	<b>40,507</b>	35,275

None of the movement in liabilities is attributable to changes in credit risk of the liabilities. Fair value movements of £4,485m (2008: £(5,671)m) are included within the income statement arising from movements in investment contract liabilities held at fair value.

Included in the carrying amount above, £36,027m (2008: £33,447m) is expected to be settled more than 12 months after the balance sheet date.

Unit-linked liabilities are based on the fair value of the underlying assets. Liabilities relating to policies with DPF are determined using methods and principles consistent with insurance contracts as set out in note 28. There is no significant difference between carrying values and maturity values of investment contract liabilities.

### 33. Loans and borrowings

	Coupon %	2009 £m	2008 £m
<b>Subordinated liabilities:</b>			
F&C floating rate subordinated loan notes due 2026 (i)	Various	-	258
Lombard undated subordinated loans	Various	4	6
£162m Friends Provident Group plc subordinated debt due 2021 (ii)	12.00	160	-
<b>Debenture loans:</b>			
Box Hill Life Finance plc securitisation notes – class A-1 due 2016 (iii)	3m LIBOR +0.20	23	23
Box Hill Life Finance plc securitisation notes – class A-2 due 2019 (iii)	3m LIBOR +0.23	100	100
F&C Commercial Property Trust secured bonds due 2017 (iv)	5.23	219	219
£35m F&C loan notes due 2010 (v)	Various	-	35
<b>Reinsurance:</b>			
Lombard financial reinsurance treaty	EURIBOR +2.12	27	16
Friends Provident financial reinsurance treaty	3m EURIBOR +1.75	4	9
<b>Other:</b>			
Amounts owed to credit institutions (overdrafts)		32	63
<b>Total loans and borrowings</b>		<b>569</b>	729

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

(i) £260m of subordinated loan notes were issued by F&C in December 2006 and initially recognised net of issue costs of £2m. The loan notes are redeemable in 2026. For the period 20 December 2006 to 19 December 2016, interest accrues at a rate of 6.75% per annum, payable annually in arrears. For the period 20 December 2016 to 20 December 2026, interest accrues at a rate of 2.69% above 3m LIBOR per annum, payable quarterly in arrears. These loan notes are no longer recognised by the Group following the demerger of F&C in 2009.

(ii) On 21 May 2009, as part of the financial restructuring detailed in note 34, Friends Provident plc (renamed Friends Provident Limited in June 2009) exchanged £322m of its Step-Up Tier one Insurance Capital Securities for £162m 12 per cent. Sterling Denominated Fixed Rate Subordinated Guaranteed Notes due 2021. These notes are irrevocably guaranteed on a subordinated basis by Friends Provident Life and Pensions Limited. The subordinate debt is carried at £160m, being £162m principal less capitalised issue costs of £2m.

(iii) On 16 December 2004 FPLP raised £380m of core regulatory capital in the form of floating rate secured notes through a securitisation of the cash flows expected to emerge from a book of life insurance policies. £280m was raised through class A-1 notes due 2016 and £100m through class A-2 notes due 2019. The repayment of principal on the notes started on the 15 April 2006 and every year thereafter, dependent on the surplus emerging from the book of life insurance policies. For the purpose of securitisation, two special purpose vehicles were established, namely Box Hill Life Finance plc and Box Hill Loan Finance Limited. Both companies have been treated as Group companies for the purposes of the consolidated accounts. On 16 December 2004 Box Hill Life Finance plc issued the two classes of floating rate secured notes. The notes benefit from a financial guarantee provided by Ambac Assurance UK. Interest is payable quarterly in arrears on 15 January, April, July and October each year. The floating rate secured notes will be repaid in April 2010.

£82m of the notes were repaid in 2006, £144m in 2007, and £31m in 2008.

(iv) £230m of secured bonds were issued in February 2005. The carrying value was initially recognised net of amortised issue costs of £1m. The reduction of £10m relates to an intragroup holding eliminated on consolidation.

(v) £35m of loan notes were issued on 3 September 2008 by F&C as part consideration for the acquisition of the REIT Group. Interest is payable quarterly in arrears on 28 February, 31 May, 31 August and 30 November. First payment was due 30 November 2008 at 2% pa above 3 month LIBOR on issue date, increasing to 3% on 16 December 2008 and to 4% on 16 June 2009. The loan notes were repayable on 30 June 2010. These loan notes are no longer recognised by the Group following the demerger of F&C in 2009.

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

	2009 £m	2008 £m
Within one year or on demand	169	71
Between one and two years	9	42
Between two and three years	6	2
Between three and four years	4	3
Between four and five years	1	11
In more than five years	380	600
<b>Total loans and borrowings</b>	<b>569</b>	<b>729</b>

Included in the carrying amount above, £409m (2008: £642m) is expected to be settled more than 12 months after the balance sheet date.

