

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED  
REPORT OF THE DIRECTORS  
FOR THE YEAR ENDED 31 DECEMBER 2009**

**DIRECTORS**

T J MATTHEWS MA FIA, FIAA, ASA (Chairman)  
E B BOURKE MBA, FIA  
A BROWN MBA, ACIB  
R SEPE BSc, FIA

**SECRETARY**

D MONGER, B Soc Sc (Hons) FCIS

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**PRINCIPAL ACTIVITY**

Friends Provident Life Assurance Limited (the Company) is a wholly owned subsidiary of Friends Provident Life and Pensions Limited (FPLP), which in turn is a wholly owned subsidiary of Friends Provident Limited

The Company operates as part of the UK Life and Pensions segment of the Friends Provident Group (the Group)

Friends Provident Limited (formerly Friends Provident plc) was de-listed in June 2009 as part of a group reorganisation. A new holding company, Friends Provident Group plc, was inserted as the parent company of the Group at the same time. Friends Provident Limited was re-registered as a private company in November 2009.

On 4 November 2009, Friends Provident Holdings (UK) Limited, a subsidiary of Resolution Limited, acquired a 100% interest in the Group. As such, at 31 December 2009 the Company's ultimate parent and controlling company was Resolution Limited.

The Company conducts ordinary long-term insurance business in the United Kingdom. Having been closed to new business for several years, the Company began writing new conventional life, unit-linked life and income protection business in April 2004. No change in this activity is envisaged in the future. The Company is authorised by the Financial Services Authority (FSA).

The financial statements have been prepared on a going concern basis.

As the Company is not managed solely as a standalone entity, but as part of the Group's UK Life and Pensions segment (which consists of 'UK Corporate' and 'UK Individual'), the directors believe that these financial statements should not be viewed in isolation from other Group undertakings.

**RESULTS AND BUSINESS REVIEW**

**Operational Structure**

The operational structure of the UK business was revised in 2008 to align decision-making structures with the UK corporate and UK individual customer segments, each of which has a distinct distribution network. This allows greater flexibility and accountability of decision-making.

The Company largely operates in the UK protection and savings and investment markets. Within the UK protection market, the Company aims to maintain its market share, having restructured its sales force and strengthened its protection proposition. It will also continue to pursue opportunities to broaden distributions.

**Trading performance and outlook**

During the year the Company entered into reinsurance agreements with FPLP, accepting its unit-linked life business and the risks and cash-flows of its non-unitised policies from FPLP, and ceding the conventional life business to FPLP. Further details are included in note 17 to the financial statements. These agreements have had a significant impact on the Company's results.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**REPORT OF THE DIRECTORS (continued)**

**RESULTS AND BUSINESS REVIEW (continued)**

**Trading performance and outlook (continued)**

The Company's results show earned premiums, net of reinsurance, increased by 246% to £2,015m (2008 £582m). The 2009 figure is distorted by the reinsurance premium of £1,808m. The comparative figure has been distorted by a one-off reinsurance inwards premium of £403m received from a fellow subsidiary company, Friends Provident Pensions Limited (FPP). Excluding these amounts, premiums, net of reinsurance, have increased by 17% to £201m.

With effect from 1 November 2008, FPP reinsured all pension immediate annuities, sold between 1 January 2007 and 30 June 2008 to the Company. This reinsurance treaty aims to transfer sufficient annuity liabilities to the Company in order for the Company to fully utilise its negative reserves and therefore increase its FSA surplus.

New business premiums on an APE basis (APE represents gross regular premiums plus 10% of gross single premiums) have decreased by 16% to £65m (2008 £77m) including both insurance and investment contracts.

New business premiums for saving and investment products have fallen by 23% to £24m (2008 £31m). The Company remains in this market on a purely tactical basis, following the Group's decision announced in January 2008 to no longer seek to develop a franchise in wealth management beyond the manufacture and administration of products. This has particularly impacted single premiums that have fallen by 55% to £36m (2008 £80m).

New business sales of protection products have fallen by 9% to £41m (2008 £45m) reflecting the significant deterioration in the housing market. Individual protection business remains a key area of focus, and outlook is difficult to predict given the competitiveness of this market coupled with the current economic impact on UK housing market.

As part of the Annual Review within Friends Provident Group plc's 2009 Group Annual Report and Accounts, the sections of the Business Review 'UK Corporate' and 'UK Individual' of which the Company forms a part, outlines the Group's view of its performance and outlook for these markets.

**Financial performance**

The profit on ordinary activities before tax, as set out on page 9, for 2009 is £83m (2008 loss of £115m). The balance transferred from the long-term business technical account to the non-technical account is a profit of £71m (2008 loss of £85m). This amount includes tax movements for the year arising within the long-term funds. The transfer for the year results from

	<b>Surplus £m</b>	<b>Explanation</b>
Basis changes	(9)	See note 2
New business strain	(44)	Acquisition expenses incurred writing German pensions business
Surplus arising from existing business	81	
One off items of surplus	(9)	
Surplus on shareholders retained capital	3	
Deferred taxation	2	
Corporation taxation	1	
<b>FSA surplus</b>	<b>25</b>	
Basis changes	1	See note 2
Deferred acquisition costs	15	
Deferred front end fees	(17)	
Policyholder liability adjustments	5	As a result of fair valuing liabilities
Deferred taxation	38	
Other	4	
<b>UK GAAP transfer to the non technical account</b>	<b>71</b>	

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**REPORT OF THE DIRECTORS (continued)**

**RESULTS AND BUSINESS REVIEW (continued)**

**Financial performance (continued)**

The profit for the year of £72m transferred to reserves and a capital injection of £10m has led to shareholders' funds increasing to £416m (2008 shareholder funds decreasing by £83m to £333m)

The majority of the Key Performance Indicators (KPI) used to manage the Group are not monitored at a standalone entity level. The one KPI that the Company is managed with is the Free Asset Ratio (FAR)

**Financial strength**

The Free Asset Ratio (FAR), a common measure of financial strength, is the ratio of company assets less liabilities (including actuarial reserves but before the required regulatory solvency margin) expressed as a percentage of actuarial reserves. On a FSA regulatory basis (which is a different basis to the UK GAAP basis under which the accounts have been prepared), this decreased to 8.50% at the end of 2009 (2008 13.6%) and available assets to meet capital requirements decreased to £334m from £286m.

**Risks**

Members of senior management are responsible for identifying and evaluating key risks facing their areas of the business. Directors manage risks at both a segmental level and individual business level. The key operational risks facing the UK Life and Pensions segment and the responses to these risks that are also applicable to the Company are:

- **Changes to the distribution landscape** – The announcement of the Group's revised strategy in January 2008 led to the suspension of UK Life and Pensions' positions on some of the best advice and multi-tie panels of leading distributor firms. UK Life and Pensions has sought to regain those places through focusing on its core strengths of delivering excellent service, products and technology. It continues to monitor developments in the distribution sector and is also monitoring the progress of the FSA's Retail Distribution Review and its potential impacts on the future distribution in the UK.
- **Competitors develop more advanced IT solutions and service capability** – The UK Life and Pensions' operating platforms are highly regarded and its structure is designed for continuous development to be achieved. UK Life and Pensions announced in 2008, the outsourcing of much of its IT service delivery and it is looking to develop its use of outsourcing in IT development so that it can maintain and develop its IT solutions and service capability at optimal cost.
- **Changes in volume or profitability in key market segments or emergence of new markets** – The changes of the housing market and in unemployment levels are risks for UK Life and Pensions' key markets during 2009. The Company will continue to monitor its product range and competitive position and analyse its new business volumes and experience of policy claims and lapses. It uses this information to re-price its products or develop new ones. For example, during 2008, it re-priced its range of protection products to ensure their continuing competitiveness.
- **Changes to the funding requirements of the pensions scheme** – The Group maintains a defined benefit pension scheme for past and current employees of the UK life and pensions business. Given the current economic and financial difficulties and for the prospects for them to continue over the near and medium term, the Group will keep its pensions under regular review, balancing its positive impact on staff morale and retention against the implications any increased investment would have on the UK Life and Pensions' competitiveness.

The financial risks facing the Company are discussed in note 19 of the notes to the financial statements.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**REPORT OF THE DIRECTORS (continued)**

**FRS 27 LIFE ASSURANCE**

The Company writes life assurance business. Liabilities (including options and guarantees) are calculated in a prudent manner in accordance with FSA regulations. The Company also has a closed with-profits fund. The liabilities (including options and guarantees) are valued on a regulatory basis as the fund is significantly below the £500m level that the FSA has determined should be applied for calculating liabilities under the realistic methodology.

Guarantees and options are not considered to be material to the Company's future cash flows. In addition they have largely been matched with suitable assets and as a result there is no material exposure to market or interest rate changes. Provision has been established using deterministic scenarios based on prudent assumptions.

Disclosure of the regulatory capital position of the Group is contained in the Friends Provident Group plc's Annual Report and Accounts 2009.

**DIVIDEND**

The directors do not recommend the payment of a final dividend for the year ended 31 December 2009 (2008 £nil).

**SHARE CAPITAL**

During the year the Company has increased its issued share capital from £434m to £444m by the issue at par of 10m shares of £1 each (Fully paid) to Friends Provident Life and Pensions Limited.

The directors intend to recommend a capital reduction in 2010 to improve the level of distributable reserves. The proposal is to reduce the level of share capital by £394m to create additional reserves of £394m. Subject to shareholder's consent, it is expected that this proposed capital reduction becomes effective by the end of March 2010.

**DIRECTORS**

Tony Brown was appointed as director on 12 February 2009. Evelyn Bourke was appointed as director on 1 May 2009. Jane Stevens resigned as director on 13 January 2009. Charles Bellringer resigned as director on 30 April 2009. Simon Clamp ceased to be a director on 12 March 2010. All other directors named on page 1 held office throughout the year.

Diana Monger replaced Gordon Ellis as Secretary on 31 December 2009.

**EMPLOYEES**

A fellow Group undertaking, Friends Provident Management Services Limited (FPMS), provides the Company's services and administration and employs all staff. Accordingly, the Company has no direct employees. The average number of employees of FPMS during 2009 was 2,892 (2008 3,478).

