# Press Release

**31 March 2015**

# Royal London reports strong trading performance and operating profits

Royal London, the UK's largest mutual life, pensions and investment Group, presents its unaudited results for the year ended 31 December 2014.

**Trading Highlights** (figures in brackets show movement compared to 2013)

- New life and pensions business (on a PVNBP basis)[1] £4,826m (+39%).

Significant growth in new business sales reflects the strength of Royal London's individual pensions, group pensions and drawdown propositions.

- EEV Operating profit before tax and exceptional items £220m (+12%).

This is the result of strong new business figures, particularly in intermediary pensions and in the wealth business, resulting in new business profits of £85m (2013: £70m) and existing business profits of £159m (2013: £140m).

- Group funds under management £82.3bn (+12%).

Increased due to net inflows and good underlying investment performance.

- EEV Profit from continuing operations before tax and Profit Share £259m (-53%)

This reflects an exceptional £150m gain from the acquisition of CIS, its subsidiaries and TCAM[2] reported in the 2013 financial results. Other factors impacting on this result were a one-off £61m charge relating to the workplace pensions charge cap, as previously reported in the Interim Statements (issued in August 2014) and the historically low yields on government bonds at the end of 2014.

- Surplus regulatory (Insurance Groups Directive) capital £3,390m (+23%)[3].

Stronger capital position is a consequence of underlying positive performance and the capital benefit of the Part VII Transfer of CIS.

**Phil Loney, Group Chief Executive of Royal London, said:**

*"The last year was marked by a very strong trading performance and a healthy increase in operating profit. New business performance was strong with particularly good contributions from group pensions and sales of income drawdown products. We anticipate that these will continue to be areas of growth for some time to come.*

*We continued to see strong inflows into our investment management operations. 2014 saw significant inflows into our Equity Income, Cash Plus and fixed income funds.*

*We are building our protection offering. The intermediary protection business is seeing a positive response to the improvements we made in the final quarter to both technology and improved critical illness definitions. Our consumer protection business has been growing significantly since it started marketing insurance products direct to consumers in Q4 2014. Our new Consumer division is now offering three new products.*

*The Part VII Court decision at the end of 2014 concluded the legal transfer of the CIS life and pensions business[2]. Full integration into Royal London is now very well advanced.*

*Our strong trading profit performance was offset in the short term by the impact of the government's decision to introduce a price cap and other alterations into auto enrolled pension schemes, and the impact of even lower yields. Royal London members who hold our workplace pension products will benefit from lower prices under the price cap, so the value has not been lost to members as a whole. The profitable growth of sales and market share across our product range provides a sound platform for future performance.*

*Although the total bonuses paid to policyholders has decreased due to a reduced volume of maturities, the bonuses paid to individual with-profits policyholders have increased. In addition, with profits policyholders benefit from a Profit Share and this year their policies have been increase by 1.15%. This is lower than recent years, primarily as a result of the one-off cost of charge capping brought in this year. Over the last decade our profit sharing approach has boosted the value of policies held by qualifying customers to the tune of £466m.*

*Royal London remains well capitalised, with surplus regulatory capital increasing to £3,390m (£2,749m in 2013)."*

1 Present Value of New Business Premiums (PVNBP) is the total of new single premium sales received in the year plus the discounted value, at the point of sale, of the regular premiums we expect to receive over the term of the new contracts sold in the year.
2 Royal London Group purchased Royal London (CIS) Limited ("CIS") (previously known as The Co-operative Insurance Society Limited) and its subsidiaries and The Co-operative Asset Management Limited ("TCAM") on 31st July 2013. In December 2014 the High Court approved the Part VII Transfer of CIS into The Royal London Mutual Insurance Society Limited.
3 Regulatory capital surplus includes tier 2 capital

-ENDS-

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Editor's notes:

1) Royal London is the largest mutual life, pensions and investment company in the UK, with Group funds under management of £82.3 billion. Group businesses serve around 5.3 million policyholders and employ 2,829 people. (Figures quoted are as at 31 December 2014).

The Group is currently moving all of its UK & Ireland Life, pension and investment businesses under a new version of the Royal London brand. The Group's independent wrap platform will remain branded Ascentric.

2) Financial calendar

| | |
|---|---|
| 31 March 2015 | Financial results for 2014 and conference call |
| 12 May 2015 | Interim management statement and first quarter new business results |
| 10 June 2015 | Annual General Meeting |
| 18 August 2015 | Interim financial results and second quarter new business results |
| 4 November 2015 | Interim management statement and third quarter new business results |
| 30 November 2015 | RL Finance Bonds No 2 plc Subordinated debt interest payment date |
| 15 December 2015 | RL Finance Bonds plc Subordinated debt interest payment date |

3) Forward-looking statements

This document may contain forward-looking statements with respect to certain of Royal London's plans, its current goals and expectations relating to its future financial position. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond Royal London's control. These include, among others, UK economic and business conditions, market-related risks such as fluctuations in interest rates, the policies and actions of governmental and regulatory authorities, the impact of competition, the timing, impact and other uncertainties of future mergers or combinations within relevant industries.

As a result, Royal London's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in Royal London's forward-looking statements. Royal London undertakes no obligation to update the forward-looking statements.

# Contents

# 1. Financial Review

## Performance Overview

We have delivered a strong operating performance in 2014, with strong new business results, particularly in our pensions business, and an increase in underlying operating profits.

On the EEV basis, our continuing operating profit before exceptional items for 2014 increased by 12% to £220m (2013: £196m). This result reflects strong contribution from new business and the existing book despite the recognition of a £51m charge representing the Royal London open fund costs we expect to incur preparing to meet the regulatory and reporting requirements of Solvency II.