Total interest expenses for financial liabilities not measured at fair value through the income statement, which arises solely from interest bearing loans and borrowings is £33m (2008: £30m).

### **34. Financial restructuring and reorganisation of the Friends Provident Group**

The objective of the financial restructuring and reorganisation was to insert a new holding company on top of the Group with increased share capital to allow it to be reduced to create distributable reserves and to provide flexibility to effect other corporate transactions including the demerger of the Group's stake in F&C. As a result of the reorganisation, Friends Provident Group plc (the Company) became the holding company of the Friends Provident group of companies. Shares in Friends Provident plc ceased to be listed and Friends Provident Group plc was admitted to listing on the Official List of the UKLA and to trading on the London Stock Exchange.

On 21 May 2009, Friends Provident plc carried out a financial restructuring by exchanging £90m of its £300m 6.875% Step-Up Tier one Insurance Capital Securities issued on 21 November 2003 (the 2003 STICS) and £232m of its £500m 6.292% Step-Up Tier one Insurance Capital Securities issued on 30 June 2005 (the 2005 STICS) for £162m 12% Sterling Denominated Fixed Rate Subordinated Guaranteed Notes due 2021, irrevocably guaranteed on a subordinated basis by Friends Provident Life and Pensions Limited.

The subordinated debt is carried at £160m, being £162m principal less capitalised and amortised issue costs of £2m.

The gain of £160m attributable to ordinary shareholders less previously capitalised issue costs in respect of the exchanged STICS of £3m has been recognised directly in equity.

The impact of the financial restructuring was to increase equity attributable to ordinary shareholders by £113m (being STICS exchanged of £322m less debt issued of £162m, original issue costs on the STICS exchanged of £3m and tax of £44m), increase loans and borrowings by £159m and reduce equity attributable to other equity holders (STICS) by £319m (being STICS exchanged of £322m less original issue costs on the STICS exchanged of £3m).

On 15 June 2009 the reorganisation became effective with the Company issuing 2,340,000,000 new ordinary shares of 48p each and the shareholders in Friends Provident plc receiving one new ordinary share in Friends Provident Group plc for every one share held in Friends Provident plc. On 16 June 2009, a Court hearing confirmed a reduction in the nominal value of each Friends Provident Group plc from 48p to 20p. The relevant Court

order was registered and the reduction of share capital became effective on 17 June 2009 and distributable reserves of £655,200,000 were created.

The reorganisation has been accounted for as a pooling of interests under IFRS 3 Business combinations, as detailed in note 1. The reorganisation has had no material impact on the Group's results.

Following on from the reorganisation, the Group demerged its stake in F&C on 3 July 2009 by means of a return of capital by the Company. Shareholder approval for this proposal was received on 12 June 2009 and on 2 July 2009, a Court hearing confirmed a reduction in the nominal value of each Friends Provident Group plc share from 20p to 5p resulting in a reduction of capital of £351m which facilitated the demerger of F&C by way of a return of capital. The reduction of capital from 20p to 5p per share reflected the return of capital of the Company's holding in F&C that was demerged (a number of shares in F&C were held back and sold to recover costs) at market value, which was £158m, together with some additional capital being reduced to create £193m of additional distributable reserves. The relevant Court order was registered and the demerger and capital reduction became effective on 3 July 2009. In the Group accounts F&C was demerged at net asset value, resulting in a reduction in equity of £100m (£118m net asset value less £18m value of shares retained).

On 6 July 2009 the external STICS, external loan notes, internal preference shares, internal STICS and bank facility were all transferred from Friends Provident plc to Friends Provident Group plc so that the new holding company is in the same position as the previous holding company.

On 4 November 2009 Friends Provident Group plc was acquired by Resolution Holdings (UK) Limited which was renamed Friends Provident Holdings (UK) Limited on the same day. The trading of Friends Provident Group plc shares on the London Stock Exchange's main market for listed securities and the listing of the shares on the Official List of the UK Listing Authority was cancelled on 5 November from 8am.

### **35. Amounts due to reinsurers**

During April 2007 Friends Provident Pensions Limited (FPP) entered into a reinsurance treaty with Windsor Life Assurance Company Limited, a subsidiary of Swiss Re. The agreement, which took effect from 1 January 2007, reinsures the mortality and investment risk, but not expense risk, of 100% of FPP's in-force post demutualisation annuity books as at 31 December 2006. Business written after 31 December 2006 is not reinsured under the treaty. The liability due to Swiss Re. represents future reinsurance premiums payable and is accounted for as a financial liability at fair value through the income statement, thereby avoiding a mismatch with the assets backing the liability. Reinsurance premium payments are funded from the fixed return on an investment in a collateralised HSBC Amortising Note, purchased with a transfer of the assets previously backing the annuity policies.

