Registered Number 03116645

FRIENDS LIFE WL LIMITED

(formerly Winterthur Life UK Limited)

REPORT AND ACCOUNTS

for the year ended 31 December 2012

Registered Office. Pixham End, Dorking, Surrey, RH4 1QA

Registered Number 03116645

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

COMPANY INFORMATION

DIRECTORS

S S Calder
D E Hynam
J S Moss
L C. J'Afari-Pak
M R B Versey
J M Black

COMPANY SECRETARY

Friends Life Secretarial Services Limited

AUDITORS

Ernst and Young LLP

Registered Number 03116645

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

DIRECTORS' REPORT

PRINCIPAL ACTIVITY

The Company's principal business is the transaction of long-term insurance business (i e life insurance, investment products and pensions) in the United Kingdom Sales, marketing and administration services are provided by Friends Life Services Limited ("FLS") Friends Life WL Limited ("FLWL") is part of the Friends Life group of companies ("the Group") which transacts long-term insurance business

The Company changed its name from Winterthur Life UK Limited to Friends Life WL Limited on 25 May 2012

RESULTS AND BUSINESS REVIEW

Operational structure

The Company operates in the UK individual and group protection, savings and investment and annuity markets

Capital transactions

A capital contribution of £5m was made to the Company from its direct parent Friends Life Limited ("FLL") on 26 June 2012

Business Performance

	2012	2011
	£m	£m
Total operating cash flow outflow	**(249.5)**	(287 4)
Profit/(Loss) after tax	**35.4**	(73 0)
Capital resources available to meet regulatory requirements	**214.8**	191 0

Total operating cash flow

Total operating cash flow is a non-GAAP key performance indicator which measures the value of net cash receipts from policyholders (i e cash flows in less cash flows out). It indicates whether the Company is gaining or losing funds under management as a result of policyholder transactions The impact of deposit accounting in respect of investment contracts means that the premiums and claims included in the profit and loss account cannot be directly compared to the total operating cash flow figure shown in the previous table Total operating cash flow for FLWL is a net outflow for both 2012 and 2011 as there is less new business being written than claims being made on existing policies

Profit after taxation

A net profit arises from the movement in the technical account, details of which are set out on page 9 of these financial statements.

Capital resources

Capital resources available to meet regulatory requirements represent the amount of admissible net assets available to meet the solvency requirements of the Company The increase in the year reflects the capital contribution and the profits generated in the year.

DIVIDENDS

The directors do not recommend the payment of a dividend for the year ended 31 December 2012 (2011 £nil)

RISK

The Group actively manages its risk profile A formalised risk management framework drives the identification and mitigation of strategic, financial and operational risks to support the achievement of its objectives Risks are predominantly managed at a Group level rather than an individual company level.

The principal inherent risks and uncertainties that the Group (and the Company) has been exposed to during 2012 and an overview of its approach to managing these exposures is set out below

Economic conditions
The Group is exposed to volatile and uncertain economic conditions as these will give rise to changes in the values of the assets and liabilities of its insurance businesses Adverse or uncertain economic conditions also impact the willingness of consumers to buy and continue to hold the Group's products The Group is particularly impacted by conditions in the UK and other European countries as a result of its operations and investment assets being focused in these countries.

The Group's business model is designed to mitigate the impact of market conditions through measures including the matching of assets and liabilities, the use of financial instruments to reduce the volatility of returns on assets, diversification in the product portfolio, and ensuring the operating companies within the Group are robustly capitalised The Group also actively monitors changes in the economic environment to enable proactive management of impacts to relevant markets

Competitor activity and business model
The Company operates in the UK which is a highly competitive market The long-term success of the Group's business model envisages the achievement of a scale that allows margins to rise and payback periods to fall to levels that provide greater returns for shareholders This must be achieved against a backdrop of strong competition and sometimes aggressive pricing that puts pressure on margins and working capital

As part of the Group's strategy for increasing operational efficiency, material long-term outsourcing arrangements have been entered into in respect of the IT and administration of its insurance businesses, resulting in significant reliance on the outsource providers.

Regulation and legislation
The Group operates in a highly regulated financial services market which has a significant impact/influence on both strategic decisions and ongoing day-to-day management of acquired businesses. Unanticipated changes in legal requirements (including taxation) and regulatory regimes, or the differing interpretation and application of regulation over time, may have detrimental effects on the Group The Group faces regulatory uncertainty over the next few years with the implementation of Solvency II, and the introduction of auto-enrolment

In March 2011 the European Court of Justice (ECJ) announced that it had upheld the ruling on gender discrimination that results in insurers not being able to use gender related information to calculate insurance premiums and benefits The ECJ declared that the adoption of unisex premiums and benefits will apply with effect from 21 December 2012 The product lines of the Group impacted are protection business, annuity business and long term care business and new processes and procedures have been put in place for these product lines to ensure gender neutral underwriting from 21 December 2012

The Group bases its business strategy on prevailing regulation and known/planned change To mitigate the risk of legislation or regulation adversely impacting its business, the Group engages with regulatory and legislative authorities and support lobbying activity conducted by relevant industry groups The Group has processes in place to identify regulatory and legislative change and to monitor the timely implementation of new requirements

Changes in taxation law
The Group may be affected by changes in tax legislation and interpretation of tax law In addition to relevant corporate taxes, life insurance companies within the Group are subject to specific rules governing the taxation of policyholders, and amendment to these rules may impact the business To mitigate the risk of taxation changes on its business, the Group engages with the relevant tax and legislative authorities and supports lobbying activity undertaken by industry groups

Legislation in respect of the new life tax regime was included in Finance Act 2012, which received Royal Assent on 17 July 2012 The new life tax regime took effect from 1 January 2013 and therefore impacts deferred tax but not current tax in the 2012 accounts There remains an element of risk and uncertainty because the legislation is new, and therefore may be subject to change either by legislative update or by developments in interpretation

Mortality and other assumption uncertainties
The writing of life assurance and pension business by the Group's insurance businesses necessarily requires the setting of assumptions for future experience of factors such as mortality/longevity, lapse/persistence rates, valuation interest rates, credit defaults and expense levels

The Group takes a prudent approach to evaluating the appropriate level of provisions and capital for these risks and the assumptions are subject to rigorous and ongoing review Stress and scenario testing is used to validate the appropriateness of key assumptions to single events and combinations of extreme events including economic conditions, investment performance, lapse and mortality/morbidity events

The financial risks facing the Company are further discussed in note 2 to the financial statements

ACTUARIAL VALUATION

A valuation of the long-term business fund was made as at 31 December 2012 which showed a surplus

A transfer of £6 0m (2011 £5 8m) of the surplus from the long-term business fund has been made to the shareholders' fund, comprising £2 0m from the with-profits fund (2011 £2 3m) and £4 0m from the segregated sub fund (2011 £3 5m)

DIRECTORS AND OFFICERS

The directors of the Company at the date of this report are shown on page 1

Mr A M Parsons resigned as a director on 30 March 2012

Ms E. B Bourke resigned as a director on 21 September 2012

Mr S S Calder and Mr J S Moss were appointed as directors on 19 September 2012

Ms L C J'Afari-Pak was appointed as a director on 1 December 2012

Mr J M Black was appointed as a director on 8 February 2013

INDEMNIFICATION OF DIRECTORS

Friends Life Group ("FLG") 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 Group and were in force for the benefit of former directors of the Group during 2012 Copies of the indemnity are available for inspection at the Company's registered office

PAYMENT OF CREDITORS

All trade purchases are dealt with through group service companies.

STATEMENT OF DISCLOSURE OF INFORMATION TO AUDITORS

Each director in office at the date of approval of this report confirms that

(a) so far as they are aware, there is no relevant audit information of which the Company's auditors are unaware, and

(b) they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

STATEMENT ON 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 working capital forecasts and estimated forecast solvency These forecasts have been subject to sensitivity tests and the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review above The ability to cope with unexpected risks to the financial position is shown within the Management of Financial Risks note on pages 24 to 35

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Directors' Report 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 United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) Under company law the directors must not approve the financial statements unless they are satisfied that they 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 accounting 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,
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

By Order of the Board

J.S. Moss
Director
19 March 2013

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRIENDS LIFE WL LIMITED (formerly Winterthur Life UK Limited)

We have audited the financial statements of Friends Life WL Limited (formerly Winterthur Life UK Limited) for the year ended 31 December 2012 which comprise the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Shareholders' Funds, the Balance Sheet and the related notes 1 to 34 The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

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

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities 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 and express an opinion on 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 Ethical Standards for Auditors

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the 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. In addition, we read all the financial and non-financial information in the Directors' Report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

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 2012 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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRIENDS LIFE WL LIMITED (formerly Winterthur Life UK Limited) (CONTINUED)

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the 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

Ernst & Young LLP

Stuart Wilson (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP, Statutory Auditor
London
20 March 2013

Registered Number 03116645

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

PROFIT AND LOSS ACCOUNT
TECHNICAL ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Earned premiums, net of reinsurance			
Gross premiums written	3	**86,530**	87,486
Outward reinsurance premiums		**(1,223)**	(3,637)
		85,307	83,849
Investment income	4	**341,950**	808,511
Unrealised gains on investments	4	**329,237**	-
Other technical income, net of reinsurance	5	**27,919**	72,158
		784,413	964,518
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		**(249,444)**	(262,314)
Reinsurers' share		**31,276**	26,894
		(218,168)	(235,420)
Change in the provision for outstanding claims			
Gross amount	18	**(3,229)**	(3,630)
Reinsurers' share	18	**(2,873)**	1,897
		(6,102)	(1,733)
		(224,270)	(237,153)
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance			
Gross amount		**73,572**	(63,038)
Reinsurers' share		**(6,919)**	16,536
		66,653	(46,502)
Other technical provisions, net of reinsurance			
Technical provisions for linked liabilities			
Gross amount	25	**(511,788)**	647,776
Reinsurers' share	25	**(136)**	453
		(511,924)	648,229
		(445,271)	601,727
Net operating expenses	7	**(56,571)**	(97,382)
Investment expenses and charges	4	**(5,227)**	(179,285)
Net loss arising on Part VII transaction	34	**-**	(47,572)
Unrealised losses on investments	4	**-**	(1,088,763)
Tax (charge) /credit attributable to the long-term business	8	**(39,039)**	7,334
Decrease in present value of future profits on non-profit business written in the with-profits fund		**(2,459)**	(875)
Transfers from the fund for future appropriations		**23,163**	1,970
Balance on the long-term business technical account		**34,739**	(75,481)

The information on pages 15 to 66 forms an integral part of these financial statements

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

PROFIT AND LOSS ACCOUNT
NON-TECHNICAL ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Balance on the long-term business technical account		**34,739**	(75,481)
Tax charge attributable to balance on long-term business technical account	8	**703**	(4,795)
Shareholders' pre-tax profit/(loss) from long-term business		**35,442**	(80,276)
Investment income	4	**2,287**	4,076
Unrealised (losses)/gains on investments	4	**(1,540)**	495
Investment expenses and charges	4	**(360)**	(925)
Other Operating Income		**552**	-
Profit/(Loss) on ordinary activities before tax		**36,381**	(76,630)
Tax (charge)/credit on profit on ordinary activities	8	**(932)**	3,586
Profit/(Loss) on ordinary activities after tax		**35,449**	(73,044)

The business transferred to AXA Wealth during 2011 was not managed as a separate business until the time of transfer Therefore it is not possible to distinguish between income which arises from continuing and discontinued operations and accordingly no such analysis of the results is presented

Note on historical profits and losses

Neither gains and losses of an insurance company arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses There are no other differences between the loss on ordinary activities before tax stated above and their historical cost equivalents

The information on pages 15 to 66 forms an integral part of these financial statements.