Our total EEV operating profit before tax was significantly impacted by a £61m one-off exceptional cost arising from the introduction of a charge cap on defined contribution group pension schemes. The total operating profit for 2013 included a £150m one-off gain arising from the acquisition of CIS and TCAM. Reflecting both of these items, there was a reduction in total EEV operating profit to £159m, a decrease of 48% for year ending 31 December 2013.

After reflecting these exceptional items and economic variances, our European Embedded Value (EEV) profit before tax from continuing operations was £195m (2013: £465m). Economic items were lower than the large favourable economic items in 2013. In particular the low gilt yield environment at the end of 2014 has resulted in higher liabilities, including the cost of guarantees and guaranteed annuity options, although underlying investment returns were good.

Our Asset Management and Administration businesses have continued to grow, with total Group funds under management increasing from £73.6bn as at 31 December 2013 to £82.3bn at 31 December 2014. Ascentric, our wrap platform administrator, has achieved strong levels of new business growth and has increased its assets under administration by 22% during 2014 to £8.9bn (31 December 2013: £7.3bn).

## Contribution from new business

The new business contribution in the table below represents the new business contribution grossed up for tax at 21% (2013: 23%). This is to aid comparability with proprietary companies which typically pay tax at the main corporation tax rate of 21% (2013: 23%).
The new business margin represents the ratio of the new business contribution to PVNBP.

| **31 Dec 2014** | **Present value of new business premiums £m** | **New business contribution £m** | **New business margin %** |
|---|---|---|---|
| Intermediary | | | |
| Pensions | 4,454 | 55.6 | 1.2 |
| Protection | 338 | 22.7 | 6.7 |
| Consumer | 34 | (12.9) | (37.9) |
| **Total life and pensions business** | **4,826** | **65.4** | **1.4** |
| Wealth | 3,755 | 29.9 | 0.8 |
| **Total** | **8,581** | **95.3** | **1.1** |

| 31 Dec 2013 | Present value of new business premiums £m | New business contribution £m | New business margin % |
|---|---|---|---|
| Intermediary | | | |
| Pensions | 2,996 | 26.7 | 0.9 |
| Protection | 436 | 20.0 | 4.6 |
| Direct | 32 | 0.9 | 2.8 |
| Continuing life and pensions business | 3,464 | 47.6 | 1.4 |
| Discontinued life and pensions business | 396 | 9.0 | 2.3 |
| Total life and pensions business | 3,860 | 56.6 | 1.5 |
| Wealth | 3,933 | 30.7 | 0.8 |
| Total | 7,793 | 87.3 | 1.1 |

Pension volumes are up 49% on 2013 due to our success in the group pensions market following the introduction of auto-enrolment and the strength of our individual pensions and drawdown propositions. The increase in margin is largely attributed to a reduction in acquisition and maintenance unit costs resulting from the increase in volumes of business sold.

Protection comprises Bright Grey, Scottish Provident and Caledonian Life (now rebranded Royal London). Overall, volumes are down reflecting the very competitive market but margins have increased reflecting the higher value associated with this business arising from lower market yields at December 2014 and from the adoption of a yield curve which more accurately reflects the value of the cashflows generated by this type of business.

Although Consumer volumes are up 10%, the new business contribution and margin reflects the development investment leading to 2014 launch of the direct to consumer proposition.

Royal London Asset Management's new business volumes from new asset management mandates continued to be strong, just down 5% on 2013, while the margin has increased slightly.

**EEV Operating profit before exceptional items**

In 2014 the Group achieved an EEV operating profit from continuing operations before exceptional items of £220m (2013: £196m). This result reflects good contribution from new business and favourable operating experience.

Our 2014 EEV operating profit includes:

- £85m profits from continuing new business (2013: £70m)
- £56m favourable operating variances (2013: £29m)
- £51m charge included within assumption changes representing costs we expect to incur addressing the requirements of Solvency II
- £73m of strategic development costs and other items (2013: £59m) which includes £31m to support initiatives that we believe are important for our future competitiveness, and we expect will deliver good returns in the future (2013: £17m).

**Exceptional items**

As discussed in our interim results, the 2014 results include a £61m charge relating to pension scheme charge capping. In March 2014, the DWP set out various proposals relating to defined contribution pension scheme charging following completion of their Better Workplace Pensions consultation. We estimate that complying with these proposals will have a £61m impact on operating profit.

The 2013 results included a one off gain arising on business combinations. On 31 July 2013, the Group acquired the life assurance and asset management business of the Co-operative Banking Group by acquiring the entire issued share capital of the Co-operative Insurance Society Limited (CIS) and The Co-operative Asset Management Limited. Under the terms of the transaction the RL (CIS) life insurance business will be maintained in accordance with a fixed charging structure for administration and asset management services for an agreed period. It is anticipated that this business can be administered and managed for less than the fixed fees, thereby generating future profits in the Royal London open fund. The estimated value of these future profits was shown as 'Gain arising on business combinations'.

**EEV Total Operating Profit**

Total operating profit before tax from continuing operations decreased by 54% to £159m due to the exceptional items noted above.

### EEV Profit before tax and Profit Share

After reflecting the impact of economic variances, our EEV profit before tax from continuing operations was £195m (2013: £465m). The decrease on the prior year is due to the impact of exceptional items, together with economic variances and assumption changes in 2014 which were in total lower than the large favourable variances and assumption changes experienced in 2013 reflecting the historically low yields on government bonds at the end of 2014. In addition, the surplus in the Royal London Group Pension Scheme decreased, mainly due to the decrease in discount rate applied to the scheme liabilities. Financing costs increased following the issue of subordinated debt in November 2013.