**STATEMENT OF DISCLOSURE OF INFORMATION TO THE AUDITOR**

The directors who held office at the date of approval of this report of the directors confirm that, so far as they are each 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/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**REPORT OF THE DIRECTORS (continued)**

**AUDITOR**

In accordance with section 516 of the Companies Act 2006, KPMG Audit Plc has resigned as auditor of the Company on 5 November 2009. The Company appointed Ernst & Young LLP to take office as auditor of the Company in accordance with section 485 of the Companies Act 2006. The auditor will remain in office pursuant to section 487 of the Companies Act 2006.

**DIRECTORS AND OFFICERS – INDEMNITY AND INSURANCE**

A parent company, Friends Provident (UK) Holdings Limited (FPH), maintains insurance cover with respect to directors' and officers' liabilities. In addition, qualifying third party indemnity arrangements (as defined in section 234 of the Companies Act 2006) are in force for the benefit of directors within the FPH 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.

**CREDITOR PAYMENT POLICY**

Services and supplies to the Company are made through a fellow Group undertaking, FPMS, and accordingly the Company does not have any trade creditors.

**USE OF FINANCIAL INSTRUMENTS**

Further information on the Company's risk management process and the policies for mitigating certain risks are set out on pages 39 to 52. Details of the financial instruments used for these purposes are on pages 39 to 52 within note 19.

**STATEMENT OF GOING CONCERN**

The financial statements have been prepared on a going concern 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 Company has adequate resources to continue in operational existence for the foreseeable future. Key information in respect of the Company's business activities, financial performance (including financial strength), and risks is set out on pages 1 to 3. In addition, note 19 to the financial statements sets out in detail the Company's risk management objectives and policies for mitigating risks including liquidity risk.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**REPORT OF THE DIRECTORS (continued)**

**STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE REPORT OF THE DIRECTORS AND THE FINANCIAL STATEMENTS**

The directors are responsible for preparing the report of the directors and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have elected to prepare the financial statements in accordance with UK Generally Accepted Accounting Practice (UK accounting standards and applicable law).

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

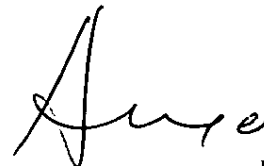
The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps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

Pixham End  
Dorking  
Surrey  
RH4 1QA

23 March 2010

Registered Number 782698

ON BEHALF OF THE BOARD



**D MONGER**  
**SECRETARY**

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**

We have audited the financial statements of Friends Provident Life Assurance Limited (the Company) for the year ended 31 December 2009, which comprise Profit and Loss Account, the Balance Sheet and the related notes 1 to 27. The financial reporting framework that has been applied in the preparation of the financial statements 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 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 auditor**

As explained more fully in the Directors' Responsibilities Statement set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit the 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 (APB's) Ethical Standards for Auditors.

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

An audit involves obtaining evidence about the amounts and disclosure 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 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 financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its profit for the year then ended,
- 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.

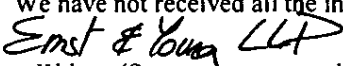
### **Opinion on other matters prescribed by the Companies Act 2006**

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 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, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements 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.

  
Stuart Wilson (Senior statutory auditor)  
for and on behalf of Ernst and Young LLP, Statutory Auditor

London  
23 March 2010

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2009**

**LONG-TERM BUSINESS TECHNICAL ACCOUNT**

		2009 £000	As restated (note 3) 2008 £000
	Notes		
<b>Earned premiums, net of reinsurance</b>			
Gross premiums written	4	2,229,571	644,772
Outward reinsurance premiums	5	(214,871)	(62,907)
		2,014,700	581,865
<b>Investment income</b>	6	116,252	140,063
<b>Unrealised gains on investments</b>	6	212,959	-
<b>Other technical income, net of reinsurance</b>	7	138,031	40,198
<b>Total technical income</b>		2,481,942	762,126
<b>Claims incurred, net of reinsurance</b>			
Claims paid			
- gross amount		452,904	137,657
- reinsurers' share		(61,235)	(32,789)
		391,669	104,868
Change in the provision for claims			
- gross amount		(3,945)	11,127
- reinsurers' share		(3,227)	(7,394)
		(7,172)	3,733
		384,497	108,601
<b>Change in other technical provisions, net of reinsurance</b>			
Long-term business provision, net of reinsurance			
- gross amount	17,18	34,391	434,769
- reinsurers' share	17	66,284	(78,071)
		100,675	356,698
Technical provisions for linked liabilities, net of Reinsurance			
- gross amount	17,18	1,636,219	(49,551)
- reinsurers' share	17	97	144
		1,636,316	(49,407)
Investment contract liabilities, net of reinsurance			
- gross amount	17,18	265,015	(960,033)
- reinsurers' share	17	(40,822)	543,931
		224,193	(416,102)
		1,961,184	(108,811)
<b>Net operating expenses</b>	8	67,761	308,702
<b>Investment expenses and charges</b>	6	26,726	9,049
<b>Unrealised losses on investments</b>	6	-	600,911
<b>Tax attributable to the long-term business</b>	9	(36,769)	4,105
<b>Transfers to/(from) the fund for future appropriations</b>		7,718	(75,098)
		65,436	847,669
<b>Total technical charges</b>		2,411,117	847,459
<b>Balance on the long-term business technical account</b>		70,825	(85,333)

**Note**

All of the amounts above are in respect of continuing operations

The notes on pages 12 to 55 form an integral part of these financial statements



**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2009**

**NON-TECHNICAL ACCOUNT**

	Notes	2009 £000	2008 £000
Balance on the long-term business technical account		70,825	(85,333)
Tax credit/(charge) attributable to balance on the long-term business technical account	9	10,083	(34,014)
<b>Profit/(loss) before tax from long-term business</b>		<b>80,908</b>	<b>(119,347)</b>
Investment income	6	1,718	4,811
Unrealised gains on investments	6	698	-
Investment expenses and charges	6	(118)	(614)
Unrealised losses on investments		-	(207)
<b>Profit/(Loss) on ordinary activities before tax</b>		<b>83,206</b>	<b>(115,357)</b>
Taxation on profit/(loss) on ordinary activities	9	(10,727)	32,771
<b>Profit/(loss) for the financial year</b>	<b>16</b>	<b>72,479</b>	<b>(82,586)</b>

**Note:**

There are no recognised gains or losses for 2009 and 2008 other than the profit/(loss) for the financial year  
Therefore no statement of total recognised gains and losses is presented

All of the amounts above are in respect of continuing operations

The notes on pages 12 to 55 form an integral part of these financial statements

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**BALANCE SHEET AS AT 31 DECEMBER 2009**

**ASSETS**

	Notes	2009 £000	As restated (note 3) 2008 £000
<b>Investments</b>			
Land and buildings	10	75	60
Investment in Group undertakings	11	3,736	2,617
Other financial investments	10	981,478	856,703
		<u>985,289</u>	<u>859,380</u>
<b>Assets held to cover linked liabilities</b>	10	3,224,556	1,512,878
<b>Reinsurers' share of technical provisions</b>			
Long-term business provision	17,18	34,563	100,847
Claims outstanding		17,467	14,240
Technical provisions for linked liabilities	17,18	41	138
Investment contract liabilities	17,18	1,691,751	1,647,069
		<u>1,743,822</u>	<u>1,762,294</u>
<b>Debtors</b>			
Debtors arising out of direct insurance operations			
- policyholders		2,276	1,439
- intermediaries		5,027	11,778
Deferred taxation	9	48,289	12,252
Other debtors	13	16,944	20,905
		<u>72,536</u>	<u>46,374</u>
<b>Other assets</b>			
Cash at bank and in hand		49,943	27,741
<b>Prepayments and accrued income</b>			
Accrued interest and rent		11,981	9,748
Deferred acquisition costs	14	174,091	159,378
		<u>186,072</u>	<u>169,126</u>
<b>TOTAL ASSETS</b>		<u>6,262,218</u>	<u>4,377,793</u>

The notes on pages 12 to 55 form an integral part of these financial statements

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**BALANCE SHEET AS AT 31 DECEMBER 2009**

**LIABILITIES**

	Notes	2009 £000	2008 £000
<b>Capital and reserves</b>			
Called-up share capital	15,16	444,000	434,000
Share premium account	16	12	12
Profit and loss account	16	(28,429)	(100,908)
<b>Equity shareholders' funds</b>	16	415,583	333,104
<b>Fund for future appropriations</b>		75,047	67,329
<b>Technical provisions</b>			
Long-term business provision	17	742,536	708,145
Claims outstanding		13,813	17,758
		756,349	725,903
<b>Technical provisions for linked liabilities</b>	17,18	1,800,031	163,812
<b>Investment contract liabilities</b>	17,18	3,154,062	3,022,829
<b>Creditors</b>			
Creditors arising out of direct insurance operations		3,157	7,586
Creditors arising out of reinsurance operations	21	9,467	14,577
Other creditors including taxation and social security	20	16,507	27,343
		29,131	49,506
Accruals and deferred income		32,015	15,310
<b>TOTAL LIABILITIES</b>		6,262,218	4,377,793

Approved by the Board on 23 March 2010 and signed on its behalf by



TREVOR MATTHEWS  
DIRECTOR

The notes on pages 12 to 55 form an integral part of these financial statements

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS**

**1. ACCOUNTING POLICIES**

**(a) Basis of preparation**

The financial statements have been prepared in accordance with Schedule 3 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulation 2008 (SI2008/410) made under the Companies Act 2006 with the exception set out in note 1(m) and comply with the Association of British Insurers (ABI) Statement of Recommended Practice on Accounting for Insurance Business (SORP) December 2005 (as amended in December 2006)

As explained in the directors' report, these financial statements have been prepared on a going concern basis. In considering whether the Company accounts should be prepared under the going concern basis, the directors have considered the information contained in these financial statements, the latest business plan profit forecasts for the Company, the latest working capital forecasts for the Company and estimated forecast solvency. These forecasts have been subject to sensitivity tests given the current uncertain economic outlook and the directors are confident that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing these financial statements.

The financial statements have also been prepared in accordance with applicable accounting standards and under the historical cost convention as modified by the revaluation of land and buildings, derivatives and financial instruments at fair value through profit and loss as set out in note 1(m) and 1(r).