Included in the carrying amount of £1,610m is £1,489m (2008: £1,667m) that is expected to be settled more than 12 months after the balance sheet date.

### 36. Net asset value attributable to unit-holders

The movements in the value of third party interests in open-ended investment companies and unit trusts that are consolidated by the Group are as follows:

	2009 £m	2008 £m
<b>At 1 January</b>	<b>668</b>	909
Share of total return in the period	136	(271)
Share of distributions in period	(21)	(27)
Amount paid on issue of shares	526	583
Amount received on cancellation of shares	(534)	(684)
Acquired upon funds coming into scope (i)	22	150
Disposed upon funds going out of scope (ii)	(137)	-
Share of reinvested accumulations	8	8
<b>At 31 December</b>	<b>668</b>	668

(i) Third party interests in F&C managed funds which were consolidated by the Group for the first time at the respective balance sheet date, as the Group holding was above 50%.

(ii) Third party interests in F&C managed funds previously consolidated by the Group, but which were deconsolidated at the respective balance sheet date, as the Group holding was below 50%.

The carrying value of net asset value attributable to unit holders approximates fair value.

### 37. Provisions

	2009 £m	2008 £m
<b>Analysis of total provisions</b>		
Pension deficits (note 9)	-	22
Other provisions	72	86
<b>At 31 December 2009</b>	<b>72</b>	108

	Review of mortgage endowment sales £m	Future consideration £m	Other £m	Total £m
<b>Analysis of other provisions</b>				
<b>At 1 January 2009</b>	<b>17</b>	<b>3</b>	<b>66</b>	<b>86</b>
Charged in the year	7	-	58	65
Acquisition of subsidiaries	-	4	4	8
Demerger of F&C	-	-	(17)	(17)
Released in the year	(1)	-	(3)	(4)
Utilised in the year	(9)	(2)	(55)	(66)
<b>At 31 December 2009</b>	<b>14</b>	<b>5</b>	<b>53</b>	<b>72</b>

Included in the carrying amount above, £28m (2008: £19m) is expected to be settled more than 12 months after the balance sheet date.

#### (a) Review of mortgage endowment sales

Provision has been established for the estimated likely cost of redress, including administrative costs, arising from the review of the suitability of mortgage endowment policies. In addition to the accounting provision of £13m (2008: £17m), an actuarial reserve of £4m (2008: £5m) was held in the insurance contracts provision of FPLP's With-Profits Fund in respect of estimated further complaints. This review is now substantially complete.

## (b) Future consideration

Provision was established for the estimated future consideration payable on acquisition of Pantheon Financial Limited and Quadrant Caldwell Drake Limited in 2007.

## (c) Other

Other provisions include £10m (2008: £9m) in respect of costs associated with Group restructuring, £21m (2008: £25m) lapse provisions within Sesame and £8m (2008: £10m) in respect of vacant properties.

## 38. Insurance payables, other payables and deferred income

	2009	2008
	£m	£m
Creditors arising out of direct insurance operations	74	181
Creditors arising out of reinsurance operations	20	25
Accruals and deferred income	81	103
Investments purchased for subsequent settlement	58	64
Deferred front end fees	136	131
Employee benefits	-	27
Derivative contracts	54	242
Put option	-	66
Other payables	153	164
<b>Total insurance payables, other payables and deferred income</b>	<b>576</b>	<b>1,003</b>

Included in the carrying amount above, £90m (2008: £366m) is expected to be settled more than 12 months after the balance sheet date.

## 39. Share capital and share premium

### (a) Allotted, called up and fully paid share capital of the Company

	2009	2008(i)
	£m	£m
<b>Authorised</b>		
2,500m ordinary shares of 5 pence (2008: 2,500m ordinary shares of 10 pence)	125	250
<b>Allotted, called up and fully paid</b>		
2,340m ordinary shares of 5 pence (2008: 2,341m ordinary shares of 10 pence)	117	234

(i) 2008 numbers are in respect of Friends Provident plc which was the holding company at 31 December 2008.

As explained below, Friends Provident Group plc became the holding company on 15 June 2009 when it issued 2,340,000,000 ordinary shares of 48 pence each.