### Royal London Profit Share

In 2014, Royal London's Board exercised its discretion to allocate £60m (£64m gross of tax in EEV) to qualifying policyholders of Royal London Profit Share (previously known as Mutual Dividend). In 2013, the corresponding figure was £81m (£86m gross of tax in EEV).

### Attributed tax charge

EEV profits are calculated net of tax and then grossed up at an appropriate tax rate. In general, this will be 6%, the expected long-term rate of tax payable by Royal London, although subsidiary companies may be subject to different rates of tax.

## IFRS results

The main financial basis we use for assessing our results is the EEV basis. However, we have also calculated our Operating Profit for the purpose of assessing the amount of our IFRS result attributable to our operating activities. Our Operating Profit for continuing operations before exceptional items was £192m (2013 £187m).

Our IFRS result before tax from continuing operations for the period was £356m (2013 £445m). This result reflects many of the features described above within the EEV results. Appendix 3 to this Supplementary Information reconciles the IFRS result to the EEV result for the period.

Our IFRS results reflect the impact of a reinsurance transaction completed during 2014, whereby RL (CIS) Limited reinsured approximately £1bn of annuities in payment with Reinsurance Group of America (RGA).

The table in Appendix 3 to this Supplementary Information reconciles our Operating Profit to IFRS profit after tax.

**IFRS Balance sheet**

As a result of our performance in the year, the Unallocated Divisible Surplus has increased from £3,005m at 31 December 2013 to £3,139m at 31 December 2014.

Our balance sheet remains robust and we experienced no significant asset impairments in the period. Our total investment portfolio (including investment property) was £64,219m at 31 December 2014, an increase on 31 December 2013 of 14%. Our financial investments portfolio remains high quality, with the majority (88%) of our bond investments in assets rated A or above. 53% (31 December 2013 53%) of our asset portfolio is in fixed income investments and cash.

The Group's exposure to sovereign debt from Portugal, Italy, Ireland, Greece and Spain amounted to £52m, or 0.1% of the total assets on the balance sheet.

**Investment performance**

We measure our investment returns against benchmarks that we have constructed from market indices weighted to reflect the asset mix of each sub-fund. In 2014 the investments backing the asset shares of the Royal London Open Fund achieved a return of 10.9%, which was ahead of the return achieved in 2013 of 10.6% but slightly below our benchmark of 11.1%

The Royal London with-profits investment performance for UK equities was 1.5% (benchmark 1.2%), overseas equities returned 10.0% (benchmark 11.0%), returns from corporate bonds were 14.2% (benchmark 12.2%), government bonds achieved a return of 19.9% (benchmark 20.7%) and our property portfolio returned 21.0% (benchmark 19.6%).

## 2. Capital Strength

The Group's capital strength has continued to improve in 2014, as a result of the contribution from new business and improving investment markets.

Our regulatory (Insurance Group Directive) capital position is summarised as follows:

| | **2014** | | | 2013 | | | |
|---|---|---|---|---|---|---|---|
| **£m** | **Open Fund** | **Closed Funds** | **Total** | Open Fund | Closed Funds | RL (CIS) Adjust-ment[1] | Total |
| Available capital (including tier 2 capital) | **3,917** | **9,449** | **13,366** | 3,184 | 2,586 | 3,333 | 9,103 |
| Capital required | **(527)** | **(814)** | **(1,341)** | (435) | (290) | (504) | (1,229) |
| **Surplus** | **3,390** | **8,635** | **12,025** | 2,749 | 2,296 | 2,829 | 7,874 |
| Restriction on surplus of closed funds | **-** | **(8,635)** | **(8,635)** | - | (2,296) | (2,829) | (5,125) |
| **Excess capital** | **3,390** | **-** | **3,390** | 2,749 | - | - | 2,749 |
| **Capital cover** | **744%** | **100%** | **134%** | 732% | 100% | 100% | 143% |

[1] The RL (CIS) Adjustment represents the adjustment required to the regulatory capital position in respect of RL (CIS) Limited.

Our total Group available regulatory capital increased from £9,103m at 31 December 2013 to £13,376m at 31 December 2014. Excess capital has increased by 23% mainly driven by the impact of the Part VII transfer of RL (CIS) Limited into a separate closed sub-fund of the Royal London Open Fund. The Group has maintained a strong regulatory capital cover of 134% (31 December 2013 143%). While surplus capital has increased significantly, the capital requirements have also increased reflecting the transfer of the RL (CIS) Limited business into a Royal London closed sub-fund, reducing the coverage ratio.

The available capital of the closed sub-funds is retained within those funds, as it is ultimately for the benefit of the closed sub-fund policyholders. Therefore only the surplus of the open fund counts towards our Group capital position. The excess regulatory capital of the Royal London Open Fund increased by 23% from £2,749m to £3,390m. The IGD capital cover for the Royal London Open Fund of 744% increased on 2013 (732%).

Our realistic capital position is summarised as follows:

| £m | 2014 Open Fund | 2014 Closed Funds | 2014 Total | 2013 Open Fund | 2013 Closed Funds | 2013 Total |
|---|---|---|---|---|---|---|
| Available capital (including tier 2 capital) | **3,407** | **3,052** | **6,459** | 3,074 | 972 | 4,046 |
| Capital required | **(15)** | **-** | **(15)** | - | - | - |
| **Surplus** | **3,392** | **3,052** | **6,444** | 3,074 | 972 | 4,046 |
| Closed fund transfer commitments | **-** | **(3,052)** | **(3,052)** | - | (972) | (972) |
| **Excess capital** | **3,392** | **-** | **3,392** | 3,074 | - | 3,074 |

Our excess realistic capital (the excess of assets over liabilities, as measured by the PRA's realistic reporting requirements) has increased from £3,074m to £3,392m. This increase is due to a strong operating result and the impact of the Part VII transfer of RL (CIS) Limited into a separate closed sub-fund of the Royal London Open Fund.