In accordance with Financial Reporting Standard (FRS) 1 Cash flow statements (Revised 1996), the Company is exempt from preparing a cash flow statement on the grounds that it is a wholly owned subsidiary undertaking of a parent undertaking which provides a cash flow statement in its consolidated financial statements which are publicly available.

The Company is exempt under section 400 of the Companies Act 2006 from the obligation to prepare group accounts as the Company is a wholly owned subsidiary of Resolution Ltd in whose consolidated accounts the Company is included. Accordingly, the financial statements present information about the Company as an individual entity and not about its group.

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

**FRS 8 Related Party Disclosures (amendments)**

Amendments to FRS 8 aligned certain definitions with IAS 24 Related Party Disclosures, and replaced the exemption for 90% or more owned subsidiaries which are included in publicly available consolidated accounts from disclosing certain related party transactions with an exemption from disclosing intragroup transactions between wholly owned subsidiaries. Additional disclosures arising from these amendments are included in note 24.

**FRS 29 Financial Instruments - disclosures (amendments)**

Amendments to FRS 29 require enhanced disclosures relating to fair value measurements and liquidity risk. The additional disclosures in respect of fair value measurements are reported in note 10 and provide additional information about the methods used and assumptions applied in determining fair values. The new liquidity risk disclosures are reported in note 19 and provide a revised maturity analysis for derivative and non-derivative financial liabilities.

All accounting policies have been reviewed for appropriateness in accordance with FRS 18 Accounting Policies. The principal accounting policies set out below have been applied consistently throughout the year.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED  
NOTES TO THE FINANCIAL STATEMENTS**

**1 ACCOUNTING POLICIES (continued)**

**(b) Product classification**

**(i) Insurance contracts**

Contracts under which the Company 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. 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 transfer some financial risk.

Once a 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 the period. As a general guideline, the Company 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.

**(ii) Investment contracts**

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

**(c) Foreign currencies**

Assets and liabilities held in foreign currencies at the balance sheet date are expressed in sterling at rates ruling on that date. Income and expenditure denominated in foreign currencies are translated at rates ruling at the date on which the transaction occurs. All resulting exchange gains and losses are included within that part of profit and loss in which the underlying transaction is reported.

**(d) Premiums**

Premium income in respect of single premium insurance contracts 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. Further details relating to the classification of new business premiums are included in note 4(b).

**(e) Reinsurance**

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

**(f) Fee and commission income**

Insurance and 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 investments.

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

Front-end fees are charged to the policyholder at the inception of the contract. The consideration received is deferred as a liability and recognised over the expected term of the contract on a straight-line basis.

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

Fee and commission income are included in the long-term business technical account as part of 'other technical income'.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**1. ACCOUNTING POLICIES (continued)**

**(g) Investment income**

Investment income includes dividends, interest, rents and gains and losses on the realisation of investments. Such income includes any withholding tax but excludes other taxes such as attributable tax credits.

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

Interest income is recognised as income as it accrues, taking into account the relevant coupon rate or an applicable floating rate.

Realised gains and losses on investments are calculated as the difference between the net sales proceeds and the carrying value of the investment determined in accordance with the accounting policies applicable to the investment.

Investment income relating to investments that are directly connected with the carrying on of long-term business is recorded in the long-term business technical account. Other than long-term business, investment income is recorded in the non-technical account.

**(h) Unrealised gains and losses on investments**

Unrealised gains and losses on investments represent the difference between the valuation of investments designated as fair value through the profit and loss, derivatives and land and buildings at the balance sheet date and their original cost, or if they have been previously fair valued, 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 investment disposals in the current period.

Unrealised gains and losses relating to investments that are directly connected with the carrying on of long-term business are recorded in the long-term business technical account. With the exception of unrealised gains and losses on investments in shareholder subsidiaries, which are recognised directly in equity, non long-term business realised gains and losses and permanent diminutions in the value of shareholder subsidiaries are recorded in the non-technical account.

**(i) Claims and surrenders**

Insurance claims reflect the cost of all claims incurred during the year, including claims handling costs. Death claims and surrenders are recorded 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 contract liabilities.

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.

**(j) Transaction costs**

Transaction costs in respect of brokers fees, stamp duty fees and other expenses on investments are charged to profit and loss in the period in which they are payable.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**1. ACCOUNTING POLICIES (continued)**

**(k) Bonuses**

Bonuses charged to the long-term business technical account in a given period comprise reversionary bonuses declared in respect of that period, which are provided within the calculation of the long-term business provision, and terminal bonuses paid, which are included within claims paid

**(l) Taxation**

Taxation in the non-technical account and long-term business technical account 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

Current taxation relating to items recognized directly in equity is recognised in equity and not in the profit and loss account

Provision is made for deferred taxation liabilities, using the liability method, on all material timing differences, including fair valuation adjustments recognised through profit and loss, as the investments are fair valued. 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 tax liabilities are discounted using gilt yield rates appropriate to the estimated year in which the timing differences are expected to reverse. Deferred taxation is recognised through profit and loss for the period

Deferred tax assets are recognised to the extent that they are regarded as recoverable

The transfer of the balance on the long-term business technical account to or from the non-technical account is grossed up by attributable tax, using the full rate of corporation tax applicable for the period

Expenses are charged gross of VAT. Credits are attributed separately, where appropriate, in relation to partial exemption

**(m) Investments**

Investments are shown in the balance sheet as follows

**(i) Land and buildings**

Land and buildings are valued each year on an open market basis by qualified Chartered Surveyors. Properties are valued by an external valuator at least once every 5 years. Those properties that are occupied by the Group are valued on an existing use basis and with vacant possession

In accordance with Statement of Standard Accounting Practice (SSAP) 19 Investment Properties, no depreciation is provided in respect of freehold investment properties or amortisation in respect of leasehold properties with over 20 years to expire. This is a departure from the requirements of the Companies Act 2006 which requires all properties to be depreciated. However, these properties are held solely for investment purposes and the directors consider that systematic annual depreciation would be inappropriate. Depreciation or amortisation is only one of the factors reflected in the annual valuations of properties, and the amounts, which might otherwise have been shown, cannot reasonably be separately identified or quantified. The accounting policy adopted is therefore necessary for the financial statements to give a true and fair view

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**1. ACCOUNTING POLICIES (continued)**

**(m) Investments (continued)**

**(ii) Other financial investments**

The Company classifies its 'other financial investments' as 'financial investments at fair value through profit and loss'

Purchases and sales of financial investments are recognised on the date the Company commits to purchase or sell the investment

A financial investment is derecognised when and only when the contractual right to receive cashflows expire or when the amount, together with substantially all of the risks and rewards of ownership, has been transferred

• **Financial assets at fair value through profit and loss**

All financial assets at fair value through profit and loss, with the exception of derivatives, are designated on initial recognition as they are managed individually or together on a fair value basis. Derivative financial instruments are classified as fair value through profit and loss as they are held for trading purposes

The fair value on initial recognition represents the consideration given, excluding any transaction costs directly attributable to their acquisition. Subsequent to initial recognition, all such financial investments are measured at fair value. Movements in fair value are taken to profit and loss in the period in which they arise

Embedded derivatives are separated from the host contract (including embedded derivatives in insurance contracts), recognised as a stand-alone derivative and measured at fair value through profit and loss, when the following conditions are met

- the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and the risks of the host contract,
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and
- the hybrid instrument is not measured at fair value with changes in fair value recognised through profit and loss

**(n) Investments in Group undertakings and participating interests**

Investments in group undertakings are held at current value

**(o) Other financial assets**

Other financial assets primarily include insurance and other debtors, including amounts due from Group undertakings and cash at bank

Insurance and other debtors are recognised when due and are carried at fair value. Cash at bank is also reported at fair value at the balance sheet date



**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**1 ACCOUNTING POLICIES (continued)**

**(p) Deferred acquisition costs**

For both insurance contracts and investment contracts with Discretionary Participation Features (DPF), acquisition costs comprise all direct and indirect costs arising from writing the contracts, which are incurred during a financial period. Costs are deferred 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 deferred acquisition costs on such contracts is proportional to the future margins emerging in respect of the related policies, over the lifetime of those policies.

For investment contracts without DPF, deferred 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 deferred to the extent that they are recoverable out of future margins. Such deferred acquisition costs are amortised uniformly over the lifetime of the policy.

Annual impairment reviews are performed to identify whether there are any circumstances that might indicate impairment. If such circumstances exist, the carrying values are adjusted to the recoverable amounts and any resulting impairment losses are charged to profit and loss.

**(q) Funds for future appropriations (FFA)**

The FFA 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.

The balance on this account represents the value of future final and regular bonus payments to policyholders.

**(r) Financial liabilities**

The Company classifies financial liabilities as either financial liabilities at fair value through profit and loss or financial liabilities carried at amortised cost.

Financial liabilities at fair value through the profit and loss, 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 or group of financial liabilities are managed individually or together on a fair value basis.

A financial liability is recognised when, and only when, the Company 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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**1. ACCOUNTING POLICIES (continued)**

**(s) Insurance contracts**

For UK operations the liabilities are calculated based on the relevant Financial Services Authority (FSA) rules for contained in the Prudential Sourcebook for Insurers

Insurance contract liabilities are disclosed separately from investment contract liabilities in the balance sheet. Technical provisions disclosed in the balance sheet for the long-term business, claims outstanding and linked liabilities represent amounts only for insurance contracts. Correspondingly, the change in other technical provisions in the long-term business technical account for long-term business and linked liabilities, including reinsurance amounts, is for insurance contracts only.

The calculation of liabilities to policyholders in respect of conventional with-profits business include 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 provision of insurance contract liabilities can never be definitive as to the overall level of liabilities or their timing and is subject to regular reassessment.

The Company carries out an annual liability adequacy test on its insurance 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.

**(t) Investment contracts**

Currently investment contracts are either classified as unit-linked or contracts with a Discretionary Participation Feature (DPF) (mainly unitised with-profits contracts).

A unit-linked investment contract is valued by calculating the number of units allocated to the policyholders in each of the unit-linked funds multiplied by the unit price of those funds 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 in the 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 inception.