## (b) Changes to share capital and share premium during the year

	Treasury shares number (i)	Ordinary shares number	Total number	Share capital £m	Share premium £m
<b>Friends Provident plc:</b>					
At 1 January 2008	18,124,284	2,322,993,799	2,341,118,083	234	2,372
Employee share schemes	(889,876)	889,876	-	-	-
<b>At 31 December 2008</b>	17,234,408	2,323,883,675	2,341,118,083	234	2,372
Employee share schemes	(1,646,782)	1,646,782	-	-	-
Transfer of Treasury shares	(14,469,543)	14,469,543	-	-	-
Cancellation of Treasury shares	(1,118,083)	-	(1,118,083)	-	-
<b>At 15 June 2009</b>	-	2,340,000,000	2,340,000,000	234	2,372
<b>Friends Provident Group plc</b>					
Allotment of shares (ii)	-	2,340,000,000	2,340,000,000	1,123	-
First capital reduction (ii)	-	-	-	(655)	-
Second capital reduction and demerger of F&C (ii)	-	-	-	(351)	-
<b>At 31 December 2009</b>	-	2,340,000,000	2,340,000,000	117	-

(i) On 10 June 2009, 14,469,543 ordinary shares of Friends Provident plc were transferred from treasury of Friends Provident plc for nil consideration to Halifax EES Trustees International Limited, to be held on the terms set out in the Friends Provident Employee Benefit Trust deed.

Friends Provident Group plc became the new holding company for Friends Provident on 15 June 2009. The shares held by the Employee Benefit Trust were cancelled and replaced with newly issued shares in Friends Provident Group plc.

On 4 November 2009, Friends Provident Group plc became a subsidiary of Resolution Limited and its shares held by the Employee Benefit Trust were replaced with shares of Resolution Limited.

(ii) On 15 June 2009, as part of the reorganisation detailed in note 34, the Company issued 2,340,000,000 new ordinary shares of 48p each. On 16 June 2009, a Court hearing confirmed a reduction in the nominal value of each Friends Provident Group plc share from 48p to 20p. The relevant Court order was registered and the reduction of share capital became effective on 17 June 2009.

On 2 July 2009, as part of the reorganisation detailed in note 34, a Court hearing confirmed a reduction in the nominal value of each Friends Provident Group plc share from 20p to 5p resulting in a reduction of capital of £351m which facilitated the demerger of F&C by way of a return of capital. The relevant Court order was registered and the demerger and capital reduction became effective on 3 July 2009. Of the £351m reduction in capital, £158m was returned to shareholders, being the market value of the Group's investment in F&C at the date of the transaction, and £193m was recognised in retained earnings as set out in note 40.

## (c) Options

Outstanding options under the Group's option schemes at 31 December 2009 are set out in note 10.

#### 40. Other reserves

Other reserves included in equity attributable to equity holders of the parent are as follows:

	Retained earnings £m	Merger reserve £m	Foreign currency translation reserve £m	Total £m
<b>At 1 January 2009</b>	<b>(344)</b>	-	<b>175</b>	<b>(169)</b>
Profit for the year	195	-	-	195
Actuarial loss on defined benefit schemes	(62)	-	-	(62)
Foreign exchange and other adjustments	-	-	(50)	(50)
Dividends	(91)	-	-	(91)
Tax relief on STICS interest	11	-	-	11
Share based payments	15	-	-	15
STICS exchange (i)	113	-	-	113
Group reorganisation (ii)	929	1,483	(23)	2,389
Other	5	-	-	5
<b>At 31 December 2009</b>	<b>771</b>	<b>1,483</b>	<b>102</b>	<b>2,356</b>

(i) Note 41

(ii) The merger reserve arose as part of the Group reorganisation in June 2009 and represents the difference between the share capital and share premium of Friends Provident plc of £2,606m and the share capital of the new holding company, Friends Provident Group plc, of £1,123m at the date of acquisition.

The £929m credit to retained earnings arises on the capital reductions undertaken by the Company, as set out in notes 13 and 39(b)(ii).

Further details of the Group reorganisation are set out in note 34.

	Retained earnings £m	Foreign currency translation reserve £m	Total £m
At 1 January 2008	319	27	346
Loss for the year (Restated)	(556)	-	(556)
Actuarial gain on defined benefit schemes	53	-	53
Foreign exchange and other adjustments	-	148	148
Dividends	(153)	-	(153)
Tax relief on STICS interest	15	-	15
Share based payments	11	-	11
Acquisition of subsidiaries	(35)	-	(35)
Disposal of subsidiaries	2	-	2
At 31 December 2008	(344)	175	(169)

#### 41. Step-up Tier one Insurance Capital Securities

	2003 STICS £m	2005 STICS £m	Total £m
At 1 January 2008	299	511	810
Interest payable in the year	21	31	52
Interest paid in the year	(21)	(31)	(52)
At 31 December 2008	299	511	810
Interest payable in the year	16	23	39
Interest paid in the year	(17)	(30)	(47)
Exchange for subordinated debt	(89)	(230)	(319)
<b>At 31 December 2009</b>	<b>209</b>	<b>274</b>	<b>483</b>

The Company has issued two STICS. These are identified as the 2003 STICS and the 2005 STICS. Under IFRS, it is necessary to treat STICS as equity as there is no requirement to settle the obligation in cash or another financial asset. Interest and dividends on instruments classified as equity are not treated as expenses but as an appropriation of profit. The Group considers that the commercial intent of the instruments is debt, accordingly the interest is included in the operating profit calculation of the Group.