## 3. Other Matters

**Impact of Solvency II**

Solvency II is a major European Union directive that will transform how we manage and report risk and capital. It has been confirmed that the Solvency II regime will be implemented from 1 January 2016. There are significant details which remain to be clarified about the new regime but it is possible that over time the outcome from Solvency II will require insurance companies to hold more regulatory capital than they are currently required to. We will seek to comply with the new capital requirements without any impact on policyholders but if we are required to hold significantly increased capital, then the levels of Royal London Profit Share we are able to allocate to our participating members could need to be restricted in the short-term.

**Project Chrysalis & Mutuality**

We continue to engage with our regulators, the FCA and PRA in relation to their review of the application of conduct of business rules to mutual with profit life insurers.

We are committed to our mutual status. We are owned by our members and we want our members to benefit from our successes. Over the past decade we have given £466m in Royal London Profit Share back to our eligible with-profits products policyholders.

One of the challenges we face is that the number of customers choosing traditional forms of with-profits products has been declining – so fewer customers benefit from our Profit Share each year. At the same time the number of our members who are not with-profits policyholders has been increasing. We want to bring things back into line by extending the scope of our Profit Share – so that more of our customers share in our successes – and hope to achieve this by launching a new form of with-profits product next year.

It is essential that we treat all of our customers, in particular our with-profits customers fairly in the way we introduce these new with-profits products. To ensure this we have agreed with our regulators that an independent expert should review our proposals to ensure that our plans are fair. Our Board will consider the independent expert's views later this year and decide whether we can proceed with what we believe is an exciting and innovative strategy. We've made good progress but there is still a lot to do and we hope to say more about this later this year.

**Ratings agencies**

Our capital strength and financial stability are reflected in our financial ratings from external ratings agencies. Our credit ratings remain unchanged in 2014 at 'A - stable outlook' from Standard and Poor's and 'A2 - Good Financial Security' from Moody's.

**Part VII transfer of Royal London (CIS) Limited**

In December, the High Court approved the transfer of the CIS life insurance business into the The Royal London Mutual Insurance Society Limited, and the transfer itself was completed on 30 December 2014. As a result Royal London paid the outstanding deferred consideration of £180m to the Co-operative Banking Group. As part of the transfer, the assets and liabilities of CIS were placed into a separate closed sub-fund of Royal London called the CIS sub-fund.

**APPENDIX 1 and APPENDIX 2 include the Group's IFRS and EEV primary financial statements and basis of preparation notes. The full set of IFRS and EEV results will be available on the Royal London Group website in April 2015.**

# Appendix 1

## Consolidated income statement – EEV basis for the year ended 31 December 2014

| | **2014** | 2013 |
|---|---|---|
| | **£m** | £m |
| **Continuing operating activities** | | |
| Contribution from new business | **85** | 70 |
| Profit from existing business | | |
| – Expected return | **91** | 63 |
| – Operating experience variances | **56** | 29 |
| – Operating assumption changes | **12** | 48 |
| Expected return on opening net worth | **42** | 34 |
| Profit on uncovered business | **7** | 11 |
| Strategic development costs and other items | **(73)** | (59) |
| **Operating profit before tax from continuing operations and exceptional items** | **220** | 196 |
| Gain arising on business combinations | **-** | 150 |
| Exceptional cost arising from regulatory change | **(61)** | - |
| **Total operating profit before tax from continuing operations** | **159** | 346 |
| Operating profit/(loss) before tax from discontinued operations | **-** | (40) |
| **Total operating profit before tax** | **159** | 306 |
| Economic experience variances | **325** | 140 |
| Economic assumption changes | **(143)** | 83 |
| Movement in RLGPS pension scheme surplus | **(42)** | 8 |
| Financing costs | **(40)** | (26) |
| Profit Share | **(64)** | (86) |
| **EEV profit before tax from continuing operations** | **195** | 465 |
| Attributed tax charge | **(35)** | (36) |
| **EEV profit after tax from continuing operations** | **160** | 429 |
| **EEV profit after tax from discontinued operations** | **-** | (38) |
| **Total EEV profit after tax** | **160** | 391 |

## Consolidated Balance Sheet - EEV basis as at 31 December 2014

| | 2014 | 2013 |
|---|---|---|
| | £m | £m |
| **Assets** | | |
| Assets held in closed funds | **32,927** | 9,538 |
| Assets backing non-participating liabilities | **21,938** | 18,567 |
| Reinsurance assets | **7,576** | 2,466 |
| Assets backing participating liabilities and net worth | | |
| – UK equities | **1,781** | 1,938 |
| – Overseas equities | **687** | 624 |
| – Land and buildings | **776** | 657 |
| – Approved fixed interest securities | **2,313** | 1,716 |
| – Other fixed interest securities | **1,332** | 1,353 |
| – Other assets | **669** | 910 |
| Value of in-force business | **1,838** | 1,701 |
| Royal London Group Pension scheme (RLGPS) surplus | **48** | 90 |
| **Total** | **71,885** | 39,560 |
| **Liabilities** | | |
| Liabilities in closed funds | **32,927** | 9,538 |
| Non-participating liabilities | **21,938** | 18,567 |
| Reinsured liabilities | **7,576** | 2,466 |
| Participating liabilities | **5,438** | 5,062 |
| Current liabilities | **1,020** | 1,101 |
| **Total** | **68,899** | 36,734 |
| **Embedded Value** | | |
| Net worth | **1,100** | 1,035 |
| Value of in-force business | **1,838** | 1,701 |
| Pension scheme surplus (RLGPS) | **48** | 90 |
| **Total** | **2,986** | 2,826 |