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Profit/(Loss) for the financial year	22	**35,449**	(73,044)
Revaluation reserve	22	**1**	515
Total recognised gains and losses relating to the year		**35,450**	(72,529)

The information on pages 15 to 66 forms an integral part of these financial statements

Registered Number 03116645

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Total shareholders' funds at 1 January		**118,562**	146,091
Profit/(Loss) for the financial year	22	**35,449**	(73,044)
Capital contribution received	22	**5,000**	45,000
Revaluation reserve – other	22	**1**	515
Total shareholders' funds at 31 December		**159,012**	118,562

The information on pages 15 to 66 forms an integral part of these financial statements

Registered Number 03116645

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

BALANCE SHEET AS AT 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Assets			
Investments			
Land and buildings	11	**3,025**	4,275
Investment in group undertakings and participating interests	12	**1,398**	1,397
Other financial investments	15	**1,598,912**	1,597,557
		1,603,335	1,603,229
Present value of future profits on non-profit business written in the with-profit fund		**17,400**	19,859
Assets held to cover linked liabilities	17	**5,607,374**	5,398,079
Reinsurers' share of technical provisions			
Long-term business provision		**397,613**	404,532
Claims outstanding	18	**1,903**	4,776
Technical provision for linked liabilities		**1,549**	1,685
		401,065	410,993
Debtors			
Debtors arising out of direct insurance operations	19	**11**	10
Debtors arising out of reinsurance operations		**628**	586
Deferred tax asset	26	**-**	22,029
Other debtors	20	**38,272**	36,538
		38,911	59,163
Other assets			
Cash at bank and in hand		**6,066**	10,175
Prepayments and accrued income			
Accrued interest and rent		**15,351**	16,133
Other prepayments and accrued income		**1,774**	1,274
		17,125	17,407
Total assets		**7,691,276**	7,518,905

The information on pages 15 to 66 forms an integral part of these financial statements

Registered Number 03116645

FRIENDS LIFE WL LIMITED
(formerly Winterthur Life UK Limited)

BALANCE SHEET AS AT 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Liabilities			
Capital and reserves			
Called up share capital	21	**27,400**	27,400
Capital contribution	22	**159,000**	154,000
Revaluation reserve	22	**1,398**	1,397
Profit and loss account	22	**(28,786)**	(64,235)
Total shareholders' funds		**159,012**	118,562
Fund for future appropriations		**9,748**	32,911
Technical provisions			
Long-term business provision		**1,768,297**	1,841,869
Claims outstanding	18	**35,689**	32,355
		1,803,986	1,874,224
Other technical provisions			
Technical provisions for linked liabilities	25	**5,605,819**	5,394,495
Provisions for other risks	26	**6,903**	6,017
Creditors			
Creditors arising out of direct insurance operations		**1,392**	580
Creditors arising out of reinsurance operations		**65**	1,454
Deferred tax liability	26	**13,572**	-
Other creditors including current tax and social security	27	**65,478**	60,715
		80,507	62,749
Accruals and deferred income	28	**25,301**	29,947
Total liabilities		**7,691,276**	7,518,905

The financial statements were approved by the Board of Directors on 19 March 2013 and were signed on its behalf by

J.M. Black
Director

The information on pages 15 to 66 forms an integral part of these financial statements

1. STATEMENT OF ACCOUNTING POLICIES

The principal accounting policies are set out below

Basis of presentation

The financial statements have been prepared in accordance with the provisions of Schedule 3 of The Large & Medium-sized Companies & Groups (Accounts & Reports) Regulations 2008 applicable to insurance companies

The financial statements have also been prepared in accordance with applicable United Kingdom 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 these notes and with the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business ("ABI SORP") dated December 2005 and revised in December 2006

Compliance with Statement of Accounting Practice ("SSAP") 19 (Accounting for Investment Properties) requires departure from the requirements of the Companies Act 2006 relating to depreciation and an explanation of the departure is provided in the accounting policy note relating to investments below

Under FRS 1 (Cash flow statements (revised 1996)), the Company is exempt from the requirement to prepare a cash flow statement on the grounds that it is a subsidiary undertaking of a parent undertaking which produces a consolidated cash flow statement which is publicly available

The Company has taken advantage of section 400 of the Companies Act 2006 and has not produced consolidated financial statements on the basis that it is a subsidiary undertaking of FLG which prepares consolidated financial statements

The Company has applied all applicable accounting standards and interpretations effective at 31 December 2012

Contract classification

FRS 26 (Financial Instruments Measurement) requires contracts issued by an insurer to be classified as insurance, investment with a discretionary participation feature ("DPF") or investment Contracts classified as investment fall within the scope of FRS 26 whilst those classified as insurance or investment with DPF fall within the scope of the ABI SORP

The Company issues contracts that transfer insurance risk or financial risk or both

Insurance contracts are those contracts that transfer significant insurance risk and may also transfer financial risk As a general guideline, the Company defines significant insurance risk as the possibility of having to pay benefits on the occurrence of the insured event that are at least 10% more than the benefits payable if the insured event did not occur A contract that is classified as an insurance contract continues to be treated as such until all rights and obligations under the contract expire

Investment contracts are those contracts that transfer financial risk but do not transfer significant insurance risk Unit-linked contracts where the liability under the contract is dependent on the value of the underlying financial assets, derivatives or investment property are classified as investment contracts unless the contracts also contain features that transfer significant insurance risk

All with-profits contracts contain a DPF which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses

- that are likely to be a significant proportion of the total contractual benefits,
- whose amount or timing is contractually at the discretion of the Company, and
- that are contractually based on
    - the performance of a specified pool of contracts or a specified type of contract,
    - realised and/or unrealised investment returns on a specified pool of assets held by the Company;
    - the profit or loss of the fund that issues the contracts

The terms and conditions of these contracts, together with UK regulations and the Principles and Practices of Financial Management ("PPFM") for the Company set out the bases for the determination of the amounts on which the additional discretionary benefits are based and within which the Company may exercise discretion as to the quantum and timing of their payment to policyholders

With-profits contracts or mixed policies containing both unit-linked and with-profits elements are classified as either insurance contracts or investment with DPF contracts depending on the level of insurance risk transferred

Unitised policies which contain both unit-linked and with-profits elements are split in accordance with a Scheme approved by the High Court in 2001 (as amended in 2004) with the unit-linked liabilities in the non-profit fund and the with-profits liability in the with-profits fund Both elements are classified as insurance contracts if there is a transfer of significant insurance risk If there is not significant insurance risk then the unit-linked component is classified as investment and the unitised with-profits component is classified as investment with DPF

Where business is written via contracts with legal form of reinsurance, the contract is assessed to determine whether it transfers significant risk For this assessment a significant transfer of persistency or expense risk can give rise to insurance risk.

Insurance contracts and with-profits investment contracts

Premium income and commission

Premiums, reinsurance premiums, commission and reinsurance commission are accounted for when due, other than those in respect of unit-linked policies

Premiums in respect of unit-linked policies are accounted for in the same period the policy liabilities resulting from those premiums are created.

Claims

Maturities and annuities are accounted for when due, death and disability claims when notified, and surrenders when paid, except for unit-linked business, where such transactions are accounted for when the policy ceases to hold units in the fund

Reinsurance recoveries are accounted for when the related claims become due

Acquisition costs and deferred acquisition costs

The costs of acquiring new business written outside of the with-profits fund which are expected to be recoverable from future revenue margins are deferred and recognised in the balance sheet as deferred acquisition costs For business written within the with-profits fund, acquisition costs are not deferred

The deferred acquisition cost asset is amortised over the period in which the costs, net of the related deferred tax provision, are expected to be recoverable out of margins arising from the related policies The rate of amortisation is consistent with the pattern of emergence of such margins

Long-term reinsurance contracts

Long-term business is ceded to reinsurers under contracts to transfer part or all of one or more of the following risks mortality, morbidity, investment, persistency and expenses Such contracts are accounted for as insurance contracts provided the risk transfer is significant

Certain outwards reinsurance contracts, which transfer significant insurance risks, relate in whole or in part to underlying investment contracts that are subject to deposit accounting Deposit accounting has been adopted for those elements of reinsurance contracts that relate to direct written inwards contracts which are classified as investment contracts and which are deposit accounted for This presentation has been adopted in order to remove the accounting mismatch that would otherwise arise in the profit and loss account in respect of gross and reinsurance premiums and claims

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the profit and loss account as 'Outwards reinsurance premiums' when due

Present value of future profits on non-profit business written in the with-profit fund

In determining the realistic liabilities for with-profit policies, an amount is included as an allowance for future bonuses that will be payable out of profits from non-profit business written within the with-profits fund An asset is therefore recognised to represent the present value of future profits ("PVFP") arising on this business These profits include profits expected to arise from margins for prudence in the gross premium valuation basis.

The value of the PVFP is determined in accordance with the FSA's 'realistic' liability regime In particular, the methodology and assumptions are based on current estimates of future experience and current market yields The value is also adjusted to remove the value of regulatory capital requirements in respect of the non-profit business

Unit-linked investment contracts

Amounts received in respect of unit-linked investment contracts are accounted for using deposit accounting, under which amounts collected are credited directly to the balance sheet, as an adjustment to the liability to the policyholder Financial liabilities in respect of unit-linked investment contracts are carried in the balance sheet as 'Technical provisions for linked liabilities' (see separate accounting policy note).

Fees receivable (included in other technical income) are recognised in the profit and loss account in the year they are assessed unless they relate to services to be provided in future years, in which case they are deferred and recognised as the service is provided

Incremental costs that are directly attributable to securing unit-linked investment contracts, and are expected to be recoverable, are deferred and recognised in the balance sheet as deferred acquisition costs The asset is amortised on a straight line basis allowing for expected level of surrenders

In addition, expected future payments to intermediaries, which will be funded by future income from policyholders, are deferred and recognised in the balance sheet as deferred acquisition costs The asset is amortised in line with actual payments to intermediaries

Outwards investment contracts

Long-term business ceded to reinsurers under contracts which do not transfer significant risk but have the legal form of reinsurance are classified as financial instruments. Deposit accounting is adopted in respect of these contracts and the reinsurance asset is shown under assets held to cover linked liabilities

Investment return

Investment income and expenses include dividends, interest, rent, gains and losses on the realisation of investments and related expenses (including those on land and buildings) Dividends are recognised on the date which shares are quoted ex-dividend Income from government and other fixed income securities, loans and deposits is recognised on an accruals basis Shareholder investment income and expenses are recognised in the non-technical account Investment income and expenses of the long-term insurance business fund are recognised in the technical account

Unrealised gains and losses represent the difference between the most recent valuation at the balance sheet date and either the valuation at the last balance sheet date or original cost if purchased during the period, net of disposals during the period Unrealised gains and losses on assets are taken to the profit and loss account Those arising from long-term business or held to cover linked liabilities are recognised in the technical account Other unrealised gains and losses arising are included in the non-technical account

Realised gains and losses are calculated as sale proceeds less purchase cost

Expenses incurred and interest payables on the management of investments are accounted for on an accruals basis.