Following the acquisition of Friends Provident by Resolution Limited, the alternative coupon satisfaction mechanism ("ACSM") feature of the STICS, in light of the new structure, no longer functions as originally intended. Resolution is currently reviewing options to allow reinstatement of the ACSM feature in a manner that meets the original intention for the instruments. The ACSM feature is designed to facilitate the repayment of deferred interest in the event that a coupon should be deferred. No coupons on these securities have been deferred.

#### 2003 STICS:

On 21 November 2003, the Company issued £300m of STICS, which bear interest from November 2003 to November 2019 at a rate of 6.875%. The STICS have no maturity date but will be redeemable at the option of the Company on 21 November 2019, thereafter on the coupon payment date falling on or nearest successive fifth anniversaries of this date. The STICS are perpetual securities and are not redeemable at the option of the holders at any time. The STICS are irrevocably guaranteed on a subordinated basis by FPLP. The guarantee is intended to provide holders with rights against FPLP in respect of the guaranteed payments which are as near as possible equivalent to those which they would have had if the STICS had been directly issued preference shares of FPLP. For each coupon period after 20 November 2019, the STICS will bear interest that is reset every five years. Interest is payable in equal instalments in arrears on 21 May and 21 November of each year. The 2003 STICS are carried at £209m, after the exchange for Fixed Rate Subordinated Guaranteed Notes detailed below, being £210m principal less capitalised issue costs of £1m, plus interest due of £2m not yet paid to STICS holders.

#### 2005 STICS:

On 27 June 2005, the Company issued £500m of STICS, which bear interest from 30 June 2005 to 30 June 2015 at a rate of 6.292%. The STICS have no maturity date but will be redeemable in whole or part at the option of the Company on 1 July 2015, thereafter on every fifth anniversary of this date. The STICS are perpetual securities and are not redeemable at the option of the holders at any time. The STICS are guaranteed on a limited and subordinated basis by FPLP. For each coupon period after 1 July 2015, the STICS will bear interest that is reset every five years. Interest is payable in arrears on 30 June of each year. The 2005 STICS are carried at £274m, after the exchange for Fixed Rate Subordinated Guaranteed Notes detailed below, being £268m principal less capitalised issue costs of £3m, plus interest due of £9m not yet paid to STICS holders.

#### Fixed Rate Subordinated Guaranteed Notes

On 21 May 2009, as part of the reorganisation detailed in note 34, Friends Provident plc exchanged £90m of its £300m 2003 STICS and £232m of its £500m 2005 STICS for £162m 12 per cent. Sterling Denominated Fixed Rate Subordinated Guaranteed Notes due 2021.

## 42. Contingent liabilities and commitments

### (a) Contingent liabilities

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

### (b) Commitments

#### Operating leases where the Group is lessee

The Group leases a number of properties under operating leases. These leases typically run for a period of 50 years, with an option of renewal at the end of the lease. Lease terms include annual escalation clauses to reflect current market conditions.

The future minimum rentals payable under non-cancellable leases are as follows:

	2009			2008		
	Land and buildings £m	Other £m	Total £m	Land and buildings £m	Other £m	Total £m
Within one year	3	1	4	17	6	23
Between one and five years	12	1	13	55	3	58
In more than five years	10	-	10	58	-	58
<b>Total operating lease payables</b>	<b>25</b>	<b>2</b>	<b>27</b>	130	9	139

#### Sub-lease receivables

Future minimum rentals receivable under non-cancellable operating leases at the year-end are as follows:

	Premises	
	2009 £m	2008 £m
Within one year	-	3
After one year but not more than five years	-	8
More than five years	-	1
<b>Total sub-lease receivables</b>	<b>-</b>	<b>12</b>

## 43. Business combinations

### (a) Financial Partners Business AG (FpB)

On 22 December 2009, the Group acquired 100% of the voting rights of Financial Partners Business AG (FpB), a distribution business based in Germany for a total consideration of €24m (£21m). Details of the purchase consideration and the fair value of the net assets acquired are set out in the following table:

	<b>£m</b>
Fair value of assets acquired	<b>8</b>
Goodwill arising on acquisition	<b>16</b>
<b>Total (i)</b>	<b>24</b>
<b>Discharged by:</b>	<b>£m</b>
Cash	<b>21</b>
Deferred consideration	<b>3</b>
<b>Total consideration : (i)</b>	<b>24</b>

(i) Includes transaction costs of £3m

### **(b) Bankhall acquisition**

On 29 October 2009, the Group acquired 100% of the voting rights of Bankhall and Premier Mortgage Services (PMS) for a total consideration of £1m.