## Value of in-force business - EEV basis as at 31 December 2014

| | 2014 | 2013 |
|---|---|---|
| | £m | £m |
| Value of in-force business before allowance for burn-through and capital costs | **1,881** | 1,736 |
| Burn-through cost | **(9)** | (2) |
| Cost of capital | **(34)** | (33) |
| Value of in-force business | **1,838** | 1,701 |

## (a) Basis of preparation

The EEV results presented in this document have been prepared in accordance with the EEV Principles and the Additional Guidance issued in 2005 by the CFO Forum. They provide supplementary information for the year ended 31 December 2014 and should be read in conjunction with the Group's IFRS results. These contain information regarding the Group's financial statements prepared in accordance with IFRS issued by the International Accounting Standards Board and adopted for use in the European Union.

The EEV Principles and Guidance were designed for use by proprietary companies to assess the value of the firm to its shareholders. As a mutual, Royal London has no shareholders. Instead we regard our members as the nearest equivalent to shareholders and have interpreted the EEV Principles and Guidance accordingly. With-profits policies held by members do not generally contribute to the value of in-force business. However, the liabilities associated with these contracts are deducted from total assets to arrive at net worth. Hence, any movement in liabilities not matched by a corresponding movement in assets will change the net worth and flow through the income statement. The reported embedded value provides an estimate of Royal London's value to its members.

EEV Operating profit follows the same principles, in terms of items to include and exclude, as Operating Profit with the exception of certain items which are recognised under IFRS but are excluded from EEV. This is because the basis of preparing the Group EEV results, are prepared by reference to the Realistic Balance Sheet (RBS). Some items recognised under IFRS are inadmissible in the RBS and are therefore not recognised in our EEV reporting. Most notably, Operating Profit includes amortisation of intangibles (and impairment if relevant) whereas in our EEV reporting, we exclude goodwill or other intangible assets arising on the acquisition of a subsidiary or business (other than Value of In-Force business) because such items are not permitted to be recognised in the RBS.

The RBS is produced at the level of the Parent company. In order to present the EEV balance sheet as a group balance sheet, the RBS is grossed up to include the assets and liabilities of subsidiaries which are included in the RBS at the value of the Parent company's net investment. However, this gross up excludes any assets and liabilities held within the long term funds of subsidiaries for which the net result is retained wholly within that fund, most notably the long term fund of Royal London (CIS) Limited at 31st December 2013 (subsequently transferred into the Parent on 30th December 2014).

A further presentation adjustment is made to the EEV balance sheet in respect of reinsurance. The RBS shows reinsured liabilities net of the related reinsurance asset. The EEV balance sheet is grossed up to show the reinsured liabilities and assets separately.

# Appendix 2

## IFRS consolidated statement of comprehensive income for the year ended 31 December 2014

| | **2014** £m | 2013 Restated £m |
|---|---|---|
| **Revenues** | | |
| Gross earned premiums | **1,218** | 1,092 |
| Premiums ceded to reinsurers | **(1,794)** | (366) |
| Net earned premiums | **(576)** | 726 |
| Fee income from investment and fund management contracts | **243** | 217 |
| Investment return | **7,796** | 3,798 |
| Gain arising on business combinations | **-** | 125 |
| Other operating income | **47** | 37 |
| **Total revenues** | **7,510** | 4,903 |
| **Policyholder benefits and claims** | | |
| Claims paid, before reinsurance | **2,569** | 2,229 |
| Reinsurance recoveries | **(432)** | (290) |
| Claims paid, after reinsurance | **2,137** | 1,939 |
| Increase /(decrease) in insurance contract liabilities, before reinsurance | **3,749** | (1,054) |
| Reinsurance ceded | **(1,515)** | 570 |
| Increase/(decrease) in insurance contract liabilities, after reinsurance | **2,234** | (484) |
| Decrease / (increase) in non-participating value of in-force business | **3** | (279) |
| Increase in investment contract liabilities | **1,846** | 2,313 |
| **Total policyholder benefits and claims** | **6,220** | 3,489 |
| **Operating expenses** | | |
| Administrative expenses | **486** | 424 |
| Investment management expenses | **190** | 175 |
| Amortisation charges and impairment losses on acquired PVIF and other intangible assets | **72** | 70 |
| Investment return attributable to external unit holders | **101** | 235 |
| Other operating expenses | **42** | 35 |
| **Total operating expenses** | **891** | 939 |
| **Finance costs** | **43** | 30 |
| **Result before tax from continuing operations** | **356** | 445 |
| **Tax charge** | **207** | 73 |
| **Transfer to the unallocated divisible surplus from continuing operations** | **149** | 372 |
| **Result after tax from discontinued operations** | **-** | (42) |
| **Transfer from the unallocated divisible surplus from discontinued operations** | **-** | (42) |
| **Profit for the year** | **-** | - |

**IFRS consolidated statement of comprehensive income for the year ended 31 December 2014 (continued)**

| | **2014** | 2013 Restated |
|---|---|---|
| | **£m** | £m |
| **Other comprehensive income from continuing operations** | | |
| **Items that will not be reclassified to profit or loss** | | |
| Remeasurements of defined benefit pension schemes | **(15)** | 7 |
| Transfer (from)/to the unallocated divisible surplus | **(15)** | 7 |
| **Other comprehensive income for the period net of tax from continuing operations** | **-** | - |
| **Other comprehensive income from discontinued operations** | **-** | - |
| **Total comprehensive income for the period** | **-** | - |

As a mutual company, all earnings are retained for the benefit of participating policyholders and are carried forward within the unallocated divisible surplus. Accordingly, there is no profit for the year shown in the statement of total comprehensive income.