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

- (i) that are likely to be a significant portion of the total contractual payments,
- (ii) 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 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

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

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**1 ACCOUNTING POLICIES (continued)**

**(u) Classification of financial instruments between debt and equity**

The classification of financial instruments between debt and equity is based on the principles in FRS 25 rather than the instruments' legal form or their commercial intent. The Company applies these principles when classifying its financial instruments. In order to be classified as debt, the financial instrument, in situations where the contract will not be settled by the Company's own shares, must have a contractual obligation to

- (i) deliver cash or another financial asset to another entity, or
- (ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company

For some instruments the contractual obligation to pay cash or another financial asset is dependant on the occurrence or non-occurrence of some future event. If this event is out of the control of the Company, then this usually means that the instrument still meets its definition of debt. However, if the Company is only required to settle the obligation in the event of liquidation or if the likelihood of the event occurring (or not occurring) is so remote that it is extremely unlikely that the obligation will be triggered, then the Company treats the instruments as equity, as required by FRS 25. Payments on instruments classified as equity are not treated as expenses but as an appropriation of profit.

**(v) Other financial liabilities**

Other financial liabilities primarily include creditors arising out of insurance and reinsurance operations and other obligations due to Group undertakings or third parties. These are reported at the estimated amounts required to settle the obligation at the balance sheet date.

**2 USE OF JUDGMENTS, ESTIMATES AND ASSUMPTIONS**

The Company makes judgments in the application of critical accounting policies, that affect the reported amounts of assets and liabilities. The Company 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**

Contracts are 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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 USE OF JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)**

**(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,
- 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 (liquidity premium) compared to gilts. One of the key judgements is the assessment of how much of the spread is attributable to liquidity premium,
- the methodology for determining the liquidity 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.
- 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 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 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.

**(c) Impairment testing**

Assets, other than those held at fair value through the income statement, are reviewed where there is an indication of possible impairment. For most assets this requires the Company to estimate future cashflows and discount these amounts using a suitable rate which reflects the risk of those cashflows. In projecting cashflows, the most significant assumptions include, investment market conditions, sales and margins, expenses, policy/client lapses, discount rates, and terminal values.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2. USE OF JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)**

**(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 that are managed on a fair value basis.

Fair values of financial assets 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 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 considered to be observable prices. In determining fair value, market makers will take into account transactions they have observed in identical or similar assets as well as movements in market indices and any other factors that they regard as relevant. In some cases, consensus prices have been based on fewer, and potentially more historic, transactions.

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 derivatives 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 calculated using published bid values.

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

**(e) 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.

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

Investment properties and properties occupied by Group companies 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. In a sharply falling market in which most transactions involve distressed assets, the valuers have indicated they are having difficulty in establishing rental multiples. Key assumptions include occupancy and rental income.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 USE OF JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)**

**(g) Changes in accounting estimates**

The total impact of changes in accounting estimates in 2009 amounted to a £8 0m decrease in profit, as follows

**One off basis changes: Expense assumptions**

The impact on profit before tax is a decrease of £8 0m from an increase in liabilities to policyholders mainly due to an expense over-run on Overseas Life Assurance business (OLAB)

The total impact of changes in accounting estimates in 2008 amounted to a £1 6m decrease in loss, as follows

**One off basis changes: Expense assumptions**

- (i) The liabilities to policyholders have been strengthened on income protection business to reflect the claims cost incurred. The impact on profit before tax is a decrease of £13 1m
- (ii) The life and pensions maintenance expense assumptions have been modified to improve the allocation across product lines on expenses categorised in previous years as development costs. The impact on profit before tax is an increase of £33 0m

**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 on profit before tax is a decrease of £18 3m from an increase in liabilities to policyholders

**3. PRIOR PERIOD ADJUSTMENTS**

**Product classification**

Contracts are classified as either 'insurance contracts' or 'investment contracts' based on the significance of insurance risk present in the contract. Following a review of reinsurance agreements, certain reinsurance contracts have been reclassified during the year. Comparative technical provisions and movements in those provisions have been restated based on the revised classification.

The effect of restating comparatives on the balance sheet has been to reclassify £12 6m of reinsurers share of technical provisions as 'Reinsurers Share of Investment Contract Liabilities', with corresponding adjustments to 'Changes in Technical Provisions' in the Technical Account. 'Outwards Reinsurance Premiums' have decreased by £6 7m, and 'Reinsurer's Share of Claims Paid' have decreased by £1 8m, with corresponding adjustments to 'Change in Investment Contract Liabilities'. There is no impact on profit and no impact on tax.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**4. SEGMENTAL INFORMATION**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Gross written premiums on insurance contracts and investment contract deposits	2,251,883	524,060
Less investment contract deposits written	(22,312)	120,712
<b>Gross written premiums per the long-term technical account</b>	<b>2,229,571</b>	<b>644,772</b>
<b>Analysed</b>		
Direct insurance premiums	228,516	224,614
Inward reinsurance premiums	2,001,055	420,158
<b>Gross written premiums per the long-term technical account</b>	<b>2,229,571</b>	<b>644,772</b>

**(a) Direct insurance premiums written by type**

	<b>Regular premiums</b>		<b>Single premiums</b>			<b>Total</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Individual</b>						
Protection	211,293	206,284	-	-	211,293	206,284
Savings and investment	12,796	12,722	-	-	12,796	12,722
Pensions	500	573	3,901	5,008	4,401	5,581
<b>Total individual premiums</b>	<b>224,589</b>	<b>219,579</b>	<b>3,901</b>	<b>5,008</b>	<b>228,490</b>	<b>224,587</b>
<b>Group</b>						
Pensions	26	28	-	-	26	28
<b>Total group premiums</b>	<b>26</b>	<b>28</b>	<b>-</b>	<b>-</b>	<b>26</b>	<b>28</b>
<b>Total life and pensions</b>	<b>224,615</b>	<b>219,607</b>	<b>3,901</b>	<b>5,008</b>	<b>228,516</b>	<b>224,615</b>

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Premiums from non-participating contracts	210,875	203,404
Premiums from participating contracts	4,748	6,075
Premiums from investment linked contracts	12,893	15,135
<b>Total life and pensions</b>	<b>228,516</b>	<b>224,614</b>

**(b) New business written by type**

The new business written for the purpose of this note includes premiums on all types of contracts written by the Company (including gross premiums on investment contracts, which have not been included as part of the 'gross premiums written' in the long-term business technical account, under paragraph 162 of the ABI SORP 12/2005)

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**4. SEGMENTAL INFORMATION (continued)**

**(b) New business written by type (continued)**

	Regular premiums		Single premiums		APE	
	2009	2008	2009	2008	2009	2008
	£000	£000	£000	£000	£000	£000
<b>Individual</b>						
Protection	40,816	44,603	-	-	40,816	44,603
Savings and investment	20,304	23,145	36,075	79,949	23,912	31,140
Pensions	-	-	7,531	8,426	753	843
<b>Total individual premiums</b>	<b>61,120</b>	<b>67,748</b>	<b>43,606</b>	<b>88,375</b>	<b>65,481</b>	<b>76,586</b>
<b>Group</b>						
Pensions	-	8	-	-	-	8
<b>Total life &amp; pensions</b>	<b>61,120</b>	<b>67,756</b>	<b>43,606</b>	<b>88,375</b>	<b>65,481</b>	<b>76,594</b>

The new Life & Pensions APE represents gross new regular premiums plus 10% of gross new single premiums

In classifying new business premiums the following basis of recognition is adopted

- (i) single new business premiums consist of those contracts under which there is no expectation of continuing premiums being paid at regular intervals
- (ii) regular new business premiums consist of those contracts under which there is an expectation of continuing premiums being paid at regular intervals, including repeated or recurrent single premiums where the level of premiums is defined, or where a regular pattern in the receipt of premiums has been observed
- (iii) non-contractual increments under existing group pension schemes are classified as new business premiums
- (iv) transfers between products where open market options are available are included as new business premiums and  
regular new business premiums are included on an annualised basis

**(c) Life and pensions gross premiums**

	2009	2008
	£000	£000
<b>Source</b>		
United Kingdom	2,229,571	644,772
	<b>2,229,571</b>	<b>644,772</b>
<b>Destination</b>		
United Kingdom	2,222,018	635,668
Rest of the World	7,553	9,104
	<b>2,229,571</b>	<b>644,772</b>



**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**4 SEGMENTAL INFORMATION (continued)**

**(d) Life and pensions new business**

	Regular premiums		Single premiums	
	2009 £000	2008 £000	2009 £000	2008 £000
<b>Source</b>				
United Kingdom	61,120	67,756	43,606	88,375
	61,120	67,756	43,606	88,375
<b>Destination</b>				
United Kingdom	40,987	45,253	34,820	75,454
Rest of the World	20,133	22,503	8,786	12,921
	61,120	67,756	43,606	88,375

**(e) Profit/(Loss) on ordinary activities before tax**

	2009 £000	2008 £000
<b>Source</b>		
United Kingdom	83,206	(115,357)
	83,206	(115,357)
<b>Destination</b>		
United Kingdom	82,957	(119,618)
Rest of the World	249	4,261
	83,206	(115,357)

**(f) Net assets**

The net assets supporting the Rest of the World geographical segment are the same as those supporting the United Kingdom segment and therefore have not been separated

**5. OUTWARD REINSURANCE PREMIUMS**

Outward reinsurance premiums are net of reinsurance premium rebates and net of a provision for clawbacks, of £20,268,000 (2008 £16,815,000) The aggregate of all reinsurance balances in the long-term business technical account for the year ended 31 December 2009 is a debit of £175,968,000 (2008 £488,728,000 debit balance restated)

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**6. INVESTMENT RETURN**

	Technical account		Non-technical account	
	2009	2008	2009	2008
	£000	£000	£000	£000
<b>Investment income</b>				
Income from land and buildings	39,272	50,824	-	-
Income from other investments (i)	72,278	67,356	1,666	4,811
Income from group undertakings	4,702	7,121	-	-
Gains on the realisation of investments	-	14,762	52	-
	116,252	140,063	1,718	4,811
<b>Unrealised gains on investments</b>	212,959	-	698	-
<b>Investment expenses and charges</b>				
Investment management expenses	(6,707)	(7,656)	(118)	(195)
Other interest	(500)	(1,393)	-	-
Losses on the realisation of investments	(19,519)	-	-	(419)
	(26,726)	(9,049)	(118)	(614)
<b>Unrealised losses on investments</b>	-	(600,911)	-	(207)
<b>Total net investment return</b>	302,485	(469,897)	2,298	3,990

(i) Includes £691,000 (2008 £2,176,000) arising from investments not held at fair value through the income statement

Included in total investment return is an amount of £70,753,000 (2008 £72,167,000) that represents interest and dividends on investments classified as 'fair value through profit and loss' and a loss of £194,190,000 (2008 loss of £586,775,000) that represents net realised and unrealised gains/losses on investment classified as 'fair value through profit and loss'

Included in unrealised gains/(losses) is a net loss of £469,000 (2008 £784,000 profit restated) arising on investments classified as 'fair value through profit and loss' that are determined using valuation techniques

**7. OTHER TECHNICAL INCOME, NET OF REINSURANCE**

**Other technical income in the long-term business technical account comprises:**

	2009	2008
	£000	£000
Unit management charges recoverable from Friends Provident Life and Pensions Limited (FPLP)	15,671	14,164
Interest received from Friends Provident Life and Pensions Limited (FPLP)	98,508	-
Fee and commission income from service activities	23,715	25,968
Other income	137	66
	138,031	40,198

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**8 NET OPERATING EXPENSES**

A fellow Group undertaking, Friends Provident Management Services Limited (FPMS), provides the Company's services and administration and employs all staff

- (a) Net operating expenses in the long-term business technical account, including those on investment contracts, are analysed as follows.

