Press Release

19 August 2014

Royal London reports strong half year growth in sales and operating profits

ROYAL LONDON WARNS OF DAMAGING CONSEQUENCES OF GOVERNMENT'S PRICE CAP

Royal London, the UK's largest mutual life, pensions and investment company, presents its interim financial statements and new business results for the six months ending 30 June 2014.

Key performance indicators (figures in brackets show movement compared to H1 2013)

Financial results

- EEV operating profit from continuing operations before exceptional items £110m (+8%)
- EEV profit before tax from continuing operations £139m (-45%)
- IFRS result before tax from continuing operations £136m (-49%)

Whilst continuing EEV operating profit before exceptional items was ahead of half year 2013, the full EEV result has been adversely impacted by a £61m assumption change arising from the introduction of charge capping and other regulatory changes on defined contribution group pension schemes. The EEV result before tax has also been impacted by this exceptional item and smaller positive economic variances compared to the equivalent period in the prior year.

New business and trading focus

- Total continuing new life and pensions business (on a PVNBP basis)[1] was up 31% at £2,265m (June 2013: £1,728m). Main product line performance:
  - Group Pensions £1,061m (+91%)
  - Individual Pensions £609m (+15%)
  - Drawdown £358m (+19%)
  - Protection £161m (-33%)

- Strong sales growth in all areas of Royal London's pension product range reflects the ongoing performance and popularity of our governed investment range and our established service reputation in the pensions market.
- Asset management business continues to perform well, with Royal London Asset Management ("RLAM") achieving net new external business inflows of £1,315m (June 2013 £308m). Wholesale flows of £745m were predominantly into Equity Income and Credit funds. Institutional flows of £569m include a new client, Hertfordshire County Council, with around £250m into RLPPC Credit fund and various charities investing into its popular Cash Plus fund.
- The Ascentric wrap platform achieved net new assets of £651m (June 2013 £813m) and has £8.0bn assets under administration, a 30% increase on last year (£6.2bn in June 2013). The business is making good progress with its programme of technology improvements to further enhance its already strong service and to support growth.
- In the first half of 2014, new business volumes for the Group's protection proposition are down on the same period last year when business was buoyed by the spike in demand created by the removal of gender-specific pricing. Royal London continues to invest in service enhancements and product improvements with the aim of increasing future protection market share.
- Royal London's new consumer division is launching its first products aimed at improving access to fairer and better value products for mass market consumers who do not use financial advisors. These include a fairer Over 50s Plan, an annuity bureau service and simple online term assurance, all featuring competitive pricing to build future market share.

[1] See Editor's Note 3 for an explanation of the PVNBP basis.

Long term fund performance

- Royal London with-profits fund investment performance was 3.8% against benchmark of 3.7% (H1 2013 3.9% against benchmark of 3.3%).
- Total Group funds under management were £77.0bn at 30 June 2014, +5% on 31 Dec 2013 and +51% on 30 June 2013 (including £20bn of assets taken on from the acquisition of The Co-operative Asset Management Limited in July 2013)

Capital strength

- Regulatory (Insurance Group Directive) capital surplus was £2,935m (+7% on 31 December 2013).

Phil Loney, Group Chief Executive of Royal London, on strategic direction and trading:

"I am pleased with the trading momentum of the group during the first half of the year. Our aspiration is to build a business that delivers the best customer outcomes and experiences in the market and these results show that we are progressing towards that goal.

I am encouraged by a number of factors in our results:

- *Both **individual and group pensions** continue to register impressive results, with market share forging ahead in both areas. Our focus on medium sized employers for automatic enrolment schemes should ensure that the flow of new business remains robust.*

- *With a **72% share of the external linked free standing drawdown market**[2] we continue to be the market leaders. The freedoms announced in March's Budget are likely to make drawdown in all its forms a far more popular method of generating an income in retirement than it is currently, which will put us in a particularly strong position.*

- *In our **asset management business**, new business acquisition remains extremely positive, especially in the wholesale sector. Just as importantly, we are experiencing high levels of retention in this area of the business, demonstrating that the growth we're seeing in asset management is long-term.*

- ***The protection market** continues to be challenging for us, but I am encouraged by the work we have done to date to increase focus and investment in this aspect of the*

[2] ABI

business with the aim of achieving the kind of established reputation for good service, strong product and good value for money that we have already built in the pensions market.