## IFRS Consolidated Balance Sheet as at 31 December 2014

| | Group | | | Parent company | | |
|---|---|---|---|---|---|---|
| | **2014** | 2013 Restated | 1 Jan 2013 Restated | **2014** | 2013 Restated | 1 Jan 2013 Restated |
| **ASSETS** | **£m** | £m | £m | **£m** | £m | £m |
| **Property, plant and equipment** | **46** | 34 | 42 | **-** | - | - |
| **Investment property** | **4,727** | 4,074 | 2,284 | **4,633** | 2,503 | 2,234 |
| **Intangible assets** | **931** | 1,041 | 1,083 | **893** | 879 | 957 |
| **Reinsurers' share of insurance contract liabilities** | **5,462** | 3,947 | 1,159 | **5,462** | 608 | 1,159 |
| **Pension scheme asset** | **128** | 151 | 144 | **128** | 151 | 144 |
| **Deferred tax asset** | **-** | 61 | 121 | **-** | 49 | 108 |
| **Current tax asset** | **-** | 4 | 10 | **-** | 8 | 7 |
| Financial investments | **59,492** | 52,321 | 31,648 | **44,231** | 18,964 | 18,833 |
| Investments in Group entities | **-** | - | - | **12,894** | 11,098 | 8,094 |
| Trade and other receivables | **412** | 508 | 277 | **285** | 314 | 174 |
| Cash and cash equivalents | **2,736** | 2,160 | 2,899 | **2,259** | 1,760 | 2,091 |
| **Total assets** | **73,934** | 64,301 | 39,667 | **70,785** | 36,334 | 33,801 |

## IFRS Consolidated Balance Sheet as at 31 December 2014

| | Group | | | Parent company | | |
|---|---|---|---|---|---|---|
| | **2014** | 2013 Restated | 1 Jan 2013 Restated | **2014** | 2013 Restated | 1 Jan 2013 Restated |
| **LIABILITIES** | **£m** | £m | £m | **£m** | £m | £m |
| Participating insurance contract liabilities | **29,607** | 26,365 | 11,722 | **29,682** | 11,268 | 11,722 |
| Participating investment contract liabilities | **2,308** | 2,284 | 1,947 | **2,308** | 1,980 | 1,947 |
| Unallocated divisible surplus | **3,139** | 3,005 | 2,668 | **3,183** | 2,938 | 2,668 |
| Non-participating value of in-force business | **(1,332)** | (1,335) | (963) | **(1,332)** | (1,169) | (906) |
| | **33,722** | 30,319 | 15,374 | **33,841** | 15,017 | 15,431 |
| Non-participating insurance contract liabilities | **7,506** | 6,999 | 4,069 | **7,504** | 3,388 | 3,797 |
| Non-participating investment contract liabilities | **22,691** | 19,148 | 17,501 | **22,691** | 16,254 | 13,397 |
| | **30,197** | 26,147 | 21,570 | **30,195** | 19,642 | 17,194 |
| Subordinated liabilities | **640** | 640 | 398 | **640** | 640 | 398 |
| Payables and other financial liabilities | **5,544** | 4,095 | 352 | **5,486** | 558 | 293 |
| Provisions | **250** | 248 | 238 | **237** | 232 | 228 |
| Other liabilities | **316** | 320 | 322 | **244** | 245 | 257 |
| Liability to external unit holders | **3,122** | 2,486 | 1,413 | **-** | - | - |
| Current tax liability | **52** | - | - | **51** | - | - |
| Deferred tax liability | **91** | 46 | - | **91** | - | - |
| **Total liabilities** | **73,934** | 64,301 | 39,667 | **70,785** | 36,334 | 33,801 |