Purchases and sales of financial assets are accounted for at trade date

Other income

Other income is accounted for on an accruals basis

Investments

Land and buildings

Land and buildings are valued at open market value Full valuations are made by independent, professionally qualified valuers every year

Under the Companies Act 2006, land and buildings are required to be depreciated over their expected useful economic lives In respect of freehold investment properties and leasehold investment properties with over 20 years to run, this requirement conflicts with the generally accepted accounting principle set out in SSAP 19 that no depreciation should be provided in respect of such investments The directors consider that to depreciate the investment properties would not give a true and fair view and accordingly the provisions of SSAP 19 have been adopted It is considered that if depreciation was charged it would not be significant on the basis of expected future residual values

In respect of owner-occupied freehold properties, the directors consider that the lives of these assets and their residual values (based on prices prevailing at the time of acquisition or subsequent valuation) are such that their depreciation is insignificant and is therefore not provided

Investments in group undertakings and participating interests

Shares in subsidiary undertakings owned by the long-term fund are valued at current value with valuation movements going to the profit and loss account Shares in subsidiary undertakings held by the shareholders' fund are valued at current value with valuation movements going to the revaluation reserve

Loans issued to group undertakings are initially stated at fair value plus directly attributable transaction costs and are then subsequently valued at amortised cost using the effective interest method The effective interest rate is determined by identifying the yield on financial instruments with similar terms and conditions to the loans being valued

Other financial investments

The Company designates all its shares, other variable yield securities, units in unit trusts and open ended investment companies, debt securities and other fixed interest securities at fair value through profit and loss The designation of investments is determined at initial recognition

Financial assets are recognised when the Company becomes a party to the contractual provision of the instruments For equities and debt securities, this is taken to be the trade date Financial assets are derecognised when the Company's contractual rights to the cash flows of the financial assets expire provided that substantially all risks and rewards have been transferred For equities and debt securities the derecognition date is taken to be the trade date of the sale transaction

Investments in the long-term fund are recorded at fair value through profit and loss. This policy is appropriate because, within the profit and loss account, it results in the matching of movements in the policyholder liabilities with the movements in the financial assets backing these liabilities Investments in the shareholders' fund are recorded at fair value through profit and loss because the assets are managed and their performance evaluated on a fair value basis

The fair values of investments listed in an active market are based on current bid prices at the balance sheet date The fair values of other unlisted investments, including corporate debts, for which no active market exists, are established by the directors using valuation techniques The valuations are generally provided by an external broker pricing service, using proprietary models, based on techniques using observable inputs During the period, the Company has performed independent reviews of the pricing models to ensure that appropriate methodologies have been applied

Loans, receivables, deposits with credit institutions and certificates of deposits are non-derivative financial assets with fixed or determinate payments that are not quoted in an active market. These instruments are classified upon initial recognition at fair value through profit and loss. This policy is appropriate because, within the profit and loss account, it results in the matching of movements in the policyholder liabilities in the long-term business fund with the movements in the financial assets backing these liabilities Where the assets are in the shareholders' fund the policy is appropriate because the assets are managed on a fair value basis

Derivative financial instruments
Derivative financial instruments include futures, forward foreign exchange contracts, over the counter swaptions, credit default swaps ("CDS"), currency swaps, equity put and call options and interest rate swaps They are classified as held for trading Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value Fair values are obtained from quoted market prices in active markets and valuation techniques including option pricing models which have certain inputs based on observable market prices Over the counter derivative valuations are obtained from counterparties

The fair value of CDS is obtained from the Sophis system, valued internally and independently from fund management Spread data required in the valuation is provided by "Markit", an external, independent pricing data provider Markit receives contributed CDS data from market makers from their official books and records This data then undergoes a rigorous cleaning process where they test for stale, flat curves, outliers and inconsistent data

Changes in the fair value of derivative instruments are recognised immediately in net fair value gains in the profit and loss account for the period. No adjustment is made to the classification of existing investments to reflect the effect of the future settlement of these transactions Unrealised gains and losses on derivatives and financial instruments attributable to the long-term funds or held to cover linked liabilities are included in the long-term business technical account.

Loans and receivables, including debtors

Loans and receivables are initially recorded at fair value plus incremental direct transaction costs, and are subsequently measured at their amortised cost, using the effective interest method Debtors are accounted for as loans and receivables

Impairment of assets

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired A financial asset accounted for at amortised cost is impaired and impairment losses are incurred only if there is objective evidence of impairment This may be as a result of one or more events that have occurred after the initial recognition of the asset which have an impact on the estimated future cash flows of the financial assets

Allocation of surpluses and the fund for future appropriations

Surpluses arising from participating (with-profits) business are ascertained as a result of the annual actuarial valuations of the related assets and liabilities The directors make appropriations from the surpluses to participating policyholders by way of bonuses charged to the long-term business technical account in a given year and comprise

- New reversionary bonuses declared (which are guaranteed once credited) in respect of that year which are provided within the calculation of the long-term business provision, and
- Terminal bonuses (which are not guaranteed) paid out to policyholders on maturity, death or surrender and are included within claims paid

The fund for future appropriations ("FFA") represents the excess of assets over policyholder liabilities for the Company's with-profit fund The main components of this are the value of future shareholders' transfers on a realistic valuation basis, less the expected support required from the segregated sub fund The segregated sub fund is a separate pool of assets maintained to provide support for the with-profits fund

The amount of appropriated surplus released to the non-technical account is determined by the directors in accordance with applicable laws and regulations

Long-term business provision

The long-term business provision is calculated using recognised actuarial methods, with due regard to the actuarial principles set out in Council Directive 2002/83/EC

The principal assumptions underlying the calculation of the long-term business provision for non-participating policies are detailed in Note 23 "Technical provisions"

Technical provision for linked liabilities

Liabilities under unit-linked contracts are recognised as and when the units are created and are dependent on the value of the underlying financial assets, derivatives or investment property

Unit-linked contracts which transfer significant insurance risk are classified as insurance contracts and are carried in the balance sheet at an amount determined by the valuation of the related units on the valuation date, based upon the value of the underlying assets.

Unit-linked contracts classified as investment contracts are carried in the balance sheet at amortised cost The amortised cost of these financial liabilities is equivalent to the amount payable on demand The Company considers this basis to be equivalent in all material aspects to the valuation of contracts which transfer significant insurance risk and to the fair value of the liabilities

In addition to the above, allowance is made within the technical provision for linked liabilities for associated tax obligations having regard to their expected timing

Other financial liabilities

Other financial liabilities are held at fair value on initial recognition and then subsequently valued at amortised cost using the effective interest method, with movements included in the profit and loss account

Financial liabilities are recognised when the Company becomes a party to the contractual provision of the instruments Financial liabilities are derecognised when the obligation specified in the instrument is discharged, cancelled or expires

Offsetting financial instruments

Financial assets and liabilities are only offset when a legally enforceable right to offset exists and when there is either an intention to settle on a net basis or it is intended to realise the asset and settle the liability simultaneously

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year Foreign currency transactions are recorded at the actual rate of exchange prevailing on the date of the transaction and any exchange differences are dealt with in the part of the profit and loss account in which the underlying transaction is reported

Non monetary items measured in terms of historical cost in a foreign currency are translated into sterling at the actual exchange rate at the date of the transaction. Non monetary items that are measured at fair value in a foreign currency are translated using the exchange rate at the date of latest valuation

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes Provision is made for deferred tax liabilities, using the incremental liability method, on material timing differences, including revaluation gains and losses on investments recognised in the profit and loss account Deferred tax assets are recognised to the extent that they are regarded as recoverable Deferred tax is calculated using rates substantively enacted at the balance sheet date Deferred tax balances have not been discounted

The balance transferred from the long-term business technical account to the non-technical account is grossed up at the effective shareholders' corporation tax rate applicable.

2. MANAGEMENT OF FINANCIAL RISK

Overview

The Company in the course of doing business is exposed to the following categories of risk:

- Financial risks including market risk, credit risk and liquidity risk, and
- Operational risks arising from inadequate or failed internal processes or from people systems or external events Operational risks include regulatory, financial crime, people, legal, information technology and business protection risks.

The Board of FLG, an intermediate holding company, has overall responsibility for the Group's risk management framework and for setting its risk appetite and risk policies The Company's risk management framework is aligned with the Resolution Limited risk management framework The Resolution Limited board have approved a set of risk management policies within which the Company operates

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

Hedge accounting

There are no current or forecasted transactions for which hedge accounting is used.

Main classes of financial assets

The main classes of financial assets that the Company are exposed to are Equities and Debt Securities and funds invested in other Insurance Funds as set out below A full reconciliation of these amounts to the balance sheet is found in Notes 15 and 17

	2012	2011
	£000	£000
Financial assets		
Equities:		
Other financial investments (Note 13)	**418,535**	363,390
Linked assets (Note 17)	**3,006,010**	2,850,165
	3,424,545	3,213,555
Debt securities:		
Other financial investments (Note 14)	**1,090,722**	1,132,208
Linked assets (Note 17)	**426,683**	439,215
	1,517,405	1,571,423
Other insurance funds:		
Linked assets (Note 17)	**2,088,147**	2,022,197

Market risk

Market risk can be defined as the risk that movements in market factors namely equity, bond, property and commodity prices, interest rates and foreign exchange rates impact adversely the value of, or income from, shareholder and policyholder funds

For an insurance company market risk appetite is required to reflect the aim of retaining prudent margins to avoid insolvency. Other factors which are relevant to market risk strategies are meeting the regulatory duty to Treat Customers Fairly and the desire to optimise investment performance

In order to control market risk, assets are chosen, where relevant, to match underlying liability characteristics such as duration, inflation (e g index-linked) and currency The investment guidelines for each portfolio document the necessary constraints to help control the impact of price risks on the portfolio The Board sets appetite for market risk for each of the different asset classes taking account of the risk appetite set by the Resolution Board 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 market risk policy sets out how market risk should be managed and is primarily owned by the Chief Investment Officer. As part of the annual refresh of risk policies, the Chief Risk Officer, supported by the Head of Financial Risk, is responsible for ensuring that the policy is reviewed.

The Market Risk Policy is further embedded in the business through the operation of Investment Limits These specify the permitted asset classes for investment, the limits for exposures to asset classes including bond exposures, cash exposures, derivative exposures, equity and other exposure and also limits in relation to interest rate risk, inflation risk, foreign exchange risk, implied and equity and interest rate volatility The relevant limits are also reflected in investment guideline documents which are maintained for each fund

To support the setting of Investment Limits, the Asset and Liability Management ("ALM") function is responsible for carrying out strategic asset allocation studies on each block of business within a three year life cycle This review considers risk appetite, capital requirements and other metrics.

The Investment Oversight Committee which is a sub-committee of the FLG Board oversees investment policy and strategy, which the Group controls primarily through the use of investment fund mandates Day-to-day implementation of investment policy and strategy is managed by AXA Investment Managers UK Limited ("AXA IM").

Mandates are set for each fund within each of the insurance legal entities within the Group taking account of the relevant factors outlined above

The Group manages market risk attaching to assets backing specific policyholder liabilities and to assets held to deliver income and gains for the shareholder Within the unit-linked funds and with-profits funds, the Group manages market risk so as to provide a return in line with the expectations of policyholders The principal objective for shareholder assets is to manage them so that they meet the capital requirements of the Group, and support its future strategic and operational objectives

With-profits funds

The investment strategy of the with-profits funds is set out in the PPFM. The overall strategy is to invest in a broad range of asset types with the intention of providing the best investment return for the policyholders subject to the nature of the funds and its liabilities The financial strength of the funds influences the proportion invested in equities and properties

Non-profit funds

The investment strategy adopted aims to ensure that even under extreme investment conditions there are sufficient assets to back the liabilities and the value of assets remains broadly aligned to the value of liabilities This means that the duration of fixed interest assets is closely matched with the liabilities

Shareholder funds

Shareholder funds invest in cash designed to generate a return over that available on cash deposits at low level of price risk

Derivatives are used to facilitate efficient portfolio management where their use is provided for in the relevant fund mandates

In order to monitor market risk, liability and asset profiles are subject to annual price risk stress and scenario testing to examine the impact of significant market movements on shareholders' and policyholder funds and the implications for supporting capital requirements.