### **(c) F&C Managed Investment Funds**

As a result of demerging its interest in F&C, the Group no longer exercises control over F&C European Capital Partners and as such has deconsolidated its interest in this investment fund at 31 December 2009.

## **44. Related parties**

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

The principal subsidiary undertakings of the Group and its interest in associates and joint venture are shown in notes 19 and 20 respectively.

### **(a) Key management personnel compensation**

Key management personnel consists of directors of Friends Provident Group plc, directors of Friends Provident Life & Pensions Limited, and members of the Group's leadership team.

In aggregate the compensation paid to key management is as set out below:

	<b>Number</b>	<b>2009 £m</b>	<b>2008 £m</b>
Short-term employee benefits	<b>21</b>	<b>5.6</b>	7.5
Post-employment benefits (excluding defined benefit scheme)	<b>4</b>	<b>-</b>	0.9
Share based payments	<b>8</b>	<b>3.8</b>	2.1
Termination benefits	<b>7</b>	<b>1.5</b>	-
<b>Total key management personnel compensation charged to the income statement</b>		<b>10.9</b>	10.5
Post employment benefits – defined benefit schemes	<b>6</b>	<b>0.5</b>	4.7
<b>Total key management personnel compensation</b>		<b>11.4</b>	15.2

'Post-employment benefits - defined benefit schemes' comprises the change in value of key management personnel accrued pension benefits from the beginning of the relevant financial year to the end of that year. Details of pension schemes and share schemes operated by the Group, and in which key management personnel participate are given in notes 9 and 10.

There were £nil balances outstanding at the year end with key management (2008: £nil).

A number of key management personnel and their close families have long term insurance policies with the Group. Such policies are on normal commercial terms which are also

available to other members of staff. The board has considered the financial effect of such insurance policies and concluded and not material to the Group or the individuals concerned.

All these transactions were completed on terms that were no better than those available to staff.

### **(b) Other related parties**

Details of the Group's investments in associates and joint venture are given in note 20. Details of the Group's pension schemes, whose assets are managed by F&C, are provided in note 9.

Transactions made between the Group and related parties were made in the normal course of business. Loans from related parties are made on normal arm's length commercial terms.

### **Services provided to related parties**

	Income earned in year £m	2009 Receivable at year end £m	Income earned in year £m	2008 Receivable at year end £m
Associates	-	-	-	-
Employee pension schemes	-	2	1	4
Other related parties	-	-	37	10
<b>Total</b>	<b>-</b>	<b>2</b>	<b>38</b>	<b>14</b>

### **Services provided by related parties**

	Income earned in year £m	2009 Receivable at year end £m	Income earned in year £m	2008 Receivable at year end £m
Joint venture	8	-	16	-
Other related parties	-	-	4	8
<b>Total</b>	<b>8</b>	<b>-</b>	<b>20</b>	<b>8</b>

As explained in note 9, a Group company made a loan of £160m to the Friends Provident Pension Scheme in 2008, of which £68m is outstanding at 31 December 2009 (2008: £82m).

### **45. Post Balance Sheet events**

On 19 March 2010 the Group disposed of its stake in Pantheon Financial Limited. The disposal does not have a material impact on the results or financial position of the Group.

### **46. Ultimate Holding Company**

On 4 November 2009, Friends Provident Holdings (UK) Limited, a subsidiary of Resolution Limited, acquired a 100% interest in the Group and as such is the immediate parent undertaking of the Group.

The Company's ultimate parent undertaking is Resolution Limited, which is incorporated in Guernsey. Copies of the Group Report and Accounts of Resolution Limited can be viewed via its website at [www.resolution.gg](http://www.resolution.gg).

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRIENDS PROVIDENT GROUP PLC**

We have audited the parent company financial statements of Friends Provident Group plc for the year ended 31 December 2009 which comprise the Parent Company Balance Sheet and the related notes 1 to 10. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statements set out on pages 17 to 18, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

### **Opinion on financial statements**

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2009;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent company financial statements.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

**Other matter**

We have reported separately on the group financial statements of Friends Provident Group plc for the year ended 31 December 2009.