- *The process of integrating the* ***Co-op CIS*** *business (life, pensions and asset management) is well under way and we expect it to fully complete around Q3 of next year.*

Last but not least, we are very pleased with the initial results of our brand advertising. It has prompted a significant rise in consumer awareness and positive customer reaction, and it has given us great momentum as we continue to build Royal London into a well-known mutual brand."

Phil Loney, Group Chief Executive of Royal London, on charge capping workplace pensions:

"With the charge-capping and other reforms introduced by the Government to the group pensions market, we are beginning to see the first signs that this headline-grabbing policy will have precisely the opposite consequence to that which is intended.

As the leading customer owned insurer in the UK we firmly support the overall trend towards lower charges on workplace pensions, and we have been less impacted than some competitors due to our longstanding refusal to offer active member discounts, which we have campaigned against as unfair. That said, we believe that this Government intervention will only distort a market that was already moving in favour of lower charges for pension scheme members due to scale economies from auto-enrolment. Future governments should focus on increasing the onus on employers to regularly shop around the market for the best deal on offer rather than focus on centrally fixing market prices, which acts to reduce competition.

Pensions Minister Steve Webb told Parliament that pensions companies' total revenue would be reduced by £200m over a 10 year period. The provisions for the pension charge cap that we have seen from pension providers during this reporting period suggests that this is a gross underestimate. We estimate that the total reduction in long term insurer income may well reach £1bn. This seems to me to be an unacceptable margin for error in the government's understanding of the impact of its actions and the size of the impact is driving many insurers to introduce employer fee arrangements to mitigate against the impact of further reductions in the price cap. I hope that present and future governments will think *carefully about these consequences before lowering the cap further, not least because the impact of price capping is likely to fall increasingly on the hard pressed SME sector."*

-ENDS-

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Editor's notes:

1. Royal London is the largest mutual life and pensions company in the UK with Group funds under management of £77.0 billion. Group businesses serve around 5.3 million customers and employ over 2,900 people. (Figures quoted are as at 30 June 2014).

Over the next two years the Group is moving to operate all of its UK life, pension and investment business under a new version of the Royal London brand. The Group's wrap platform will remain branded Ascentric.

2. New life and pensions business for the period to 30 June 2014

Present Value of New Business Premiums

	2014 £m	2013 £m	Change %
Intermediary:			
Pensions	**2,077**	1,466	+42%
Protection	**161**	242	-33%
Consumer	**27**	20	+35%
Continuing life and pensions business	**2,265**	1,728	+31%
Discontinued life and pensions business – RL360° (1)	**-**	223	-100%
Group total	**2,265**	1,951	+16%

(1) On 14 November 2013 the Group's wholly owned offshore subsidiary, Royal London 360° Insurance Company Limited, was sold by means of a management buyout and has therefore been classified as a discontinued operation.

3. Present Value of New Business Premiums (PVNBP)

The 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.

4. Asset Management / Administration net new business

	2014 £m	2013 £m	Change
RLAM			
Net new business, excluding external cash mandates:			
Inflows	**1,855**	1,271	+46%
Outflows	**(540)**	(963)	+44%
Net	**1,315**	308	+327%
Ascentric			
Net new assets under administration	**651**	813	-20%

5. Financial calendar

6 November 2014	Interim management statement and third quarter new business figures
30 November 2014	RL Finance Bonds No 2 plc Subordinated debt interest payment date
15 December 2014	RL Finance Bonds plc Subordinated debt interest payment date

6. 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.