Valuation risk

Financial instruments held at fair value are valued based on a range of methodologies set out in Note 1

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 asset-backed securities), 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/open ended investment companies

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

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below

	2012			
	Level 1	**Level 2**	**Level 3**	**Total Fair Value**
Financial assets	**£000**	**£000**	**£000**	**£000**
Shares and other variable yield securities and holdings in collective investment schemes	4,979,457	532,400	835	**5,512,692**
Debt securities and other fixed income	1,434,506	77,147	5,752	**1,517,405**
Loans secured by mortgages	-	-	25,753	**25,753**
Other loans to policyholders	-	-	4,762	**4,762**
Deposits with credit institutions	-	48,224	-	**48,224**
Derivative assets	12,723	39,694	-	**52,417**
Cash	-	6,066	-	**6,066**
Total financial assets at fair value	**6,426,686**	**703,531**	**37,102**	**7,167,319**
Financial liabilities				
Derivative liabilities	**(804)**	**(7,353)**	**-**	**(8,157)**

	2011			
	Level 1	Level 2	Level 3	Total Fair Value
Financial assets	£000	£000	£000	£000
Shares and other variable yield securities and holdings in collective investment schemes	5,046,792	186,772	2,188	5,235,752
Debt securities and other fixed income	1,255,434	315,989	-	1,571,423
Loans secured by mortgages	-	-	26,543	26,543
Other loans to policyholders	-	-	5,037	5,037
Deposits with credit institutions	-	49,440	-	49,440
Derivative assets	16,493	39,949	-	56,442
Cash	-	10,175	-	10,175
Total financial assets at fair value	6,318,719	602,325	33,768	6,954,812
Financial liabilities				
Derivative liabilities	(2,716)	(8,831)	-	(11,547)

During the period, equities and debt securities amounting to £247 3m and £3 9m respectively were transferred from Level 1 to Level 2. Further transfers of equities and debt securities amounting to £5.4m and £218 4m respectively were made from Level 2 to Level 1 These changes arose from market activity and the changes in liquidity assessments. There were no significant changes between Level 1 and Level 2 for other financial assets

The reconciliation of movement in financial instruments categorised as level 3 is as follows

	2012					
	At 1 January 2012	Total gains / (losses) in P&L	Purchases	Sales	Transfers (to) / from Level 1 & 2	**At 31 December 2012**
	£000	£000	£000	£000	£000	**£000**
Financial Assets						
Shares and other variable yield securities and holdings in collective investment schemes	**2,188**	(295)	439	(1,598)	101	**835**
Debt securities and other fixed income	-	(54)	2,433	-	3,373	**5,752**
Loans secured by mortgages	**26,543**	(790)	-	-	-	**25,753**
Other loans to policyholders	**5,037**	-	-	(275)	-	**4,762**
Total	**33,768**	**(1,139)**	**2,872**	**(1,873)**	**3,474**	**37,102**

	2011					
	At 1 January 2011 £000	Total gains / (losses) in P&L £000	Purchases £000	Sales £000	Transfers (to) / from Level 1 & 2 £000	At 31 December 2011 £000
Financial Assets						
Shares and other variable yield securities and holdings in collective investment schemes	-	-	41	-	2,147	2,188
Loans secured by mortgages	26,737	19	-	(213)	-	26,543
Other loans to policyholders	5,447	-	-	(410)	-	5,037
Total	32,184	19	41	(623)	2,147	33,768

Interest rate risk

The Company is exposed to fair value interest rate risk where changes to interest rate result in changes to fair values rather than cash flows Bond related performance benchmarks within fund mandates are generally set so that asset profiles and hence interest rate risk is minimised

Management of interest rate risk for the Company investments managed by AXA IM is largely undertaken by ALM, which is responsible for monitoring and managing net asset-liability interest rate risk across all of the Group

Currency risk

The Company is exposed to currency risk in respect of portfolios denominated in other currencies 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. Mitigation of this risk is achieved by matching the liabilities with assets in the same currency

For unit linked contracts, the currency risk is borne by the policyholder

Business is transacted mainly in the United Kingdom and all business is denominated in sterling except for the Irish Life reinsurance arrangement which is denominated in Euros (and for which no new business is written) The amount included in the long-term business provision relating to Irish Life is £10 5m (2011 £13 5m) The currency exposure on this business is managed through asset and liability matching such that the net currency risk is not material

The Company also has a loan to 787 Holdings LLC which is secured on property and denominated in US dollars The amount included in other financial investments in respect of this loan is £25 8m (2011 £26 5m) The currency exposure on this loan is mitigated by a cross currency swap.

Credit risk

Credit risk can be defined as the risk of capital or income loss resulting from counterparty default or issuer credit downgrades. Credit risk can arise from investment related assets or from non-investment related assets Policies exist for the control of investment related credit risk and for non-investment related items All financial assets are considered to be of an acceptable quality in accordance with company policy

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 AXA IM In their decision making, AXA IM 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

Derivatives purchased over the counter have the potential to expose the Company to substantial credit risk but this risk is significantly reduced through collateral arrangements with counterparties. The ALM function is responsible for recommending derivative strategies to the Board, and assisting other teams to put into place the appropriate internal management processes The Company will endeavour only to transact over the counter derivatives with highly rated counter parties.

Collateral is received from the derivative counterparty if the sum of all contracts held with the counterparty are in-the-money (i e is an asset to the Company). The Company has a legal right to this collateral if the counterparty does not meet its obligations but has no economic benefit from holding the assets and the counterparty may, at any time, substitute the collateral delivered with another asset of the same value and quality. It is repayable if the contract terminates or the contract's fair value falls Contractual agreements between the Company and each counterparty exist to protect the interests of each party, taking into consideration minimum threshold, asset class of collateral pledged and the frequency of valuation At 31 December 2012 the fair value of such collateral held was £32 3m (2011 £33 6m) This reduced the exposure to these financial instruments by £31 7m (2011 £30 7m) leaving a remaining exposure to these derivative assets of £nil (2011 £0 2m). No collateral received from counterparties has been sold or repledged

For investment related items, credit risk is actively accepted in anticipation of the potential returns to be made on the investments The level of credit risk to which the portfolios are exposed is controlled to limit the exposure to any one counterparty and, in the case of fixed income and cash instruments, to limit total exposure to issuers with lower credit ratings

An indication of the Company's exposure to credit risk is the credit quality of the investments that it holds The Company is most exposed to credit risk on debt securities The below table provides information regarding the external credit ratings of debt securities Any unrated debt securities are included in the "below BBB" category

	2012		2011	
Ratings	**£000**	**%**	£000	%
AAA	**923,294**	**60.9**	1,041,501	66 3
AA	**141,280**	**9.3**	39,578	2 5
A	**251,519**	**16.6**	259,295	16 5
BBB	**190,036**	**12.5**	217,862	13 9
Below BBB	**11,276**	**0.7**	13,187	0 8
Total	**1,517,405**	**100.0**	1,571,423	100 0

The total amount of financial assets exposed to credit risk, which includes debt securities, deposits with credit institutions, reinsurers' share of technical provisions, investments in funds of other insurance companies, loans, receivables and cash is £4,108 5m (2011 £4,113 2m)

Of £7,231 5m (2011 £7,025 2m) of financial assets held by the Company at the balance sheet date £7,212 4m (2011 £7,005 8m) is held at fair value through profit or loss, and therefore reflects any changes in value The remaining £19 1m (2011 £19 4m) are held at amortised cost, and of those assets no amounts are past due but not impaired, and £nil (2011 £nil) have been impaired All financial assets that are neither past due nor impaired are considered to be of acceptable credit quality in accordance with company policy

The exposure of the Company to the governments of Portugal, Italy and Spain in shareholder and non-profit funds at 31 December 2012 and 2011 is set out in the table below Where the Company holds securities issued by financial companies, it has considered the Company's financial strength and the ability of the domicile government to provide financial support in the event of stress There is no exposure to Greece or Ireland

	2012			2011		
	Govt debt £000	**Corporate debt £000**	**Total £000**	Govt debt £000	Corporate debt £000	Total £000
Portugal	-	-	-	-	2,233	2,233
Italy	-	**8,808**	**8,808**	-	11,988	11,988
Spain	-	**20,616**	**20,616**	7,841	6,939	14,780
Total	-	**29,424**	**29,424**	7,841	21,160	29,001

Non-investment items which generate credit risk generally arise as a by-product of the Company's insurance operations Items covered by the non-investment credit risk policy include balances with external reinsurers, loans and advances to intermediaries, commission debts, policyholder premium debts, policyholder loans and other operational debts. Exposure to credit risk is controlled via the operation of a number of processes including external reinsurer selection and monitoring procedures, requirements for security over loans, and the active monitoring of premium debt.

At 31 December 2012, the Company has invested £2 1bn (2011 £2 0bn) of the assets backing its pension unit-linked liabilities with external providers of investment funds ("fund reinsurers") The risk of default by the fund reinsurers is small but the size of the exposure is significant The biggest exposure to a fund reinsurer at 31 December 2012 is £1 6bn (2011 £1 4bn), with Blackrock Advisors (UK) Limited Exposures to the fund reinsurers are monitored on a monthly basis

The Company has entered into a floating charge agreement with each of the fund reinsurers whereby the Company ranks (as a reinsurance policyholder) equally with direct policyholders.

The Company has developed processes to formally examine all reinsurers before entering into new business arrangements with them Counterparty limits are set for each reinsurer and these limits are monitored

The Company reinsures most of its annuity liabilities The reinsured reserve under this treaty as at 31 December 2012 was £386 0m (2011 £391 6m) The credit risk has been significantly mitigated, in respect of this transaction, by the use of collateralised security that would allow the Company to recover the bulk of the amounts paid to the reinsurer to cover future annuity liabilities, in the event of the insolvency of the reinsurer

At the reporting date there were no other significant concentrations of credit risk The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including reinsurance assets in the balance sheet plus the credit risk on the fund reinsurers

Liquidity and cash flow risk

Liquidity or cash flow risk is defined as the risk that the Company, irrespective of solvency and profitability, may not have sufficient available cash (or near cash assets or funding facilities) to enable the Company to meet policyholder, government, regulatory or operational obligations as they fall due This risk could arise as a result of illiquid asset holdings, inappropriate asset / liability matching, or inaccurate assessments of potential operating liquidity requirements resulting in insufficient short-term (including intra-day) and longer term liquidity

Liquidity risk in the Company is controlled via the requirements of the Group that business units carry out periodic liquidity reviews including stress testing to ensure that sufficient liquidity exists in the business These reviews incorporate the results of appraisals by the investment managers who monitor liquidity of the investment portfolios on an ongoing basis The approach is reviewed and updated to reflect current and expected market conditions. Operating cash flow is also monitored on a daily basis.

Assets with no stated maturity are available to address liquidity requirements across all periods

Contractually all investment contract liabilities are repayable on demand and would fall into the "less than 1 year" category if analysed on that basis The maturity analysis below shows the expected maturity of liabilities on this basis

Maturity analysis	**Less than 1 year**	**1 – 5 years**	**Over 5 years**	**Total**
2012	**£000**	**£000**	**£000**	**£000**
Financial liabilities				
Investment contract liabilities	**5,337,435**	**-**	**-**	**5,337,435**
Derivative Liabilities	**233**	**2,895**	**5,020**	**8,148**
Creditors	**72,359**	**-**	**-**	**72,359**
Total	**5,410,027**	**2,895**	**5,020**	**5,417,942**

Maturity analysis	Less than 1 year	1 – 5 years	Over 5 years	Total
2011	£000	£000	£000	£000
Financial liabilities				
Investment contract liabilities	5,083,106	-	-	5,083,106
Derivative Liabilities	2,853	2,590	6,103	11,546
Creditors	51,203	-	-	51,203
Total	5,137,162	2,590	6,103	5,148,855

The Company has financial liabilities which contain a discretionary participation feature arising as a result of investment within the Company's with-profits fund The element of the carrying value of these instruments linked to the investment in the with-profits funds is disclosed in the table above at the realistic valuation required under FRS 27 (Life Assurance) The Company cannot measure reliably the fair value of these financial liabilities due to the lack of a reliable basis to measure the supplemental discretionary returns arising on with-profits contracts and because there is not an active market for such instruments

Sensitivities

The Company uses a number of sensitivity based risk management tools to understand the volatility of earnings and capital management requirements, and to manage its capital efficiently The key management metric measuring the risk adjusted value of the business and tracking its evolution over time is Market Consistent Embedded Value ("MCEV")

The calculation methodology uses a "market-consistent" approach to setting asset return assumptions Each cash flow is discounted at an appropriate discount factor Mechanically, this can be described as assuming that all assets will earn the risk-free rate (based on UK swap curve) adjusted to include an illiquidity premium of 75bps on annuity business.