*Ernst & Young LLP*

John Headley (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London  
23 March 2010

**Parent Company balance sheet  
At 31 December 2009**

	Notes	2009 £m
<b>Fixed assets investments</b>		
Investments in Group undertakings	2	1,916
<b>Current assets</b>		
<b>Amounts owed by Group undertakings</b>		
Other debtors		3
<b>Total debtors</b>		20
<b>Cash at bank</b>		23
		43
<b>Creditors: amounts falling due within one year</b>		
Accruals		(12)
Amounts owed to Group undertakings		(3)
		(15)
<b>Net current assets</b>		28
<b>Creditors: amounts falling after more than one year</b>		
Subordinated debt	3	(162)
Amounts owed to Group undertakings		(488)
<b>Total assets less liabilities</b>		1,294
<b>Capital and reserves</b>		
Called-up share capital	4	117
Other equity	5	488
Retained earnings	6	689
<b>Equity shareholders' funds</b>		1,294

The financial statements were approved by the Board of directors on 23 March 2010.



**Evelyn Bourke**  
Chief Financial Officer

## **Notes to the Parent Company accounts**

### **1. Accounting policies**

#### **1.1 Basis of preparation**

Friends Provident Group plc (the Company) is a limited liability company, incorporated in the UK.

The Company was incorporated on 27 March 2009 and became the holding company of Friends Provident plc on 15 June 2009 following a court-sanctioned reorganisation. On that date, its shares were admitted to listing on the Official List of the UKLA to trading on the London Stock Exchange

On 5 November 2009 the shares of the Company ceased to be listed. However the Company continues to hold listed debt and for that reason the parts of the Companies Act relating to listed companies, International Financial Reporting Standards (IFRS) and the Listing Rules remain applicable, including the requirement to prepare IFRS consolidated financial statements.

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention as modified by the revaluation of investments as set out in note 1.2.3.

The Company presents individual financial statements prepared on a UK Generally Accepted Accounting Practice basis as permitted by sections 396 and 408 of the Companies Act 2006 and has adopted the exemption of omitting the profit and loss account as permitted by section 408 of that Act.

All accounting policies have been reviewed for appropriateness in accordance with Financial Reporting Standards.

Under FRS 1 the Company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the Company in its own published consolidated financial statements. The consolidated financial statements of Friends Provident Holdings (UK) Ltd, within which this Company is included, are available to the public.

The Directors have adopted the going concern basis in preparing the Company accounts (see basis of preparation for the Group on page 27).

#### **1.2 Significant accounting policies**

##### **1.2.1 Investment return**

Investment return excludes revaluation of Group investments, and includes dividends, interest, rents, gains and losses on the realisation of assets and unrealised gains and losses. Such income includes any withholding tax but excludes other tax credits, such as attributable tax credits. Income from fixed-interest securities together with interest, rents, and associated expenses are accounted for in the period in which they accrue. Dividends are included in the profit and loss account when the securities are listed as ex-dividend. Realised gains or losses on investments are calculated as the difference between the net sale proceeds and original cost. Unrealised gains and losses on investments represent the difference between the valuation of investments at the balance sheet date and their original cost, or if they have been previously revalued, the valuation at the last balance sheet date.

The movement in unrealised gains and losses recognised in the period also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of disposals in the current period.

### 1.2.2 Taxation

Taxation is based on profits and income for the period as determined in accordance with the relevant tax legislation, the movement in deferred tax and adjustments to prior periods' tax. Provision is made for deferred taxation liabilities, using the liability method, on all material timing differences, including revaluation gains and losses on investments recognised in the profit and loss account, as the investments are revalued. Deferred taxation is calculated at the rates at which it is expected that the tax will arise, and discounted to take into account the likely timing of payments and pattern of expected realisation of investments. Deferred taxation is recognised in the profit and loss account for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in the statement of total recognised gains and losses.

### 1.2.3 Valuation of investments

Shares in Group undertakings are stated at historical cost less any provision for impairment.

### 1.2.4 Share based payments

The Company operated share based payment schemes for employees of the Group, depending on eligibility. The fair value of these equity-settled share based payments was measured at the grant date, and the cost was borne by the subsidiary companies. The fair value is treated as a capital contribution and increases the cost of the Company's investments in its subsidiary undertakings, in line with the recognition of the cost borne by the subsidiaries. A corresponding credit was made to reserves. All schemes vested on acquisition of the Group by Friends Provident Holdings (UK) Limited in November 2009.

### 1.2.5 Interest-bearing loans and borrowings

Borrowings are recognised initially at cost, being the fair value of the consideration received, net of transaction costs incurred, and subsequently stated at amortised cost. Any difference between the proceeds, net of transaction costs, and the redemption value is recognised in the profit and loss account over the period of the borrowings, using the effective interest method.