## IFRS Consolidated Statement of cash flows for the period ended 31 December 2014

| | Group | | Parent company | |
|---|---|---|---|---|
| | **2014** | 2013 Restated | **2014** | 2013 |
| | **£m** | £m | **£m** | £m |
| **Cash flows from operating activities** | | | | |
| Transfer to the unallocated divisible surplus | **134** | 379 | **245** | 270 |
| Adjustments for non-cash items | **(1,036)** | (1,232) | **(2,711)** | 163 |
| Adjustments for non-operating items | **43** | 30 | **7** | (62) |
| Acquisition of investment property | **(277)** | (330) | **(264)** | (325) |
| Net acquisition of financial investments | **(414)** | (585) | **(1,777)** | (992) |
| Proceeds from disposal of investment property | **54** | 247 | **50** | 181 |
| Changes in operating receivables | **96** | (157) | **29** | (140) |
| Changes in operational payables | **1,646** | (28) | **4,918** | 249 |
| Change in liability to external unit holders | **636** | 1,001 | **-** | - |
| Net cash flows from operating activities before tax | **882** | (675) | **497** | (656) |
| Tax (paid)/received | **(47)** | (18) | **1** | (2) |
| **Net cash flows from operating activities - continuing operations** | **835** | (693) | **498** | (658) |
| **Net cash flows from operating activities - discontinued operations** | **-** | (42) | **-** | - |
| **Total net cash flows from operating activities** | **835** | (735) | **498** | (658) |
| **Cash flows from investing activities** | | | | |
| Acquisition of property, plant and equipment | **(15)** | (4) | **-** | - |
| Acquisition of intangibles | **-** | (4) | **-** | - |
| Acquisition of Group entities | **(180)** | 153 | **(8)** | (43) |
| Proceeds from disposal of Group entities | **-** | (390) | **10** | 105 |
| Proceeds from sale of property, plant and equipment | **-** | 4 | **-** | - |
| Dividends received from Group entities | **-** | - | **31** | 49 |
| **Net cash flows from investing activities - continuing operations** | **(195)** | (241) | **33** | 111 |
| **Net cash flows from investing activities - discontinued operations** | **-** | 7 | **-** | - |
| **Total net cash flows from investing activities** | **(195)** | (234) | **33** | 111 |
| **Cash flows from financing activities** | | | | |
| Proceeds on issue of debt | **-** | 394 | **-** | 394 |
| Repayments of other debt and finance lease liabilities | **-** | (154) | **14** | (154) |
| Interest paid | **(43)** | (30) | **(41)** | (28) |
| **Net cash flows from financing activities - continuing operations** | **(43)** | 210 | **(27)** | 212 |
| **Net increase / (decrease) in cash and cash equivalents** | **597** | (759) | **504** | (335) |
| **Cash and cash equivalents as at 1 January** | **2,133** | 2,892 | **1,749** | 2,084 |
| **Cash and cash equivalents at 31 December** | **2,730** | 2,133 | **2,253** | 1,749 |

An integral part of the operations of the Group is the management of a portfolio of investment assets. Cash flows relating to the purchase and sale of these assets have been treated as operating cash flows for the purposes of the statements of cash flows. In the Parent company, Open Ended Investment Companies (OEICs) and other investment funds that are classified for financial reporting purposes as subsidiaries are also part of this operating portfolio of investment assets and hence cash flows in relation to these assets are also classified as operating cash flows for the Parent company statement of cash flows.

**(a) Basis of preparation**

The financial statements of the Group and the Parent company ('the financial statements') have been prepared in accordance with International Financial Reporting Standards (IFRS) and Interpretations issued by the IFRS Interpretations Committee (IFRS IC) as adopted for use in the European Union. The financial statements have also been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared on the historical cost basis as modified by the inclusion of certain assets and liabilities at fair value as permitted or required by IFRS. The accounting policies set out below are reviewed for appropriateness each year. These policies have been applied consistently to all periods presented in these financial statements, unless otherwise stated.

All amounts in the financial statements are shown in pounds sterling, which is the presentational currency of the Group and the Parent company. Unless otherwise stated, amounts are shown in millions of pounds, rounded to the nearest million.

**New and amended standards adopted by the Group**

The following new and amended standards have been adopted by the Group for the first time in these financial statements:

- IFRS 10, 'Consolidated financial statements' changes the definition of control that determines which entities are consolidated in the Group accounts. Under the new definition the Group controls an investee if it has all of the following: power over the investee, variable returns from its involvement with the investee and the ability to use its power to affect those returns. The application of IFRS 10 has resulted in the consolidation of some investment vehicles that were not previously consolidated. The Group has applied the standard retrospectively in accordance with the standard's transitional provisions and has restated the comparative figures accordingly. The impact on the Group and Parent company is set out overleaf:

## (a) Basis of preparation (continued)

— There was no material impact on the consolidated statement of comprehensive income for the years to 31 December 2014 or 31 December 2013.

— At 1 January 2013 there was no change in total consolidated assets and liabilities, but within assets £71m has been reclassified from financial investments to investment property. Within the Parent company balance sheet £71m has been reclassified from financial investments to investments in Group entities. At 31 December 2013, consolidated assets and liabilities both increased by £177m and there was a reclassification of £158m from financial investments to investments in Group entities in the Parent company.

- IFRS 11, 'Joint Arrangements' – the Group now accounts for its joint ventures using the equity method, whereas previously proportional consolidation was used. There was no material impact from this change on the consolidated statement of comprehensive income for the years to 31 December 2014 or 31 December 2013 or on the Group and Parent company balance sheets as at those dates. In the Group balance sheet at 1 January 2013 the application of the new requirements has resulted in a reduction in 'investment property' of £106m, a reduction in 'cash and cash equivalents' of £2m and a reduction in 'payables and other financial liabilities' of £108m, with no overall net impact. The Group balance sheet as at 1 January 2013 and the Group cash flow statement for the year to 31 December 2013 have been restated for these changes.

- The impact of the above restatements is shown in the following tables.

The impact on the balance sheets as at 31 December 2013:

| | **Group – 2013** | | | **Parent company – 2013** | | |
|---|---|---|---|---|---|---|
| **Assets** | As previously reported £m | Impact of IFRS 10 £m | Restated £m | As previously reported £m | Impact of IFRS 10 £m | Restated £m |
| Investment property | 3,998 | 76 | 4,074 | 2,503 | – | 2,503 |
| Financial investments | 52,231 | 90 | 52,321 | 19,122 | (158) | 18,964 |
| Investments in Group entities | – | – | – | 10,940 | 158 | 11,098 |
| Current tax | 2 | 2 | 4 | 8 | – | 8 |
| Trade and other receivables | 505 | 3 | 508 | 314 | – | 314 |
| Cash and cash equivalents | 2,154 | 6 | 2,160 | 1,760 | – | 1,760 |
| Other assets not impacted by IFRS 10 | 5,234 | – | 5,234 | 1,687 | – | 1,687 |
| | **64,124** | **177** | **64,301** | **36,334** | **–** | **36,334** |
| **Liabilities** | | | | | | |
| Payables and other financial liabilities | 4,089 | 6 | 4,095 | – | – | – |
| Liability to external unit holders | 2,315 | 171 | 2,486 | – | – | – |
| Liabilities not impacted by IFRS 10 | 57,720 | – | 57,720 | – | – | – |
| | **64,124** | **177** | **64,301** | **–** | **–** | **–** |

## (a) Basis of preparation (continued)

At 31 December 2014, consolidated assets and liabilities were both £167m higher than would have been the case before the adoption of IFRS 10.