	2009 £000	2008 £000
Acquisition costs	65,103	172,964
Change in deferred acquisition costs	(14,713)	104,722
Administrative expenses	17,371	31,016
<b>Net operating expenses</b>	<b>67,761</b>	<b>308,702</b>

Total commissions for direct insurance accounted for by the Company during the year, excluding payments to employees of FPMS, amounted to £85,140,000 (2008 £105,697,000)

- (b) Auditor's remuneration

	2009 £000	2008 £000
Audit fees – excluding VAT	118	118

On 5 November 2009 KPMG Audit Plc resigned as auditor and Ernst & Young LLP were appointed. Fees paid to the Ernst & Young LLP and KPMG Audit Plc and their associates for services other than the statutory audit of the Company and other Group undertakings is disclosed in note 7(b) of the consolidated accounts of Friends Provident Group plc

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**9 TAXATION**

**Profit and loss account**

United Kingdom and overseas taxation has been charged in profit and loss on assessable profits and income on the bases and rates appropriate to the various classes of business

**(a) Tax charged to the long-term business technical account and non-technical account comprises:**

	<b>Technical account</b>		<b>Non-technical account</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Current taxation</b>				
United Kingdom corporation tax at 28% (2008 28.5%)	1,836	-	644	1,138
Adjustments in respect of prior years	(2,939)	23,000	-	-
	(1,103)	23,000	644	1,138
Overseas taxation	372	1,192	-	-
Tax credit attributable to balance on the long-term business technical account	-	-	10,083	(34,014)
<b>Total current taxation</b>	<b>(731)</b>	<b>24,192</b>	<b>10,727</b>	<b>(32,876)</b>
<b>Deferred taxation</b>				
Origination and reversal of timing differences	(36,363)	(21,081)	-	105
Effect of discount	325	994	-	-
<b>Total deferred taxation</b>	<b>(36,038)</b>	<b>(20,087)</b>	<b>-</b>	<b>105</b>
<b>Total taxation</b>	<b>(36,769)</b>	<b>4,105</b>	<b>10,727</b>	<b>(32,771)</b>

**(b) Factors affecting tax charge for the year on the non technical account**

The tax assessed for the year is lower than the standard rate of corporation tax in the UK 28% (2008 28.5%) The differences are explained below

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Profit/(Loss) on ordinary activities before tax</b>	<b>83,206</b>	<b>(115,357)</b>
Profit/(Loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2008 28.5%)	23,298	(32,876)
Effect of		
Income not taxable	(12,571)	105
Deferred tax movement	-	(105)
<b>Current tax charge/(credit) for period</b>	<b>10,727</b>	<b>(32,876)</b>

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**9. TAXATION (continued)**

**(c) Deferred taxation per the balance sheet**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Deferred taxation asset</b>	<b>48,289</b>	<b>12,252</b>

	<b>Technical account</b>	<b>Non-technical account</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Deferred taxation</b>			
At 1 January 2009	12,252	-	12,252
Charge in year	36,362	-	36,362
<b>At 31 December 2009 before discounting</b>	<b>48,614</b>	<b>-</b>	<b>48,614</b>
Effect of discounting	(325)	-	(325)
<b>At 31 December 2009</b>	<b>48,289</b>	<b>-</b>	<b>48,289</b>

Details of the asset for deferred taxation are given below

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Fair value investments	4,246	15,796
Deferred acquisition cost	41,940	(3,903)
Discount on deferred acquisition costs	2,103	359
<b>Discounted asset for deferred tax</b>	<b>48,289</b>	<b>12,252</b>

Deferred taxation relating to net unrealised appreciation on investments within linked funds, including that relating to the deemed disposal of OEICs, is taken into account in the calculation of technical provisions for linked liabilities and is therefore excluded from the above analysis

**(d) Factors that may affect future tax charges**

The deferred tax assets that have not been recognised due to the uncertainty of the recoverability in the foreseeable future comprise

	<b>Technical account</b>	<b>Non-technical account</b>
	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Deferred acquisition expenses</b>	<b>21,200</b>	<b>55,149</b>

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**10. INVESTMENTS**

	Fair value 2009 £000	Cost 2009 £000	Fair value 2008 £000	Cost 2008 £000
<b>Land and buildings</b>				
Freehold	75	11	60	11
<b>Total land and buildings</b>	75	11	60	11
<b>Other financial investments</b>				
Shares and other variable yield securities and shares in OEICs	166,915	151,423	119,045	138,025
Debt and other fixed income securities	775,526	766,658	660,686	604,759
Other loans	39	39	79	79
Deposits with credit institutions	38,730	38,731	76,256	76,256
Derivatives	200	329	569	1,123
Other	68	68	68	68
<b>Total other financial investments</b>	981,478	957,248	856,703	820,310
<b>Assets held to cover linked liabilities</b>	3,224,556	3,212,124	1,512,878	1,694,158

During the year, all properties have been independently valued by a qualified valuer, principally DTZ Debenham Tie Leung and CB Richard Ellis, who are both chartered surveyors. The valuation is prepared in accordance with the Royal Institute of Chartered Surveyors (RICS) appraisal and valuation standards.

Included in the carrying amounts above, £1,329,005,000 (2008 £1,391,689,000) is expected to be recovered more than 12 months after the balance sheet date.

All financial assets at fair value through profit and loss are designated on initial recognition, with the exception of derivatives, which are held for trading.

Included in 'other financial investments' and 'assets held to cover linked liabilities' are investments designated as 'fair value through profit and loss' with a fair value at year end of £4,206,070,000 (2008 £2,369,562,000).

Fair value of listed investments included within 'other financial investments' shown above comprise

	2009 £000	2008 £000
Shares and other variable yield securities	166,915	119,045
Debt securities and other fixed income securities	775,404	660,502
	942,319	779,547

Fair value of listed investments included in 'assets held to cover linked liabilities' amounted to £1,047,203,000 (2008 £838,037,000).

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**10. INVESTMENTS (continued)**

The extent and nature of derivative instruments held are as follows

	2009 £000	2008 £000
Futures backing equities	200	569
	200	569

**Determination of Fair Value Hierarchy**

In accordance with the revised requirements of FRS 29 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 (i.e., as prices) or indirectly (i.e., derived from prices). This category generally includes assets that are priced based on models using market observable inputs. Examples include 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 Company's assets held at fair value are valued based on quoted market information or market observable data. Approximately 2% (0.2% 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 Company.

The revised requirements of FRS 29 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).

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**10. INVESTMENTS (continued)**

	Including Unit-linked				Excluding Unit-linked			
31 December 2009	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000	£000	£000	£000	£000
<b>Financial assets held at fair value</b>								
Shares and other variable yield securities and OEICs	953,872	-	37,724	991,596	166,915	-	-	166,915
Debt and other fixed income securities								
- Government securities	508,785	-	-	508,785	406,322	-	-	406,322
- Corporate bonds	331,180	-	521	331,701	279,831	-	17	279,848
- Asset backed securities (ABS)	91,673	-	2,388	94,061	87,405	-	1,951	89,356
Deposits with credit institutions	44,872	19,608	-	64,480	38,730	-	-	38,730
Derivative financial instruments	24	633	-	657	2	198	-	200
<b>Total financial assets held at fair value</b>	<b>1,930,406</b>	<b>20,241</b>	<b>40,633</b>	<b>1,991,280</b>	<b>979,205</b>	<b>198</b>	<b>1,968</b>	<b>981,371</b>
<b>Financial liabilities held at fair value</b>								
Unit-linked liabilities	-	3,224,598	-	3,224,598	-	-	-	-
Derivative financial instruments	-	862	-	862	-	333	-	333
<b>Total financial liabilities held at fair value</b>	<b>-</b>	<b>3,225,460</b>	<b>-</b>	<b>3,225,460</b>	<b>-</b>	<b>333</b>	<b>-</b>	<b>333</b>

**Transfers between Level 1 and Level 2**

During the period, debt securities amounting to £11,032,163 were transferred from Level 1 to Level 2 and £10,133,318 from Level 2 to Level 1. There were no significant transfers between Level 1 and Level 2 for other financial assets.

**Level 3 Transfers**

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

	At 1 January 2009	Total gains/(losses) in income statement	Purchases	Sales	Transfers from level 1 and level 2	At 31 December 2009	Total gains or losses for the period included in profit or loss for assets held at 31 December 2009
	£000	£000	£000	£000	£000	£000	£000
<b>Financial assets held at fair value</b>							
Shares and other variable yield securities and OEICs	21,981	14,876	12,115	(11,248)	-	37,724	10,675
Debt and other fixed income securities							
- Government securities	-	-	-	-	-	-	-
- Corporate bonds (including ABS)	3,534	(616)	6,689	(6,698)	189	2,909	(616)
	<b>25,515</b>	<b>14,260</b>	<b>18,804</b>	<b>(17,946)</b>	<b>189</b>	<b>40,633</b>	<b>10,059</b>

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



**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**10 INVESTMENTS (continued)**

**Level 3 sensitivity analysis**

	31 December 2009	
	Carrying amount	Effect of reasonably possible alternative assumptions
	£000	£000
Unit-linked investments	38,665	-
Shares and other variable yield securities	-	-
Corporate bonds (including ABS)	1,968	197
Derivative financial instruments	-	-
	40,633	197

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, these instruments are subject to fluctuations in the market 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, or movements in interest rates.