The major assumptions include

- "Best estimate" demographic assumptions based on recent experience and where , appropriate long term trends

- Expense assumptions are based on experience which has been adjusted for non-recurring expenses and one-time strategic spending The impact on direct expenses of service agreements with third party providers is also taken into account in calculations,
- Some benefit from future mortality improvement is included, while annuity business includes an allowance for the costs of longevity increasing in all markets, and
- Non-financial risks are allowed for based on Individual Capital Assessment ("ICA") capital requirements

The sensitivity of the MCEV has been calculated for changes in major economic assumptions The sensitivities are applied one at a time rather than in combination

The sensitivities monitored are set out below:

Upward parallel shift of 100 basis points in reference interest rates

This simulates a sudden shock to the initial conditions This means changes to 1) the current market values of fixed-interest assets, with related possible changes to projected capital gains/losses and/or fee revenues, 2) future reinvestment rates for all asset classes, and 3) risk-discount rates Inflation rates are not changed in this analysis Policyholder and management behaviour is adjusted following normal behavioural modelling, and may not be wholly consistent with these conditions.

Downward parallel shift of 100 basis points in reference interest rates

This is the same as above but with a shift downward. Where the shift of 100 basis points would drop rates below 0%, the calculations assume a reference rate of 0%.

10% higher value of equity and property markets at the start of the projection

This simulates a shock to the initial conditions for equities and properties This means changes to current market values of equities and properties, with related possible changes to projected capital gains/losses and/or fee revenues Policyholder and management behaviour is adjusted to be consistent with these conditions

10% lower value of equity and property markets at the start of the projection

This is the same as above but a decrease

10% reduction of the value of sterling against other currencies

This simulates a shock to the initial conditions It is calculated using the equity sensitivities with the related possible changes to projected capital gains/losses and/or fee revenues Policyholder and management behaviour is adjusted to be consistent with these conditions

10% increase of the value of sterling against other currencies

This is the same as above but with an increase in the value of overseas assets

Widening of credit spreads by 100bps

This simulates a widening to the spreads of corporate bonds held by the company This means changes to the value of corporate bond assets (held in free surplus and required capital) are modelled For annuities, the illiquidity premium of 75bps is stressed by an increase of 40bps as an approximate allowance for the impact of a change in credit spreads on annuity business Policyholder and management behaviour is adjusted following normal behavioural modelling, and may not be wholly consistent with these conditions

Narrowing of credit spreads by 100bps

This is the same as above but with a narrowing of the spreads

The table below provides a summary of the estimated impact on MCEV of these sensitivities

	2012 £m	**2012 %**	2011 £m	2011 %
Base calculated MCEV	**317**	**100**	315	100
Estimated upward parallel shift of 100 bp in risk free rates	**(5)**	**(2)**	(31)	(10)
Estimated downward parallel shift of 100 bp in risk free rates	**5**	**2**	34	11
10% higher value of equity and property markets at start of projection	**8**	**3**	10	3
10% lower value of equity and property markets at start of projection	**(8)**	**(3)**	(10)	(3)
10% reduction of the value of sterling against other currencies	**(1)**	**-**	(2)	(1)
10% increase of the value of sterling against other currencies	**1**	**-**	2	1
Widening of credit spreads by 100bps	**(13)**	**(4)**	(19)	(6)
Narrowing of credit spreads by 100bps	**17**	**5**	23	7

3. SEGMENTAL ANALYSIS

In the opinion of the directors the Company operates in one business segment, being that of long-term insurance business principally in the United Kingdom

(i) Gross premiums written and investment contract deposits

	2012 £000	2011 £000
Direct insurance	**86,172**	86,592
Reinsurance inwards	**358**	894
Gross premiums written as reported in the technical account	**86,530**	87,486
Non-participating investment contract deposits		
Direct	**350,456**	1,242,785
Reinsurance inwards	**82,182**	209,088
Non-participating investment contract deposits	**432,638**	1,451,873
Gross premiums written and non-participating investment contract deposits	**519,168**	1,539,359

		Gross direct premiums written 2012 £000	Gross direct premiums written 2011 £000
Pensions	Non-participating	**47,472**	40,363
	Participating	**380**	1,500
Life	Non-participating	**16,564**	15,439
	Participating	**20,922**	24,502
PHI	Non-participating	**1,071**	5,215
	Participating	**121**	467
		86,530	87,486
	Regular premiums	**39,738**	46,951
	Single premiums	**46,792**	40,535
		86,530	87,486
	Individual premiums	**68,880**	86,358
	Premiums under group contracts	**17,650**	1,128
		86,530	87,486

		Non-participating investment contracts 2012 £000	2011 £000
Pensions	Non-participating	**432,638**	1,389,901
Life	Non-participating	**-**	61,972
		432,638	1,451,873
	Regular premiums	**318,498**	295,133
	Single premiums	**114,140**	1,156,740
		432,638	1,451,873
	Individual premiums	**187,488**	824,298
	Premiums under group contracts	**245,150**	627,575
		432,638	1,451,873

(ii) Gross new business premiums and new business investment contract deposits

	2012 £000	2011 £000
Direct	**195,856**	1,047,069
Reinsurance inwards	**-**	209,747
Gross new business premiums written and non-participating investment contract deposits on new business	**195,856**	1,256,816

Gross direct premiums written and non-participating investment contract deposits

		Regular 2012 £000	Regular 2011 £000	Single 2012 £000	Single 2011 £000
Pensions	Non-Participating	**62,436**	59,541	**133,125**	925,327
	Participating	**-**	-	**295**	229
		62,436	59,541	**133,420**	925,556
Life	Non-Participating	**-**	-	**-**	61,972
	Participating	**-**	-	**-**	-
		-	-	**-**	61,972
		62,436	59,541	**133,420**	987,528

As there is no outward reinsurance relating to new business the analyses of gross and net are the same

In classifying new business premiums and deposits, the following bases of recognition have been adopted

- Recurrent single premium contracts, including Department of Work and Pensions rebates on certain pension products, are classified as periodic where they are deemed likely to renew at or above the amount of initial premium
- Increments under existing policies are classified as new business premiums or deposits
- Funds at retirement under individual pension contracts left with the Company and transfers from group to individual contracts are classified as new business single premiums and, for accounting purposes, are included in both claims incurred and as single premiums within gross premiums written
- Regular premiums or deposits received other than annually are reported on an annualised basis

	2012	2011
	£000	£000
(iii) Reinsurance balance – credit balance	**20,125**	42,143

The balance represents the aggregate total of all of those items included in the technical account for long-term business which relate to reinsurance transactions including reinsurance premiums, claims, commission and share of technical provisions

4. INVESTMENT INCOME

	Long-term business technical account		Non-technical account	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
Income from other financial investments				
Income on assets at fair value through profit and loss	**159,219**	250,701	**606**	1,629
Income from group companies	**332**	330	**-**	-
Income from land and buildings	**3,265**	3,519	**-**	719
Gains on the realisation of investments	**179,134**	553,961	**1,681**	1,728
	341,950	808,511	**2,287**	4,076
Investment expenses and charges including interest				
Investment management charges	**(2,833)**	(14,393)	**(360)**	(25)
Interest payable	**(271)**	(783)	**-**	-
Losses on the realisation of investments	**-**	(161,795)	**-**	(900)
Transaction costs on investment purchases	**(2,123)**	(2,314)	**-**	-
	(5,227)	(179,285)	**(360)**	(925)
Net unrealised gain / (losses) on investments	**329,237**	(1,088,763)	**(1,540)**	495
Total investment return	**665,960**	(459,537)	**387**	3,646

Investment income includes changes in the fair value of financial assets estimated using a valuation technique of £0 2m (2011 £24.0m)

	Long-term business technical account		Non-technical account	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
Included in the total investment return are net gains / (losses) on financial assets at fair value through profit and loss				
Assets designated upon initial recognition	**514,993**	(727,097)	**141**	1,323
Assets held for trading	**(6,622)**	30,500	**-**	-
Total net realised and unrealised gains / (losses) included in investment return	**508,371**	(696,597)	**141**	1,323
Interest (expense) / income for financial liabilities not at fair value through profit and loss				
Interest income/ (expense) in respect of investment contracts	**(437,331)**	622,871	**-**	-
Interest income / (expense) in respect of the with-profits element of investment contracts with DPF	**6,934**	11,153	**-**	-
Interest expense payable on financial liabilities	**(271)**	(783)	**-**	-
Total interest (expense) / income for financial liabilities not at fair value through profit and loss	**(430,668)**	633,241	**-**	-

Interest income / (expense) in relation to financial liabilities in respect of unit-linked investment contracts is included in the Technical account under the change in technical provision for linked liabilities

Interest income / (expense) in relation to financial liabilities in respect of investment contracts and with-profits investment contracts is included in the Technical account under the change in long-term business provision

5. OTHER TECHNICAL INCOME, NET OF REINSURANCE

	2012 £000	2011 £000
Fees on unit-linked investment contracts	**23,992**	72,145
Other Income and Charges	**3,927**	13
	27,919	72,158

6. BONUSES

The aggregate of the bonuses added to policies in the year was £19 7m (2011 £22 3m)

7. NET OPERATING EXPENSES

	Long-term business technical account	
	2012 £000	2011 £000
Acquisition costs	**9,027**	38,628
Change in deferred acquisition costs	**-**	(10,926)
Change in financial liability in respect of trail commission	**-**	(3,619)
Administrative expenses	**47,544**	73,299
	56,571	97,382

Administrative expenses include £2 0m (2011· £27 7m) relating to net commissions on life and pension business

8. TAXATION

	Long-term business technical account		Non-technical account	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
UK corporation tax:				
UK corporation tax	**(2,300)**	(8,049)	**(229)**	(966)
Adjustments in respect of prior periods	**(449)**	1,306	**-**	-
Total UK corporation tax	**(2,749)**	(6,743)	**(229)**	(966)
Withholding tax written off	**(689)**	(4,752)	**-**	-
Tax credit attributable to balance on long-term business technical account	**-**	-	**(703)**	4,795
Total current tax	**(3,438)**	(11,495)	**(932)**	3,829
Deferred tax:				
Origination and reversal of timing differences	**(35,601)**	18,829	**-**	(243)
Total deferred tax	**(35,601)**	18,829	**-**	(243)
Tax credit / (charge) on loss on ordinary activities	**(39,039)**	7,334	**(932)**	3,586

UK corporation tax shown under the technical account is charged on the basis applicable to life assurance companies Corporation tax has been calculated at a rate of 24 5% (2011 26 5%) on shareholders' profits and 20% (2011 20%) on policyholders' income Deferred tax has been calculated at rates expected to apply on reversal of the relevant timing differences UK corporation tax shown under the non-technical account is charged at a rate of 24 5% (2011 26 5%)

Factors affecting the tax charge

The tax assessed for the year is lower (2011 lower) than the standard rate of corporation tax in the UK (24 5%) (2011 26 5%) The differences are explained below

	Non-technical account	
	2012	2011
	£000	£000
Profit/(Loss) on ordinary activities before tax	**36,381**	(76,630)
Profit/(Loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 24 5% (2011 26 5%)	**(8,913)**	20,307
Difference between effective and standard rate in balance on long-term business account	**7,981**	(16,478)
Expenses not deductible for tax purposes	**-**	(243)
Current and deferred tax credit/(charge) for the period	**(932)**	3,586

Finance Act 2012 enacted the corporation tax rate reduction to 23% with effect from 1 April 2013, the effect of which is included within the closing deferred tax liabilities of £13 6m A subsequent reduction to 21% from 1 April 2014 was announced in the Chancellor's Autumn Statement of 5 December 2012 and this will be dealt with by future legislation The effect on the Company's net assets from the further 2% reduction in the rate is estimated as approximately £3k and will be recognised as the legislation is substantively enacted.