## 2. Investments in Group undertakings

	Subsidiary undertakings £m	Loans to Group undertakings £m	Total investments £m
<b>Current value</b>			
Additions	1,616	300	1,916
Disposals	-	-	-
Revaluations	-	-	-
<b>At 31 December 2009</b>	<b>1,616</b>	<b>300</b>	<b>1,916</b>
<b>Cost</b>			
Additions	1,616	300	1,916
Disposals	-	-	-
<b>At 31 December 2009</b>	<b>1,616</b>	<b>300</b>	<b>1,916</b>

Additions consist of £1,116m in respect of Friends Provident Ltd acquired at the time of the group reorganisation and £500m in respect of FPLP.

Investments in Group undertakings on a historical cost basis are valued at £1,916m.

The principal subsidiary undertakings of the Company as at 31 December 2009 are set out in note 19 to the Group's consolidated financial statements.

### 3. Subordinated debt

The subordinated debt is carried at £162m. Details of the subordinated debt are set out in note 34 to the Group's consolidated financial statements.

### 4. Share capital

Details of the Company's share capital are set out in note 39 to the Group's consolidated financial statements.

### 5. Other equity

Other equity consists of Step-up Tier one Insurance Capital Securities (STICS) of £488m that were issued by Friends Provident plc in 2003 and 2005 and transferred to the Company in July 2009. Details of the Company's STICS are set out in note 41 to the Group's consolidated financial statements.

### 6. Reserves

	Retained earnings £m
<b>On incorporation: 27 March 2009</b>	-
Treasury shares acquired on acquisition of Friends Provident Limited	(7)
Loss for the financial year	(61)
Dividend	(91)
Capital restructuring	848
<b>At 31 December 2009</b>	<b>689</b>

The directors have considered the valuation of all fixed assets and in accordance with the Companies Act 2006 Section 841, gains on fixed assets investments have been treated as unrealised. As a result, gains of £nil have been transferred from the profit and loss account to the revaluation reserve.

### 7. Directors and employees

The Company does not directly employ any staff. The directors and employees who provide services to the Company are employed by, and receive their remuneration from FPMS, a Group undertaking. Included within the management recharges from FPMS for 2009 is an allowance for directors' and employees' emoluments in respect of their services to the Company.

Details of directors' emoluments are contained in note 8 and in the Remuneration Report of the Report & Accounts of Resolution Limited.

### 8. Related party transactions

The Company is exempt from the requirements of FRS 8 Related Party Disclosures, concerning the disclosure of transactions with other companies that qualify as related parties within the Group, as the Company's financial statements are presented together with the Group's consolidated financial statements.

Details of key management transactions are set out in note 44.

## **9. Guarantees**

The Company has given letters of support to the subsidiary undertakings, Friends Provident Limited, Friends Provident Management Services Limited and Friends Provident Distribution Holdings Limited, for at least 12 months from the date of approval of its financial statements.

## **10. Ultimate parent company**

On 4 November 2009, Friends Provident Group plc was acquired by Resolution Holdings (UK) Limited, which was renamed Friends Provident Holdings (UK) Limited on the same day, and as such is the immediate parent undertaking of the Company.

The Company's ultimate parent undertaking is Resolution Limited, which is incorporated in the Guernsey. Copies of the Group Report and Accounts of Resolution Limited can be viewed via its website at [www.resolution.gg](http://www.resolution.gg).

## **Appendix 1: Definitions**

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

**Undiscounted cash payback on new business** is the time at which the sum 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 the Market Consistent Embedded Value (MCEV) as set out in Resolution Limited's Group consolidated financial statements.

**IFRS based operating profit** is based on longer-term investment return and excludes: (i) policyholder tax, (ii) returns attributable to minority interests in policyholder funds, (iii) non-recurring items, (iv) amortisation and impairment of acquired intangible assets and present value of acquired in-force business; and is stated after deducting interest payable on STICS.

**IGD Surplus Capital resources (IGD)** is the Insurance Groups Directive surplus capital as defined by the FSA. It is calculated as the surplus of the available resources over the capital resources requirement. It excludes the surplus capital held within the long-term funds.

**Internal Rate of Return on new business (IRR)** 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 MCEV purposes. IRR assumes best estimate investment returns after an allowance for default risk. IRR also takes into account the funding and release of regulatory capital requirements.

**Shareholder cash generation** is a measure of the cash generated available to cover dividends, increases in regulatory capital requirements and other capital items.

**Shareholder cash resources (SCR)** are a measure of the tangible assets available to the Life & Pensions business and attributable to shareholders. The movement in SCR therefore provides a view of the sustainability of the business model. SCR are based on shareholders' invested net assets included within the embedded value (excluding mark-to-market of long-term debt), but adjusted to include securitisation and financial reinsurance balances, and to exclude intangible assets.