**11. INVESTMENT IN GROUP UNDERTAKINGS**

	Shares in Group Undertakings	Total
	£000	£000
<b>Current value</b>		
At 1 January 2009	2,617	2,617
Revaluations	1,119	1,119
<b>At 31 December 2009</b>	<b>3,736</b>	<b>3,736</b>
<b>Cost</b>		
At 1 January 2009	4,331	4,331
<b>At 31 December 2009</b>	<b>4,331</b>	<b>4,331</b>

The investment in Group undertakings represents a 12% holding in F&C Commercial Property Trust, 1% of which is held by the long-term business fund and the remainder by the linked funds.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**12. ASSETS ATTRIBUTABLE TO THE LONG-TERM BUSINESS FUND**

Of the total assets shown on the balance sheet on page 10, £5,854,070,000 is attributable to the long-term business fund (2008 £4,060,247,000)

**13. OTHER DEBTORS**

	2009 £000	2008 £000
Amounts due from Group undertakings	16,124	16,524
Investment income receivable	264	610
Outstanding investment sales	1	12
Other debtors	555	3,759
	16,944	20,905

All 'other debtors' amounts are expected to be recovered within 12 months after the balance sheet date, except 'amounts due from Group undertakings' that have no fixed repayment terms

**14. DEFERRED ACQUISITION COSTS**

	Insurance contracts		Investment contracts		Total	
	2009 £000	2008 £000	2009 £000	2008 £000	2009 £000	2008 £000
At 1 January	7,076	125,819	152,302	138,282	159,378	264,101
Incurred and deferred in the year	305	1,364	36,324	42,298	36,629	43,662
Amortisation charge for the year	(427)	(119,826)	(19,420)	(12,965)	(19,847)	(132,791)
Impairment	(1,252)	(281)	(817)	(15,313)	(2,069)	(15,594)
<b>At 31 December</b>	5,702	7,076	168,389	152,302	174,091	159,378

Acquisition expenses that do not meet the criteria for deferral are expensed directly as incurred

**15. CALLED-UP SHARE CAPITAL**

	2009 £000	2008 £000
<b>Authorised</b>		
1,000,000,000 ordinary shares of £1 each	1,000,000	1,000,000
<b>Allotted, called-up and fully paid</b>		
444,000,000 (2008 434,000,000) ordinary shares of £1 each	444,000	434,000

10,000,000 ordinary shares of £1 each were issued during July 2009 at par

**16. RECONCILIATION OF MOVEMENT IN TOTAL SHAREHOLDERS' FUNDS AND STATEMENT OF MOVEMENTS ON RESERVES**

	Share capital £000	Share premium account £000	Profit and loss account £000	Total shareholders' funds £000
Balance at 1 January 2009	434,000	12	(100,908)	333,104
Issue of share capital	10,000	-	-	10,000
Profit for the year	-	-	72,479	72,479
<b>Balance at 31 December 2009</b>	444,000	12	(28,429)	415,583

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**17. POLICYHOLDER LIABILITIES**

	Long-term business provision £000	Technical provisions for linked liabilities £000	Investment contract liabilities £000
<b>At 1 January 2009</b>			
Gross	708,145	163,812	3,022,829
Reinsurance (as restated – note 3)	(100,847)	(138)	(1,647,069)
<b>Net</b>	<b>607,298</b>	<b>163,674</b>	<b>1,375,760</b>
<b>Movement in year</b>			
Gross	34,391	1,636,219	131,233
Reinsurance	66,284	97	(44,682)
<b>Net</b>	<b>100,675</b>	<b>1,636,316</b>	<b>86,551</b>
<b>At 31 December 2009</b>			
Gross	742,536	1,800,031	3,154,062
Reinsurance	(34,563)	(41)	(1,691,751)
<b>Net</b>	<b>707,973</b>	<b>1,799,990</b>	<b>1,462,311</b>

	Investment contract Liabilities £000
<b>At 1 January 2009 (as restated)</b>	<b>1,375,760</b>
Premiums	(43,479)
Claims	(53,873)
Fee income	(40,290)
Investment return, annual management charges and other expenses	224,193
<b>At 31 December 2009</b>	<b>1,462,311</b>

Included within investment contract liabilities is an amount of £1,424,566,000 (2008 £1,360,204,000) relating to assets held to cover linked liabilities

During the year the Company entered into agreements with parent company, Friends Provident Life and Pensions Limited (FPLP), to reinsure, unit-linked life business from FPLP, the risks and cash-flows of non-unitised policies from FPLP, and the conventional life business to FPLP

In respect of the reinsurance of unit-linked life business, a premium equal to the unit-linked liabilities of the Company of £1,808m has been received from FPLP. The unit-linked assets have been deposited back with the Company and will be realised as and when required to meet the Company's reinsurance obligations. The value of unit-linked assets deposited with FPLP at 31 December 2009 was £1,617m

In respect of the reinsurance of the risks and cash-flows of non-unitised policies, a premium has been set at £18m due to FPLP, being 50% of the value of future profits of these policies in-force at 1 January 2009

In respect of the reinsurance of conventional life business, all future premiums on current in-force non-profit life protection and critical illness business of the Company are reinsured. Reserves in respect of this business have been transferred to FPLP and, due to the reserves being negative, FPLP has transferred £140m of assets to the Company. Maintenance expenses on the in-force and new business, together with acquisition expenses on future new business are also transferred to FPLP. Maintenance expenses of £18m and acquisition expenses of £41m have been transferred at 31 December 2009

In addition, an existing reinsurance agreement with FPLP that reinsured life and income protection business from FPLP has been cancelled

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**18 TECHNICAL PROVISIONS**

**(a) Liabilities for insurance contracts and investment contracts with DPF**

The provision for insurance contracts and investment contracts with DPF is calculated on the basis of recognised actuarial methods with 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 and the results are certified by the professionals undertaking the valuations.

Calculations are made on an individual policy basis, however where any global provisions are made these are calculated using statistical or mathematical methods. These results are expected to be approximately the same as if an individual liability was calculated for each long-term contract.

There is inherent uncertainty in estimating the technical provisions in respect of Guaranteed Annuity Options, where the option will only be of value to the policyholder depending on the economic and assumed future mortality experience at the time of retirement. The key area of uncertainty is interest rates. Where these are high at the time of retirement then market annuity rates will mean the value of the guarantee is reduced. Similarly low interest rates will increase the value of the guarantee. Lesser areas of uncertainty relate to assumed mortality at the time of retirement and take up rates for tax-free cash. Improving mortality experience increases the value of the guarantees, while increasing take up of the tax-free cash option reduces the value of the guarantees since no cost arises in respect of those funds taken as tax-free cash.

The provision for Guaranteed Annuity Options was estimated using a deterministic scenario based on prudent assumptions.

The provision for insurance contracts and investment contracts with DPF is sensitive to the principal assumptions in respect of interest rates and mortality, although the relative sensitivity will vary depending on the class of long-term business. The underlying assets are similarly sensitive and so the overall impact of any change is minimised.

The principal assumptions underlying the calculation of the provisions are set out below.

**Valuation interest rates**

Class of business	With-profits		Non-profit	
	2009 % pa	2008 % pa	2009 % pa	2008 % pa
<b>Life and annuity funds</b>				
Conventional	2.8	2.5	3.0	2.7
Unitised	3.3	3.0	3.0	2.7
<b>Pension business</b>				
Deferred annuities for the self-employed	3.6	3.2	3.8	3.4
Deferred annuities under pension schemes				
Main series	3.6	3.2	3.8	3.4
Unitised	4.2	3.75	3.8	3.4
<b>Annuities in payment</b>				
Life	-	-	3.0	2.7
Pensions (other)	-	-	3.8	3.4
Pensions (reassured from FPP)	-	-	4.93	4.18

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**18. TECHNICAL PROVISIONS (continued)**

**(a) Liabilities for insurance contracts and investment contracts with DPF (continued)**

For regular premium life protection products the interest rate used in 2009 is 2.5% per annum or 5.4% per annum, depending upon which is the most onerous (2008 2.2% per annum or 4.7% per annum)

For conventional with-profits business, explicit provision is made for vested bonuses (including those vesting following the year end 2009 valuation) Implicit allowance for future regular and final bonuses is made by a small margin in the valuation interest rate Policies are assumed to remain in force for their full term

Accumulating with-profits business (main series with-profits deferred annuities and unitised with-profits business) is valued in a similar way to linked business and includes an allowance for surrender values and both an explicit and implicit allowance for future bonuses The explicit allowance is for the greater of the guaranteed and supportable future level of bonus while an additional implicit allowance is provided by a small margin in the valuation interest rate

The total cost of regular, interim and final bonuses attributable to the year ended 31 December 2009 was £7m (2008 £14m)

Cashable deferred annuities are valued at the greater of the value of the cash option or the annuity discounted at 4.6% (2008 3.4%) per annum in payment Where a guaranteed annuity option is more valuable than the cash equivalent it is assumed that 5% of the benefit is taken as tax free cash

Regular premium individual income protection policies have been valued using a gross premium method with an interest rate of 3.3% (2008 2.9%) per annum

**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 (liquidity premium) compared to gilts One of the key judgments is the assessment of how much of the spread is attributable to liquidity premium

The liquidity premium assumed on backing assets in the derivation of valuation interest rates for annuities in payment has been changed to bring FP practice more in line with industry practice The previous allowance for liquidity was 50% of the spread on individual bonds with an upper limit of 250 basis points The new approach that has been adopted is to take the overall spread on a bond and deduct an allowance for defaults (called the credit default deduction) with the remainder of the spread being treated as liquidity premium The credit default deduction is based on

- Historical defaults and recovery experience
- A margin for prudence
- An additional short-term recessionary allowance

The end result for the interest rate to be used for valuing the annuity reserves is the yield on the corporate bonds less the credit default deduction equal to the sum of these three elements The impact is an increase in profit before tax of £4.2m

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 above The impact of these liability changes on surplus, is generally to offset some or all of the corresponding impact on the value of assets backing the liabilities

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**18. TECHNICAL PROVISIONS (continued)**

**(a) Liabilities for insurance contracts and investment contracts with DPF (continued)**

**Mortality and morbidity assumptions (continued)**

The 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

	31 December 2009	31 December 2008
<b>Non Profit Term Assurances</b>		
- smoker	93% TMS00(5) / 88% TFS00(5)	93% TMS00(5) / 88% TFS00(5)
- non-smoker	93% TMN00(5) / 86% TFN00(5)	93% TMN00(5) / 86% TFN00(5)
Critical Illness	CIBT02 <sup>(i)</sup>	CIBT02 <sup>(i)</sup>
Individual Income Protection	60% AM/AF80 ult	60% AM/AF80 ult
<b>With-Profits Assurances</b>	80% AM/AF80 ult	80% AM/AF80 ult
<b>Pension Fund</b>		
- In payment, individual	RM/FV00 <sup>(ii)</sup>	RM / FV00 <sup>(ii)</sup>
- In payment, group	PCMA / PCFA00 <sup>(ii)</sup>	PCMA / PCFA00 <sup>(ii)</sup>
- In deferment	65% AMC00ult / 55% AFC00ult	65% AMC00ult / 55% AFC00ult

<sup>(i)</sup> The percentages of the table used differ by sex and smoker status

<sup>(ii)</sup> 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 applying 1.25% per annum and 1.50% per annum to the critical illness rates, for males and females respectively.