9. AUDITOR'S REMUNERATION

	2012	2011
	£000	£000
Fees payable to Company's auditor	**65**	130
Audit-related assurance services	**70**	40
	135	170

10. REMUNERATION OF DIRECTORS AND EMPLOYEES

The directors of the Company are also directors of the holding company and/or fellow subsidiaries The total remuneration received by the directors are detailed below, all of which was paid by Friends Life Management Services Limited or Friends Life Services Limited for their services to the Group The directors do not believe that it is practicable to apportion this amount between their services as directors of the company and their services as directors of the holding and fellow subsidiary companies Amounts for annual bonus payments to the directors for the year ended 2011 were not agreed by the Resolution Limited Remuneration Committee until after the signing of the Company's accounts and were therefore not included in the 2011 emoluments but are included in the 2012 emoluments Amounts for annual bonus payments to the directors for the year ended 2012 will be agreed by the Resolution Limited Remuneration Committee after the signing of the Company's accounts and therefore are not included in the 2012 emoluments below but will be included in the 2013 emoluments.

	2012	2011
Remuneration (including awards under long term incentive schemes)	3,560,885	3,781,000
Pension contributions/Contributions to money purchase benefit schemes	83,881	10,057
Number of directors accruing benefits under defined benefit schemes	None	4

Mr A M Parsons, Mr D.E Hynam and Ms E B Bourke were directors of FLG during the year Their emoluments, which relate to their services to the Group as a whole, are also disclosed in the financial statements of the ultimate holding company, Resolution Limited.

Highest paid director remuneration

	2012	2011
Remuneration (including awards under long term incentive schemes)	1,005,007	1,363,000
Pension contributions/Contributions to money purchase benefit schemes	17,609	Nil
Accrued pension under defined benefit schemes	Nil	3,000

The total remuneration payable to directors includes £1,022,616 in respect of the highest paid director, of which £nil relates to long-term incentive schemes This is the total of the costs incurred by the Group in respect of the highest paid director due to it being impractical to isolate the element of total remuneration relating to the Company

Employees

The Company has no employees during the year (2011 none) The costs of staff are borne by the service company FLS The service companies levy management fees on the Company based upon standard rates and volumes of business processed It is not therefore possible to identify separately the amounts of staff costs within the management fees Staff costs are disclosed in the accounts of FLS

11. LAND AND BUILDINGS

	Investment properties £000
As at 1 January	**4,275**
Revaluations	**430**
Disposals	**(1,680)**
As at 31 December	**3,025**

The cost of investment properties was £3 8m (2011 £5 5m)

All land and buildings are held as freehold and are valued every year for the purpose of the financial statements at open market basis The valuation was made at 1 December 2012 by GVA, a firm of independent Chartered Surveyors

12. INVESTMENTS IN GROUP UNDERTAKINGS AND PARTICIPATING INTERESTS

The amount in the Company's balance sheet for investments in group undertakings and participating interests is

	Carrying value		Cost	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
Subsidiary holdings	**1,398**	1,397	**-**	-

Subsidiary holdings are stated at current value The assessment of current value in 2012 was based upon the net asset value of the subsidiary, consistent with the treatment in 2011

The Company's investments are wholly-owned, direct subsidiary undertakings of the Company All holdings are of fully paid ordinary shares with full voting rights All principal subsidiaries are incorporated and registered in England and Wales

Name	**Nature of business**
Investments of the Company's long-term fund	
Dextra Court Properties Limited ("DCP")	Property investment
Investments of the Company's shareholders' fund	
Friends Life WF Limited (formerly Winterthur Finance Limited)	Lending

13. SHARES AND OTHER VARIABLE YIELD SECURITIES AND HOLDINGS IN COLLECTIVE INVESTMENT SCHEMES

	2012 £000	2011 £000
UK listed	**154,827**	155,692
Other listed	**70,910**	66,934
Unlisted	**192,798**	140,764
	418,535	363,390

Included in the current year balance for unlisted investments is £192 8m (2011 £140 8m) relating to an investment in an AXA IM collective investment fund, which is a cash management fund

14. DEBT SECURITIES AND OTHER FIXED INCOME SECURITIES

	2012 £000	2011 £000
UK listed	**752,395**	785,846
Other listed	**338,327**	346,362
	1,090,722	1,132,208

15. OTHER FINANCIAL INVESTMENTS

Financial Assets	Carrying Value		Cost	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
Financial assets at fair value through profit and loss				
Designated at initial recognition	**7,159,935**	6,949,369	**6,124,893**	6,227,254
Derivative financial instruments – held for trading	**52,417**	56,442	**17,735**	22,511
	7,212,352	7,005,811	**6,142,628**	6,249,765
Loans and receivables, at amortised costs	**19,151**	19,390	**17,753**	17,993
Total financial assets	**7,231,503**	7,025,201	**6,160,381**	6,267,758

These amounts are included in the balance sheet as follows

	Carrying Value		Cost	
	2012	2011	**2012**	2011
Other financial investments	**£000**	£000	**£000**	£000
Shares and other variable yield securities and holdings in collective investment schemes (Note 13)	**418,535**	363,390	**402,298**	367,124
Debt securities and other fixed income securities (Note 14)	**1,090,722**	1,132,208	**1,010,781**	1,021,157
Derivative assets (Note 16)	**51,572**	56,415	**17,735**	22,511
Loans secured by mortgages	**25,753**	26,543	**20,632**	20,861
Loans secured by insurance policies	**4,762**	5,037	**4,762**	5,037
Deposits with credit institutions	**7,568**	13,964	**7,568**	13,964
Total other financial investments	**1,598,912**	1,597,557	**1,463,776**	1,450,654
Linked assets (see Note 17)	**5,607,374**	5,398,079	**4,672,786**	4,788,936
Receivables	**17,125**	17,407	**17,125**	17,407
Investment in group undertakings (Note 12)	**1,398**	1,397	**-**	-
Reinsurance asset	**628**	586	**628**	586
Cash	**6,066**	10,175	**6,066**	10,175
Total financial assets	**7,231,503**	7,025,201	**6,160,381**	6,267,758

Total financial assets	**7,231,503**	7,025,201	**6,160,381**	6,267,758
Other assets				
Land and buildings (Note 11)	**3,025**	4,275	**3,831**	5,500
Present value of future profits on non-profit business written in the with-profits fund	**17,400**	19,859	**17,400**	19,859
Reinsurers share of technical provisions	**401,065**	410,993	**401,065**	410,993
Debtors	**38,283**	58,577	**38,283**	58,577
Total assets	**7,691,276**	7,518,905	**6,620,960**	6,762,687

16. DERIVATIVES VALUED IN ACCORDANCE WITH FAIR VALUE ACCOUNTING RULES

The Company enters into derivative contracts to manage the market risk and credit risk arising from its investment activities

The nature and extent of derivative instruments held at 31 December 2012 are as follows

Notional and fair value of derivatives

Net assets	**2012 Notional Amount £000**	**2012 Fair Value Asset £000**	**2012 Fair Value Liability £000**	2011 Notional Amount £000	2011 Fair Value Asset £000	2011 Fair Value Liability £000
Swaptions	**96,173**	**695**	**-**	109,914	1,064	-
Interest rate swaps	**231,484**	**38,445**	**(6,119)**	245,600	36,613	(6,383)
Credit default swaps	**86,600**	**555**	**(1,234)**	96,640	2,272	(249)
Cross currency swaps	**18,695**	**-**	**(785)**	18,695	-	(2,199)
Futures	**80,160**	**139**	**(11)**	95,023	-	(2,716)
Options	**129,752**	**11,738**	**-**	167,224	16,466	-
Total	**642,864**	**51,572**	**(8,149)**	733,096	56,415	(11,547)

Assets held to cover linked liabilities	**2012 Notional Amount £000**	**2012 Fair Value Asset £000**	**2012 Fair Value Liability £000**	2011 Notional Amount £000	2011 Fair Value Asset £000	2011 Fair Value Liability £000
Futures and options	**33,617**	**845**	**(8)**	2,435	27	-

17. ASSETS HELD TO COVER LINKED LIABILITIES

	Carrying Value		Cost	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
Assets held to cover linked liabilities	**5,607,374**	5,398,079	**4,662,403**	4,788,936

The carrying value of linked assets comprises

	2012	2011
	£000	£000
Equity	**3,006,010**	2,850,165
Debt securities	**426,683**	439,215
Land and buildings	**34,901**	38,164
Deposits with credit institutions	**40,656**	35,476
Debtors and accrued income	**20,523**	14,783
Derivative assets	**845**	27
Investments in funds of other insurance companies	**2,088,147**	2,022,197
Total assets	**5,617,765**	5,400,027
Creditors	**(10,383)**	(1,948)
Derivative liabilities	**(8)**	-
Net assets	**5,607,374**	5,398,079

These investments are measured at fair value through profit and loss As disclosed in Note 2, the financial risks associated with these contracts are borne by policyholders

An analysis of total financial assets, including assets held to cover linked liabilities is provided in Note 15 "Other financial investments"

18. CLAIMS OUTSTANDING

As a result of deposit accounting for insurance and investment contracts with DPF, the change in the provision for claims recorded in the technical account for long-term business does not equal the movement in the claims outstanding. The differences are explained below

	Gross Amount		Reinsurers' Share	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
These amounts are included in the technical account as follows:				
Change in the provision for claims	**(3,229)**	(3,630)	**(2,873)**	1,897
Change in the provision for claims arising from deposit accounting	**(105)**	7,946	**-**	-
Change in provision for claims outstanding on a consistent basis with balance sheet classification	**(3,334)**	4,316	**(2,873)**	1,897
Part VII transaction	**-**	780	**-**	-
	(3,334)	5,096	**(2,873)**	1,897
Balance sheet movement in provision for claims outstanding	**(3,334)**	5,096	**(2,873)**	1,897

19. DEBTORS ARISING OUT OF DIRECT INSURANCE OPERATIONS

	2012	2011
	£000	£000
Amounts due from policyholders	**11**	10

20. OTHER DEBTORS

	2012	2011
	£000	£000
Loans to other group undertakings	**2,719**	2,838
Amounts due from other group undertakings – other amounts	**28**	55
Amounts owed by intermediaries	**1,026**	16
Taxation recoverable	**28,743**	29,046
Other debtors	**5,756**	4,583
	38,272	36,538

Loans to other group undertakings include a loan by the non-profit fund to DCP, a subsidiary of the Company, in the amount of £2.7m (2011 £2 8m) The loan is repayable on demand with twelve months notice, and interest is payable at a rate of 6% The loan is secured by way of a first all monies legal charge over the freehold property owned by DCP The carrying value of the loan is a reasonable approximation of its fair value

21. CALLED UP SHARE CAPITAL

	2012 £000	2011 £000
Allotted and fully paid		
27,400,000 ordinary shares of £1 each	**27,400**	27,400

22. RESERVES

	Capital contribution £000	Revaluation reserve £000	Profit and loss account £000	Total £000
At 1 January 2012	154,000	1,397	(64,235)	91,162
Retained profit for the financial year	-	-	35,449	35,449
Revaluation of investments in group undertakings	-	1	-	1
Capital contribution received	5,000	-	-	5,000
At 31 December 2012	159,000	1,398	(28,786)	131,612

Distributable profits for insurance companies writing long-term business are determined after taking into account the deficit in any funds within the Company calculated under prudential reporting requirements The amount of distributable profits is calculated in accordance with the Companies Act 2006 requirements, taking into account only realised profits in the shareholders' fund, the cost of bonus transferred from the with-profits fund and deducting any deficits on long term funds

As at 31 December 2012 the capital contribution and profit and loss account include £59 7m (2011 £48 0m) which is distributable

23. TECHNICAL PROVISIONS

With-profits fund

The Company has one UK with-profits fund

For with-profits contracts, the long-term business provision is calculated in accordance with the FSA's 'realistic' liability regime In particular, provision is made for all declared and future bonuses estimated in a manner consistent with the PPFM

The liabilities are based on the aggregate value of policy asset shares reflecting the premiums paid, investment return earned and expenses incurred in respect of each policy (the "with-profits benefit reserve") The liabilities also include allowances for

- the time and intrinsic value of options and guarantees and for possible future management actions such as changes to bonus rates, and
- other differences between the value of policy payouts (including future bonuses) and asset shares, due to either planned enhancements to payouts or smoothing practice.