The impact on the Group statement of cash flows for the year to 31 December 2013 is shown below. There was no impact on the Parent company statement of cash flows.

| **Cash flows from operating activities** | **As previously reported £m** | **Group –2013 Impact of IFRSs 10 & 11 £m** | **Restated £m** |
|---|---|---|---|
| Adjustments for non-cash items | (1,070) | (162) | (1,232) |
| Proceeds from disposal of investment property | 353 | (106) | 247 |
| Net acquisition of financial investments | (615) | 30 | (585) |
| Changes in operating receivables | (154) | (3) | (157) |
| Changes in operating payables | (37) | 9 | (28) |
| Changes in liability to external unit holders | 830 | 171 | 1,001 |
| Other operating cash flows not impacted by IFRSs 10 & 11 | 37 | – | 37 |
| Tax paid | (12) | (6) | (18) |
| **Total net cash flows from operating activities** | **(668)** | **(67)** | **(735)** |
| **Cash flows from investing activities** | | | |
| Acquisition of Group entities | – | – | – |
| Other investing cash flows not impacted by IFRSs 10 & 11 | (234) | – | (234) |
| **Total net cash flows from investing activities** | **(234)** | **–** | **(234)** |
| **Cash flows from financing activities** | | | |
| Repayments of other debt and finance lease liabilities | **(229)** | **75** | **(154)** |
| Other financing cash flows not impacted by IFRSs 10 & 11 | 364 | – | 364 |
| **Total net cash flows from financing activities** | 135 | **75** | 210 |
| **Net decrease in cash and cash equivalents** | (767) | 8 | (759) |
| **Cash and cash equivalents at 1 January** | 2,894 | (2) | 2,892 |
| **Cash and cash equivalents at 31 December** | **2,127** | 6 | **2,133** |

The impact in 2014 was an increase in the movement across several lines, offset by an increase of £262m in the change in liability to external unit holders.

- IFRS 12, 'Disclosure of Interests in Other Entities' has resulted in some changes to the disclosures on investments in Group entities.

Other new and amended standards and interpretations applicable for the first time in these financial statements, which have not had a material impact on the Group are listed below:

— IAS 27, 'Separate Financial Statements'.
— IAS 28, 'Investments in Associates and Joint Ventures'.
— Amendments to IFRSs 10,11 and 12 – transition guidance.
— Amendments to IAS 32, 'Offsetting Financial Assets and Financial Liabilities'.
— Amendments to IFRSs 10, 12 and IAS 27 – 'Investment Entities'.
— Amendments to IAS 39, 'Novation of Derivatives and Continuation of Hedge Accounting'.
— Amendments to IAS 36, 'Impairment of Assets', recoverable amount disclosures for non-financial assets.
— IFRIC 21, 'Levies'.

# Appendix 3

## Reconciliation of the IFRS unallocated divisible surplus to the European Embedded Value

| | **2014 £m** | 2013 £m |
|---|---|---|
| IFRS unallocated divisible surplus | **3,139** | 3,005 |
| Valuation differences between IFRS and EEV | | |
| - Goodwill and intangible assets | **(273)** | (284) |
| - Deferred tax valuation differences | **3** | (21) |
| - Subordinated debt at market value | **(42)** | (16) |
| - Capital requirements of subsidiaries and other valuation differences | **(46)** | (20) |
| Add items only included on an embedded value basis | | |
| - Valuation of asset management and service subsidiaries | **187** | 143 |
| Other valuation differences | **18** | 19 |
| **European embedded value** | **2,986** | 2,826 |

## Reconciliation of the IFRS transfer to unallocated divisible surplus to EEV profit for the year

| | **2014 £m** | 2013 £m |
|---|---|---|
| IFRS transfer to unallocated divisible surplus | **134** | 337 |
| Amortisation of intangible assets | **11** | 13 |
| Differences in valuation of subsidiaries | **17** | 57 |
| Change in realistic value of subordinated debt | **(26)** | (63) |
| Movement in valuation differences for deferred tax assets | **24** | 78 |
| Other movements in valuation bases | **-** | (31) |
| **EEV profit for the year** | **160** | 391 |

## Reconciliation of Operating Profit to IFRS result before tax

| | **2014 £m** | 2013 £m |
|---|---|---|
| **Operating Profit from continuing operations before exceptional items** | **192** | 187 |
| Exceptional cost arising from regulatory change | **(61)** | - |
| Gain arising on business combinations | **-** | 125 |
| **Operating Profit** | **131** | 312 |
| Investment return variances and economic assumption changes | **336** | 244 |
| Net gain on Group pension schemes recognised in result before tax | **(8)** | - |
| Finance costs | **(43)** | (30) |
| Profit Share | **(60)** | (81) |
| **IFRS Profit before tax** | **356** | 445 |
| Attributed tax charge | **(207)** | 73 |
| **Discontinued operations** | **-** | (42) |
| **Other comprehensive income** | **(15)** | 7 |
| **Total transfer to unallocated divisible surplus** | **134** | 337 |