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

**Provision for pension transfers and opt outs**

In accordance with guidance issued by the Financial Services Authority, the Company has reviewed the appropriateness of advice given to policyholders who purchased personal pensions contracts after 1988.

These reviews have now been substantially completed and £2.5m (2008: £2.5m) remains within the long-term business provision in respect of residual associated costs and contingencies.

Included in the carrying amount of insurance contract liabilities, is £2,550,439,000 (2008: £937,561,000) that is expected to be settled more than 12 months after the balance sheet date.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**18. TECHNICAL PROVISIONS (continued)**

**(b) Liabilities for investment contracts without DPF (continued)**

The provision for linked contracts is equal to the value of units. A non-unit liability, consisting mainly of sterling reserves, is calculated by carrying out cash flow projections on appropriate bases, including allowance for future expenses and is included within the long-term business provision. The non-unit liability makes prudent allowance for the cessation of premiums where such cessation would require an increased reserve. There is no significant difference between carrying values and maturity values of investment contract liabilities.

Included in the carrying amount of investment contract liabilities, is £2,686,190,000 (2008 £2,744,894,000) that is expected to be settled more than 12 months after the balance sheet date.

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS**

The Company 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 Company's exposure to each of the above risks and Company's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these financial statements.

The Board of Friends Provident Holdings (UK) Limited, an intermediate holding company, has overall responsibility for the Group's risk management framework and for approving risk management policy and risk appetite.

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 to the Board of Friends Provident Holdings (UK) Limited detailed policies for the management of specific classes of risk, and considers quarterly reporting from the operational businesses.

The FRC, which includes the Chief Finance Officer and other relevant senior managers, oversees the management of financial and insurance risks of the Company. 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 the 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 are recorded by the Risk function, which co-ordinates quarterly reporting to the FRC. Risks within the business change activities are identified and evaluated by senior management both in relation to the delivery and in terms of the effect on the business as a whole.

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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

The Audit Committee (AC) of Friends Provident Holdings (UK) Limited 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 Company. 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.

**Capital management**

The Company's capital comprises of equity shareholders' funds.

The Company is a regulated entity subject to a number of regulatory capital tests. The Company has complied with all regulatory capital requirements throughout the financial year.

Capital and solvency is measured using the regulations prescribed by the Financial Services Authority (FSA). These regulatory capital tests are based upon required levels of solvency capital (Capital Resources Requirement (CRR)) and a series of prudent assumptions in respect of type of business written by the Company.

A reconciliation of equity under UK Generally Accepted Accounting Practice (UK GAAP) attributable to equity holders of the Company and the excess of available capital resources to cover long-term insurance business is set out below.

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Equity shareholders' funds per the balance sheet (UK GAAP basis)</b>	<b>415,583</b>	<b>333,104</b>
Adjusted for		
Include fund for future appropriations	75,047	67,329
Sterling reserves	26,527	36,538
Actuarial funding of capital units	12,385	12,456
Other policy liability differences	(8,801)	(14,149)
Deferred acquisition costs	(174,091)	(159,378)
Deferred front end fees	32,015	15,310
Inadmissible assets	(68)	(68)
Less		
Regulatory prudence – inadmissible assets	(48,289)	(14,254)
Munich Re reinsurance	3,920	9,244
Capital resources requirement	(160,961)	(147,068)
<b>Excess of available capital resources for long-term insurance business (FSA Return, Form 2)</b>	<b>173,267</b>	<b>139,063</b>



**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(a) Quantitative risk exposure**

A summary of how each risk is mitigated is provided below with, where appropriate, quantitative information on the exposure to that risk

The table below shows the sensitivity to the regulatory capital surplus (sensitivities are symmetrical unless otherwise disclosed)

**Year ended 31 December 2009**

	Note	£000
Excess of available capital resources to cover long-term insurance business (per FSA Return, Form 2)		173,267
10% reduction in market values of equity and property assets	(i)	14,800
10% increase in market values of equity and property assets	(i)	(14,900)
1% reduction in risk-free rates with corresponding change in fixed-interest asset values	(ii)	6,600
1% increase in risk-free rates with corresponding change in fixed-interest asset values	(ii)	(14,900)
100 basis points increase in corporate bond spreads		(10,600)

**Year ended 31 December 2008**

	Note	£000
Excess available capital resources to cover long-term insurance business (per FSA Return, Form 2)		139,063
10% reduction in market values of equity and property assets	(i)	(11,900)
10% increase in market values of equity and property assets	(i)	11,900
1% reduction in risk-free rates with corresponding change in fixed-interest asset values	(ii)	52,500
1% increase in risk-free rates with corresponding change in fixed-interest asset values	(ii)	(52,500)
100 basis points increase in corporate bond spreads		(21,000)

(i) A fall in equity and property values or a reduction in the exchange rate adversely affects the following

- exposure to equities and property in the Closed Fund
- the impact on the value of future charges of movements in equity and property values in linked funds

(ii) A rise in interest rates reduces both the value of fixed interest assets and the value of liabilities. The converse is true of a fall in interest rates. Therefore the net impact is significantly less than the impact on assets alone

(iii) 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 (liquidity premium) compared to gilts

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(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 of asset prices, interest rates, or exchange rates. Market risk includes the following four elements:

- Equity risk – the risk of fluctuations in fair value or future cashflows 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 cashflows 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 cashflows 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 cashflows of a financial instrument arising from a change of or volatility in real estate values or income

The Company 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 Closed Fund, the Company 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 Company, 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 BRC 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 funds.

The following summarises the key actions undertaken by the Company to manage all aspects of market risk:

The Investment Committee of Friends Provident Holdings (UK) Limited oversees investment policy and strategy which the Company actions primarily through the use of investment fund mandates. Day-to-day implementation of investment policy and strategy is managed predominantly by F&C Asset Management plc (F&C) in line with these approved mandates.

Mandates are set for each relevant fund 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 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

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(b) Market risk (continued)**

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 Company 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 purpose of efficient portfolio management and risk reduction in accordance with policyholder contracts and marketing literature relevant to the funds.

In addition to the mandates, the Company 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 broadly match the duration and profile and cash flows of annuity and permanent health insurance policies.

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.

For with-profits 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 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 the Company's equity investments is largely undertaken by F&C. 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 Company is exposed to foreign exchange risk through its investment in foreign operations, fee income derived from financial investments denominated in currencies other than its presentational currency (pounds sterling) and revenues receivable in foreign currencies. 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 Company is exposed to the risk that the exchange rate of its presentational currency relative to other currencies may change in a manner that has an adverse effect on the value of the Company's financial assets and liabilities. This risk is accepted, in accordance with the agreed risk appetite, as being consequential upon the Company 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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(b) Market risk (continued)**

**(iii) Interest rate risk**

The Company 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 Company to cash flow interest rate risk.

Bond related performance benchmarks within fund mandates are set so that asset profiles broadly match liability profiles. This minimises against interest rate risk.

Day to day investment decisions around the management of interest rate risk and its impact on the value of the Company's investments are largely undertaken on behalf of the Company by F&C, within the boundaries set by fund mandates. In its decision making on fixed interest 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 defined performance benchmarks.

The Company 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 the Company 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 Board of Resolution Limited.

**(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 Company or the deterioration of the debtor's financial position.
- Country risk – financial loss arising from the 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 the Company defaulting/not delivering on its settlement obligations.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(c) Credit risk (continued)**

The Company will take on investment credit risk when it is deemed financially beneficial to do so in support of the financial objectives

The Company 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 Company 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 Company's corporate bond portfolio is highly rated (see table on page 47)

The Company is exposed to reinsurance counterparty risk of three different types

- as a result of debts arising from claims made by the Company but not yet paid by the reinsurer
- from reinsurance premium payments made to the reinsurer in advance
- as a result of reserves held by the reinsurer which would have to be met by the Company in the event of default

In addition, there is potential for the Company's credit risk exposure to increase significantly under adverse insurance risk events, eg if the Company received a large number of claims for which it needed to recover amounts from its reinsurers. In order to mitigate reinsurance counterparty risk, the Company 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 the Life and Pensions Finance function.

The Company 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 the aggregate holdings in any one issuer to 5%.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(c) Credit risk (continued)**

The Company is exposed to credit 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

The Company 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 the Company's investments is largely undertaken 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 the Company. The Company 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

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.
- the Company regularly reviews the financial security of its reinsurers.

The exposure to individual counterparties for non-linked and shareholder assets 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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(c) Credit risk (continued)**

Concentrations of credit risk might exist where the Company 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

The amount disclosed in the balance sheet in respect of financial assets represents the Company's maximum exposure to credit risk

An indication of the Company's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The Company is most exposed to credit risk on debt and other fixed income securities, derivative financial instruments, deposits with credit institutions, reinsurance arrangements and cash at bank. Debt and other fixed income securities mainly comprise government bonds and corporate bonds. Given the nature of the Company's investments in government bonds the credit risk associated with these is considered small and the Company 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, Fitch'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. Government bonds have also been excluded.