These allowances are determined using a market-consistent, risk-neutral, stochastic model simulating future investment returns and bonuses.

The liabilities include allowance for the shareholders' share of future bonuses At 31 December 2012 this amounted to £16 0m (2011 £10 8m) Under FRS 27, this amount is excluded from the liabilities and forms part of the FFA.

The Court Schemes covering the governance of the with-profits fund requires all of the surplus assets held in the Company's with-profits fund to be distributed Surplus assets in the fund are distributed as enhancements to the with-profits benefits reserve Similarly, subject to covering the value of any policy options and guarantees in the fund, where a deficit exists there are provisions to recover the deficit by making deductions from the with-profits benefits reserve As a consequence, on this basis, the realistic value of the assets is equal to the realistic value of the liabilities, after allowance for the support arrangement assets provided by the segregated sub fund

The principal assumptions underlying the calculation of the with-profits liabilities are set out below in "Main assumptions"

Present value of future profits on non-profit business written in the with-profits fund

Since the realistic liabilities for with-profits policies include an allowance for future bonuses that will be payable out of profits from non-profit business written within the with-profits fund, an asset is recognised representing the present value of future profits ("PVFP") arising from such business These profits include profits expected to arise from margins for prudence in the gross premium valuation basis No corresponding asset is recognised for business written in the non-profit fund

The value of the PVFP is determined in accordance with the FSA's 'realistic' liability regime In particular, the methodology and assumptions are based on current estimates of future experience and current market yields The value is also adjusted to remove the value of the regulatory capital requirements in respect of the non-profit business

Non-profit fund

For almost all conventional non-profit business, the long-term business provision is determined using a gross premium valuation method, which values guaranteed benefits, future expenses and the full premiums receivable The assumptions used for this valuation include margins in comparison with corresponding assumptions used for the realistic valuation

Unit-linked business

The technical provision for unit-linked liabilities is determined according to the policy set out in Note 1 (Statement of Accounting Policies) Additional technical provisions arising from unit-linked contracts classified under FRS 26 as insurance or investment with DPF contracts are held within the long-term business provision, and include an allowance for any excess of future costs over policy charges A discounted cash-flow valuation method has been adopted to determine these additional provisions for all major classes of business The main assumptions relate to the discount rate, future expenses, unit price growth and mortality experience Further provisions are also held

For the unit-linked liabilities, management's policy is to ensure that there is no significant mismatching between the assets and liabilities in each unit fund Assets and liabilities for the non-linked business in the non-profit fund are broadly matched and therefore the risks from changes in market conditions are limited

The principal assumptions underlying the calculation of the non-profit liabilities are set out below in "Main assumptions"

Main assumptions

With-profits business

Economic

The realistic assets and liabilities are calculated using a dynamic stochastic model based on economic data provided from a market consistent asset model This includes the cost of any options, guarantees or smoothing together with the value of any enhancement (or charges) to the with-profits benefit reserve

The assumptions underlying the projection of the liabilities are based upon best estimates Assets are taken to be consistent with the market value

For the valuation of with-profits business, the yields are derived from UK gilts, which are assumed to be risk-free The equity asset model is calibrated to market implied volatilities of in and out of the money FTSE100 put options.

The asset model used is the Barrie & Hibbert Economic Scenario Generator. This is an arbitrage-free deflator model built for the purpose of pricing contingent claims written on multiple asset classes The model is capable of recovering prices for assets and liabilities that can be directly verified from the market and is calibrated to recover the market-consistent prices for those assets that reflect the nature and term of the with-profits liabilities of the fund.

This asset model provided 2,000 simulations of the future comprising a range of good, average and poor economic scenarios which when combined were consistent with earlier calibration These simulations were then used to project the realistic value of the assets and liabilities

The stochastic model is a monthly model and projects cash flows over a period of 40 years At the end of this period any residual cost of guarantees is estimated and included in the projected liabilities

The model allows directly for some management (an allowance is made indirectly for others) and policyholder actions to be taken as economic conditions change The range of actions has been detailed below

Mortality

The mortality assumptions used in the model are largely based upon standard industry tables adjusted to reflect the expected experience of the fund For life and pensions business before retirement, the rates are 80-90% of AM92 or AF92 as appropriate (2011 80-90% of AM92 or AF92 as appropriate) In retirement male rates are 107 5% of PCMA00 with CMI 2011 (1 25%) improvements (2011 107 5% of PCMA00 with CMI 2011 (1 25%) improvements) In retirement female rates are 107.5% of PCFA00 with CMI 2011 (1.25%) improvements (2011 107 5% of PCFA00 with CMI 2011 (1 25%) improvements)

Persistency

Policy lapse assumptions are based upon recent past experience Provision is also made for policyholder actions on dates where market value reductions do not apply.

Expenses

The expense assumptions reflect the estimated future policy and investment expenses Under the terms of the Scheme of Transfer the expenses are capped It has been assumed that the expense cap will apply in the future On average these expenses were assumed to increase at 3 8% p a (2011 3 8% p a) Investment expenses were assumed to be 19 basis points (2011 19 basis points)

Bonus rates

The bonus policy of the Company is explained in detail in the PPFM In setting regular bonus rates the Company aims to ensure that final bonus should represent a targeted proportion of the total maturity payout Subject to these principles the Company will seek to smooth the amount by which regular bonus changes at any one time

The Company uses asset shares, or other appropriate models, as a guide to determining final bonus rates The general aim is that claim amounts should be based upon targeted proportions of the policy asset share, allowing for smoothing and subject to averaging over policies with the same scale of final bonus. Subject to smoothing, the current practice is to target 100% of the asset share on maturity or death and 95% of the asset share for surrenders transfers and switches For surrenders, transfers and switches, where a final bonus is not being applied, the Company targets a payout of 100% of asset share

Included within the long-term business provision are amounts of £129 0m (2011 £119 3m) relating to liabilities under with-profits investment contracts The Company cannot measure reliably the fair value of with-profits investment contracts due to the lack of a reliable basis to measure the supplemental discretionary returns and because there is not an active market for such instruments The realistic liabilities are, however, considered to be an appropriate proxy for fair value

Non-profit business

The principal assumptions underlying the calculation of the non-profit liabilities in the long-term business provision are as follows

Rates of interest:		**2012**	2011
With-profits fund	- life (immediate annuities)	**1.60%**	1 70%
	- pensions (immediate annuities)	**2.00%**	2 10%
	- life (other)	**1.60%**	1 70%
	- pensions (other)	**2.00%**	2 10%
Non-profit fund	- life	**1.35%**	2 10%
	- pensions (immediate annuities)	**3.05%**	3 20%
	- pensions (other)	**1.70%**	2.90%

Mortality tables:		2012	2011
Term Assurance	Life and Pension	Males TM92 ult (126% Smoker, 66% Non-Smoker) Females TF92 ult (108% Smoker, 66% Non-Smoker)	Males TM92 ult (150% Smoker, 80% Non-Smoker) Females TF92 ult (165% Smoker, 90% Non-Smoker)
Immediate annuities	Life and Pension	Males 98 9% PCMA00 (with CMI 2011 2% improvements)	Males 98 9% PCMA00 (with CMI 2011 2% improvements)
		Females 98 9% PCFA00 (with CMI 2011 2% improvements)	Females 98 9% PCFA00 (with CMI 2011 2% improvements)

Surrender rates on some unit linked contracts changed at the 2010 year end from 0% to the following

- 3% on group pensions without surrender penalties
- 2% on personal pensions without surrender penalties

The surrender rate is 4% on the Colonial Pacesetter Investment Plan, which is a whole life unit-linked product

No other allowance has been made for lapses

In common with other life offices in the United Kingdom, the Company has written pension transfer and opt-out business A provision of £3 5m (2011 £3 5m) has been made in respect of rectification costs for pension transfers and opt-outs from occupational schemes, and this is included in the long-term business provision. The provision has been determined with due consideration to the guidelines issued by the Securities and Investments Board in October 1994, and subsequently by the FSA The principal assumptions and estimates made in determining the provision relate to the number of cases which on investigation give rise to a loss to the policyholder, and the average costs of making good the loss

Options and guarantees

With-profits business

Some with-profits policies contain options and guarantees that can increase the benefits payable to the policyholder

The most significant options and guarantees are

- Options attaching to the pensions pure endowments Typically the maturity value can be converted to a pension on guaranteed terms consistent with a pension of £1 p a in respect of every £10 of maturity value (for a male aged 65)
- Options attaching to the pensions deferred annuities Typically the pension can be converted to a maturity value on guaranteed terms consistent with a value of £9 in respect of every £1 per annum of pension (for a male aged 65)
- For other conventional with-profits policies there is a risk that the sum assured (plus any declared bonus) will be greater than the value of the assets underlying the policy at maturity Where it is felt appropriate these risks may hedged by purchasing suitable instruments (such as equity options)
- For unitised with-profits business the main options relate to the ability to take benefits at maturity (or at specific other dates) when investment values may be depressed, without an adjustment to reflect the underlying market value of the assets supporting the policy In particular, investment bonds have dates from which benefits can be taken without any market value reduction, for some this is at any point after the eighth or tenth anniversary of the bond, and for others this is every anniversary from the seventh onwards All bonds are now past the relevant dates when this first applies

Non-profit business

For non-profit business the options are not material and the amount of policy benefits are largely fixed The investment policy of the Company is to follow a broadly matched investment position to limit the risk of being unable to meet liabilities on a realistic basis as they fall due This may lead to some degree of mismatch on a statutory basis

24. CAPITAL MANAGEMENT

Capital management policies

The Company's objectives in managing its capital are

- to ensure that guarantees to policyholders are met,
- to permit the management of the with-profits fund in accordance with the PPFM,
- to support the writing of new business,
- to satisfy the capital requirements of the regulators, and to assist in the efficient use of available capital in the Friends Life Group

Regulatory capital resources

The available capital of the Company's with-profits fund has been determined in accordance with FSA regulations and includes the FFA The FFA represents the estimated surplus in the fund that is available to meet the regulatory and solvency requirements of the fund In determining the available capital of the fund, assets and liabilities are restated onto a regulatory basis

The with-profits fund has available capital of £88 5m (2011. £81 4m) In accordance with accounting rules, the realistic balance sheet liabilities only represent amounts relating to policyholders and do not include the shareholders' share of all future bonuses The shareholders' share of bonuses which is shown as a separate adjustment in the capital statement is a deduction from capital which is available to meet regulatory requirements

The available capital in the Company's non-profit fund and the segregated sub fund has been determined in accordance with FSA regulations and amount to £20 0m and £17 9m (2011 £13 0m and £19 6m) respectively

The shareholders' fund held outside the long-term insurance fund is shown separately in the capital statement This amounted to £88 5m (2011 £76 8m) at the balance sheet date

Regulatory capital requirements

The regulatory capital resources must be sufficient to meet the regulatory capital requirements prescribed by the FSA There are two components of regulatory capital requirements

- the Long-Term Insurance Capital Requirement ("LTICR"), which is determined by applying various fixed percentages to liabilities and sums at risk,
- the With-Profits Insurance Capital Component ("WPICC"), which is described below

The WPICC is determined in respect of the with-profits funds, and is equal to the amount of additional capital, if any, required to adjust from regulatory to realistic requirements The realistic valuation is on the same basis as that reported on the balance sheet and described above, except that the WPICC also includes the Risk Capital Margin ("RCM"), which is the amount needed to cover various stress tests applicable to the realistic valuation

As described above, regulatory capital requirements differ between with-profits and other business In all cases the minimum requirement is based on a prudent valuation of guaranteed benefits, while for with-profits business additional capital may be needed to cover the realistic valuation of all prospective benefits.

Individual Capital Guidance

The FSA requires the Company to determine its Individual Capital Assessment ("ICA") The ICA is based on the Company's own assessment of the risks that it is subject to, including business risks not covered by the RCM The ICA is determined in accordance with guidance laid down by the FSA

The Company capital policy is to maintain capital resources which meet, as a minimum, the greater of the Company's assessment of

- 150% of Pillar 1 capital resources requirement (excluding WPICC), and
- 125% of Pillar 2 ICA

at all times and these capital ratios are not altered without the prior written consent of the FSA

The Company has complied with all regulatory capital requirements during this accounting period

Restrictions on available capital resources

Any available capital held in the with-profits fund can only be applied to meet the requirements of the Fund or be distributed to policyholders and shareholders Shareholders are entitled to an amount not exceeding one-ninth of the amount distributed to policyholders in the form of bonuses No new loans may be made by the with-profits fund

The segregated sub fund is a separate pool of assets maintained to provide support to the with-profits fund For the non-profit fund, surplus can generally be distributed to shareholders subject to meeting regulatory requirements and other capital management objectives of the Company

No transfers from the with-profits or non-profit funds can take place without an up to date actuarial valuation

The capital held within the shareholders' funds is generally available to meet any requirements, including distribution to the shareholders, provided that regulatory requirements and other capital management objectives of the Company remain satisfied

Arrangements to provide capital

The segregated sub fund was set up under the Colonial demutualisation scheme in 1996 and is available as an additional source of capital to support the with-profits fund under certain circumstances It amounted to £17 9m (2011 £19 6m) at the balance sheet date

Sensitivity of liabilities and capital to changes in market variables

With-profits fund

The enhanced capital requirement for the fund is determined by examining liabilities on a realistic basis As discussed above, this uses a market consistent stochastic approach projecting the cash flows of the fund in the future for a large number of potential different scenarios The present value of these cash flows is taken to form a realistic balance sheet. In the projections provision is made for some management and policyholder actions to be taken in response to the changing conditions.

The management actions below are allowed for within these projections through the model

- changing regular bonus rates
- changing final bonus rates

The following three management items are not determined by the model, but are allowed for in capital calculations by altering the bases used for the stress runs

- changes to the assumed asset allocation for the fund
- refinement to the term of fixed interest assets assumed to be held in the fund
- enhancements (or deductions) from the with-profits benefit reserve

Policyholder actions relate to the exercise of options in different scenarios. For instance, guaranteed annuity options are assumed to be taken if they are in the money on a particular scenario

In certain adverse scenarios, there is provision within the Scheme of Transfer for the segregated sub fund to provide support to the with-profits fund On a realistic basis, the expected amount of support that will be provided by the segregated sub fund amounts to £6 1m (2011 £8 4m)

On a realistic basis the capital requirement for the with-profits fund is calculated as the capital required to cover additional liabilities on set criteria of adverse scenarios laid down by the FSA The set of scenarios requiring the largest amount of capital is selected, giving the risk capital margin

On this basis the capital required to support the fund is £12 1m (2011 £14 4m). This relies upon £6 1m (2011 £8 4m) capital support being provided by the segregated sub fund and risk capital margin of £6 0m (2011 £6 0m) to cover the additional liabilities under adverse scenarios

The capital available in the fund amounts to £88 5m (2011 £81 4m) However on a realistic basis, under the governance arrangements for the fund, this is all distributed and additional capital of £12 1m (2011 £14 4m) is required The capital requirement for the fund is made up of the minimum capital requirement of £30 7m (2011 £34 1m) and the with-profits insurance capital component of £63 7m (2011 £58 0m) giving an overall capital requirement of £94 3m (2011 £92 1m)

Non-profit fund

The assumptions to which the long-term business provision is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders

25. TECHNICAL PROVISION FOR LINKED LIABILITIES

	2012	2011
	£000	£000
Investment contracts liabilities with no DPF	**5,157,105**	4,943,666
Insurance contract liabilities	**448,714**	450,829
Technical provision for linked liabilities	**5,605,819**	5,394,495

Financial liabilities in respect of unit-linked investment contracts are carried in the balance sheet at amortised cost which closely approximates fair value

As a result of deposit accounting for unit-linked investment contracts, the change in technical provisions for linked liabilities recorded in the technical account for long-term business does not equal the movement in the technical provision for linked liabilities In addition for 2011, the change in reinsurers' share of technical provisions for linked liabilities for long-term business does not equal the movement in the reinsurers' share of the technical provision for linked liabilities due to the part VII transaction There is no difference for 2012 The differences are explained below

	Gross Amount		Reinsurers' Share	
	2012	2011	**2012**	2011
	£000	£000	**£000**	£000
These amounts are included in the technical account as follows:				
Change in technical provision for linked liabilities	**511,788**	(647,776)	**136**	(453)
Adjustments made for contracts which do not transfer significant risk				
Gross premiums written	**432,638**	1,451,873	**-**	-
Claims paid	**(709,110)**	(1,404,261)	**-**	-
Other technical income	**(23,992)**	(72,145)	**-**	-
Change in technical provision arising from deposit accounting	**(300,464)**	(24,533)	**-**	-
Change in technical provision for linked liabilities on a consistent basis with balance sheet classification	**211,324**	(672,309)	**136**	(453)
Part VII transaction	**-**	(6,557,377)	**-**	819
	211,324	(7,229,686)	**136**	366
Balance sheet movement in technical provision for linked liabilities	**211,324**	(7,229,686)	**136**	366

26. DEFERRED TAXATION AND PROVISIONS FOR OTHER RISKS

a) Deferred taxation

	2012	2011
	£000	£000
At 1 January	**(22,029)**	(10,966)
Movement in year	**35,601**	(18,586)
Part VII transaction	**-**	7,523
At 31 December	**13,572**	(22,029)

The balance in respect of deferred tax liability/(asset) can be analysed as follows

	2012	2011
	£000	£000
Unrealised gains / (losses) on investments	**4,227**	(2,866)
Capital losses carried forward	**10,249**	(17,392)
Deferred income liability	**(5,230)**	(6,666)
Short-term timing differences	**11,808**	8,046
Trading losses carried forward	**(7,482)**	(3,151)
Total liability/(asset)	**13,572**	(22,029)

Legislation in respect of the new life tax regime was included in Finance Act 2012, which received Royal Assent on 17 July 2012. The new life tax regime took effect from 1 January 2013 and therefore impacts deferred tax but not current tax in the 2012 accounts There remains an element of risk and uncertainty because the legislation is new, and therefore may be subject to change either by legislative update or by developments in interpretation

b) Other provisions

	2012	2011
	£000	£000
Provisions for other risks and charges	6,903	6,017

	Endowment complaints £000	**Other provisions £000**	**Total £000**
At 1 January 2012	**2,725**	**3,292**	**6,017**
Charged in the year	**1,897**	**-**	**1,897**
Utilised in the year	**(1,011)**	**-**	**(1,011)**
At 31 December 2012	**3,611**	**3,292**	**6,903**

The endowment complaints provision relates to the compensation costs likely to be incurred in respect of complaints relating to missold policies Other provisions include £3 2m (2011 £3 2m) in respect of potential compensation and professional fees expected to arise as a result of reviewing administrative procedures

The provisions are reviewed on a regular basis and are anticipated to be fully utilised on completion of the investigations

27. OTHER CREDITORS INCLUDING TAX AND SOCIAL SECURITY

	2012 £000	2011 £000
Amounts owed to group undertakings	**20,134**	3,718
Tax payable	**32,060**	33,063
Other creditors	**13,284**	23,934
Total Other Creditors	**65,478**	60,715

All remaining creditors are payable within a period of one year

28. ACCRUALS AND DEFERRED INCOME

	2012 £000	2011 £000
Other accruals and deferred income	**2,561**	3,280
Deferred front end fees	**22,740**	26,667
	25,301	29,947

29. CONTINGENT LIABILITIES

The Company has a contingent liability of £3 5m (2011 £3 5m) in relation to certain SIPP cases that have exceeded the 20% permitted links limit on investments in unregulated collectives

No amount has been recognised under the financial guarantee requirements of FRS 26 as the likelihood of any liability arising from the above items is considered remote and so its fair value is deemed to be immaterial

30. ASSETS ATTRIBUTABLE TO THE LONG-TERM BUSINESS FUND

The total assets attributable to the long-term business fund valued in accordance with the Large & Medium-sized Companies & Groups (Accounts and Reports) Regulations 2008 is £7 6bn (2011 £7 4bn)

31. SHAREHOLDINGS IN EXCESS OF TWENTY PER CENT

There are no holdings that exceed 20% of one class of shares for UK equities

32. RELATED PARTIES

As the Company is a wholly-owned subsidiary it has taken advantage of the exemption granted under FRS 8 (Related Party Disclosures) where subsidiary undertakings do not have to disclose transactions with Group companies qualifying as related parties provided that consolidated financial statements are publicly available

33. IMMEDIATE AND ULTIMATE PARENT COMPANY

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

The smallest group in which the results of the Company are consolidated is that headed by Friends Life Group plc Copies of the Group Report and Accounts can be viewed via its website at www friendslife co uk

34. NET LOSS ARISING ON PART VII TRANSACTION

A portfolio of insurance reserves and associated assets were transferred to AXA Wealth Limited for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 14 September 2011 The assets and liabilities that were transferred are as follows

	Note	2011 £'000
Assets		
Assets held to cover linked liabilities		6,565,410
Reinsurers' share of technical provisions		
Technical provision for linked liabilities	25	819
Debtors arising out of direct insurance operations		500
Deferred tax asset	26	7,523
Other debtors		11,137
Cash at bank and in hand		(5,630)
Deferred acquisition costs		199,035
Liabilities		
Long term business provision		(3,269)
Claims outstanding	18	(780)
Technical provisions for linked liabilities	25	(6,557,377)
Creditors arising out of direct insurance operations		(738)
Other creditors		(78,861)
Accruals and deferred income		(90,197)
Net assets transferred		**47,572**
Consideration		**-**
Loss on transfer of net assets		**47,572**

No consideration was received in respect of the transfer of business, the transfer having been reflected in the terms of the Sale and Purchase Agreement agreed between FLG and AXA UK plc on 15 September 2010