**As at 31 December 2009**

	AAA	AA	A	BBB	BB	B	Not rated	Total
	£000	£000	£000	£000	£000	£000	£000	£000
Debt & other fixed interest securities	116,447	70,389	143,368	16,856	1,045	15,860	5,240	369,205
Derivatives	-	-	201	-	-	-	-	201
Reinsurers' share of technical provisions – claims outstanding	-	17,467	-	-	-	-	-	17,467
Deposits with credit institutions	230	32,131	6,369	-	-	-	-	38,730
Cash at bank and in hand	-	766	49,177	-	-	-	-	49,943

**As at 31 December 2008**

	AAA	AA	A	BBB	BB	B	Not rated	Total
	£000	£000	£000	£000	£000	£000	£000	£000
Debt & other fixed interest securities	56,332	60,128	84,820	16,560	-	-	798	218,638
Derivatives	-	-	568	-	-	-	-	568
Reinsurers' share of technical provisions – claims outstanding	-	14,240	-	-	-	-	-	14,240
Deposits with credit institutions	44,449	22,955	8,852	-	-	-	-	76,256
Cash at bank and in hand	21,966	5,195	-	580	-	-	-	27,741

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(c) Credit risk (continued)**

The following tables show the amounts of 'debtors' and 'accrued interest and rent' that are neither past due nor impaired, past due but not impaired and those where provision for impairment has been made. 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.

<b>As at 31 December 2009</b>	<b>Debtors and accrued interest and rent</b>
<b>Financial assets neither past due nor impaired</b>	63.02%
<b>Financial assets that are past due:</b>	
0-3 months past due	10.72%
3-6 months past due	0.96%
6-12 months past due	0.46%
More than 12 months past due	6.41%
<b>Impaired financial assets for which provision is made</b>	18.42%
<b>Total before provision for impairment (£000)</b>	<b>23,965</b>

<b>As at 31 December 2008</b>	<b>Debtors and accrued interest and rent</b>
<b>Financial assets neither past due nor impaired</b>	73.89%
<b>Financial assets that are past due:</b>	
0-3 months past due	8.39%
3-6 months past due	0.56%
6-12 months past due	0.38%
More than 12 months past due	9.20%
<b>Impaired financial assets for which provision is made</b>	7.57%
<b>Total before provision for impairment (£000)</b>	<b>23,850</b>

**(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 Company 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)
- 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 management 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).



**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(d) Liquidity risk (continued)**

The Company 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 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 cashflows of 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 the property funds

Exposure to policyholder liquidity risk can be split between non-linked and linked funds. As a general rule, the Company 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
- 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

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. Where premiums exceed claims the amounts are negative.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(d) Liquidity risk (continued)**

**As at 31 December 2009**

**Contractual undiscounted cash flows:**

	Carrying value £000	Within 1 year or payable on demand £000	1-5 years £000	More than 5 years £000
<b>Non-Derivative Financial Liabilities</b>				
Technical provisions	756,349	68,733	(188,715)	468,206
Technical provisions for linked liabilities	1,800,031	1,800,031	-	-
Investment contract liabilities	3,154,062	3,168,483	-	-
Creditors arising out of direct insurance operations	3,157	3,157	-	-
Outstanding investment purchases	495	493	2	-
Premium rebate clawbacks	-	-	-	-
Other creditors (excluding derivative financial liabilities)	1,299	1,299	-	-
Accruals and deferred income	32,015	32,015	-	-
<b>Derivative Financial Liabilities</b>				
Futures backing equities	328	328	-	-
Forward currency contracts	5	5	-	-

**As at 31 December 2008**

**Contractual undiscounted cash flows:**

	Carrying value £000	Within 1 year or payable on demand £000	1-5 years £000	More than 5 years £000
Technical provisions	725,903	74,213	(263,967)	371,631
Technical provisions for linked liabilities	163,812	163,812	-	-
Investment contract liabilities	3,022,829	3,032,797	-	-
Creditors arising out of direct insurance operations	7,586	7,586	-	-
Outstanding investment purchases	4	4	-	-
Premium rebate clawbacks	7,822	7,822	-	-
Other creditors	2,428	2,428	-	-
Accruals and deferred income	15,310	15,310	-	-

All unit-linked liabilities arising from insurance contract and investment contract liabilities are payable on demand and have been included in the column 'within 1 year or payable on demand'

Amounts expected to be settled from the fund for future appropriation (FFA) 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, £75,033,000 (2008 £53,836,000) is expected to be settled more than 12 months after the balance sheet date.

'Amounts due to Group undertakings' have not been included in the analysis as they do not have any fixed repayment terms.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(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 Company 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 Company to do so, or where the taking of these risks is in support of the Company's strategic objectives.

Underpinning the Company's management of policy cash flow risk is

- adherence to an approved underwriting policy that takes into account the level of risk that the Company 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 Company'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 Company sells a diverse range of products to a diverse group of people. Overseas Life Assurance Business (OLAB) is the only overseas business.

Note 18 describes the main insurance contracts written by the Company 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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)**

**(e) Policy cash flow risk (including insurance risk) (continued)**

**(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 that 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 Company 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.

**(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 UK Life and Pensions division in particular, and the general economic environment.

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**

The whole of the impact of changes in expense levels is borne by shareholders except in the Closed Fund where the risk is entirely borne by the with-profits policyholders.

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.

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**20. OTHER CREDITORS INCLUDING TAXATION AND SOCIAL SECURITY**

	2009 £000	2008 £000
<b>Amounts falling due within one year</b>		
Taxation	6,480	10,787
Outstanding investment purchases	495	4
Amounts owed to Group undertakings	7,900	6,302
Premium rebate clawbacks	-	7,822
Other creditors	1,632	2,428
	<b>16,507</b>	<b>27,343</b>

**21. CREDITORS ARISING OUT OF REINSURANCE OPERATIONS**

On the 31 December 2007, the Company entered into a Financial Reinsurance agreement with Munich Reinsurance Company who advanced €16,000,000 in respect of certain German pension business

The loan repayments are contingent on the emergence of future margins on policies whilst the policy remains in force or alternatively, reimbursement of commissions if the policy lapses or is surrendered

The loan arrangement will terminate on the earlier of the balance outstanding by receipt of sufficient repayments as defined above, or upon policies reaching the end of their reduced allocation periods

Each month an interest charge will be applied on the loan at the annual rate of 3 month EURIBOR + 1.75%

Loan repayments on the emergence of surplus of £5,170,000 have been made in the year

**22. FINANCIAL COMMITMENTS**

- (a) Capital expenditure for which provision has not been made in the financial statements is estimated as follows

	2009 Property £000	2008 Property £000
Contracted for	880	5,915

- (b) Annual commitments under non-cancelable operating leases for which no provision has been made in the financial statements, were as follows

	2009 Land and buildings £000	2008 Land and buildings £000
Operating leases which expire in over five years	471	471

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**23. DIRECTORS' EMOLUMENTS**

The directors are employed by and receive their remuneration from FPMS, a fellow Group undertaking Included within the management recharges from FPMS for 2009, is an allowance for directors' emoluments in respect of their services to the Company, details of which are given below This is a proportion of the costs of the directors' salaries as incurred by the Company

	2009 £000	2008 £000
<b>All directors</b>		
Management salaries and benefits in kind	208	801
Amounts receivable under annual incentive bonus schemes	57	227
Company contributions to money purchase pension scheme	3	1
Compensation for loss of office	-	368
	268	1,397

During the year 6 directors (2008 nil) exercised share options and 6 directors (2008 11) had shares receivable under long-term incentive schemes At 31 December 2009 retirement benefits were accruing to two directors (2008 ten) under a defined benefit scheme and three directors (2008 one) received retirement benefits under a defined contribution scheme

**Highest paid director**

The total of salaries, benefits in kind, and results-related payments and amounts receivable under long-term incentive schemes payable to directors includes £76,000 (2008 £184,000) in respect of the highest paid director, of which £nil (2008 £nil) relates to long-term incentive schemes Pension contributions to money purchase pension schemes include £968 (2008 £992) for the highest paid director This is a proportion of the costs incurred by the Company in respect of the highest paid director and not their full salary The highest paid director is not a member of a defined benefit pension scheme

**24. RELATED PARTY TRANSACTIONS**

The Company is a wholly owned subsidiary undertaking of Friends Provident Life and Pensions Limited (FPLP) The results of both the Company and FPLP are consolidated in the results of Resolution Limited, the Company's ultimate parent and controlling company, whose financial statements are publicly available Accordingly, the Company is exempt from the requirements of FRS 8 Related Party Disclosures, concerning the disclosure of transactions with fellow wholly owned subsidiary undertakings, which qualify as related parties within the Group

During the period until its demerger from the Group in July 2009, F&C Asset Management plc invoiced the Company £2,121,000 (2008 £4,198,000) in respect of investment management charges No amounts (2008 £nil) were outstanding at 31 December 2009

**FRIENDS PROVIDENT LIFE ASSURANCE LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**25. CONTINGENT LIABILITIES**

The FSA and other regulatory bodies may wish, in future, to examine the suitability of past sales of products that could affect the Company and the industry in general. The directors of the Company also conduct ongoing reviews of such products. As a result, it is possible that additional unprovided liabilities could arise.

Provision for liabilities in connection with policyholder contracts are based on best estimate assumptions, using historical experience but adjusted where there is reasonable cause to expect future experience to be different. However, actual experience may differ from that assumed. Regulatory action, legal judgments, future economic conditions or other unforeseen events may impact ultimate settlements made.

**26. UNDERTAKING TO FSA**

Friends Provident Life Assurance Limited gave an undertaking to LAUTRO (subsequently transferred to the PIA and now to the FSA under the Financial Services and Markets Act 2000) that it will assume responsibility for all liabilities (including complaints) and any other matters which may arise in connection with the business conducted on its behalf by FP Financial Management Limited, formerly NM Financial Management Limited. At the balance sheet date, no claims have been paid or are pending.

**27. ULTIMATE PARENT UNDERTAKING**

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).

The smallest group in which the results of the Company are consolidated is that headed by Friends Provident Group plc. Copies of the Group Report and Accounts of Friends Provident Group plc can be viewed via its website at [www.friendsprovident.com](http://www.friendsprovident.com).