7. Financial Review

Overview

We have delivered a strong operating performance in the first half of 2014, with strong new business results, particularly in group pensions business, and an increase in underlying operating profits.

On the EEV basis, our continuing operating profit before exceptional items for H1 2014 was £110m (H1 2013 £102m). This result reflects good contribution from new business and favourable operating experience.

We also incurred a £61m one-off exceptional cost arising from the introduction of a charge cap on defined contribution group pension schemes which reduced total EEV operating profit to £49m, a decrease of 52% on 30 June 2013.

After reflecting this exceptional cost and economic variances, our European Embedded Value (EEV) profit before tax from continuing operations was £139m. This result reflects the improved investment markets and an increase in the value of the Royal London Group Pension Scheme surplus. It is, however, lower than the equivalent result of £265m for H1 2013, as economic variances for H1 2014 were lower than the large favourable variances experienced in H1 2013.

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 £77.0bn at 30 June 2014. Ascentric, our wrap platform administrator, has achieved strong levels of new business and has increased its assets under administration by 10% in the first 6 months of 2014 to £8.0bn (31 December 2013 £7.3bn).

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:

	30 June 2014				31 Dec 2013			
£m	**Open Funds**	**Closed Funds**	**RL (CIS) Adjust-just-ment**[1]	**Total**	Open Funds	Closed Funds	RL (CIS) Adjust-ment[1]	Total
Available capital (including tier 2 capital)	**3,388**	**2,706**	**3,243**	**9,337**	3,184	2,585	3,333	9,102
Capital required	**(453)**	**(284)**	**(513)**	**(1,250)**	(435)	(290)	(504)	(1,229)
Surplus	**2,935**	**2,422**	**2,730**	**8,087**	2,749	2,295	2,829	7,873
Restriction on surplus of closed funds	**-**	**(2,422)**	**(2,730)**	**(5,152)**	-	(2,295)	(2,829)	(5,124)
Excess capital	**2,935**	**-**	**-**	**2,935**	2,749	-	-	2,749
Capital cover	**748%**	**100%**	**100%**	**146%**	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 £9,337m at 30 June 2014. The Group has maintained strong regulatory capital cover of 146% (31 December 2013 143%).

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 from £2,749m to £2,935m.

Our realistic capital position is summarised as follows:

£m	**30 June 2014**			31 Dec 2013		
	Open Funds	**Closed Funds**	**Total**	Open Funds	Closed Funds	Total
Available capital (including tier 2 capital)	**3,187**	**1,035**	**4,222**	3,074	972	4,046
Capital required	**(12)**	**-**	**(12)**	-	-	-
Surplus	**3,175**	**1,035**	**4,210**	3,074	972	4,046
Closed fund transfer commitments	**-**	**(1,035)**	**(1,035)**	-	(972)	(972)
Excess capital	**3,175**	**-**	**3,175**	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 £3,175m.

The Group's realistic capital position includes the impact of RL (CIS) Limited within investments in subsidiaries within the Open fund available capital.

CIS acquisition

On 31 July 2013 Royal London acquired Co-operative Insurance Society Limited (now known as Royal London (CIS) Limited) along with its subsidiaries and The Co-operative Asset Management Limited (now known as Royal London Asset Management (CIS) Limited), by way of a share purchase. We acquired the entire issued share capital of the two entities for an initial consideration of £40m and deferred consideration of £180m. The payment of this deferred consideration will be made when certain conditions are met, in particular that assets of the same value currently held in Royal London (CIS) Limited become available to the Royal London Open Fund.

We will administer the CIS and subsidiary policies and investments that we have acquired in return for a schedule of agreed fees paid out of the CIS long-term fund. The £150m in profit that we have recognised on the acquisition in the 31 December 2013 accounts reflects the present value of the difference between these fixed fees and our projected operating costs for administering the business. We hope to recognise further profits from this acquisition in the future through cost-efficiencies. In particular, we intend to undertake a Part VII transfer of the CIS long-term fund into the Royal London open fund.

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, even likely, 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 mutual dividend we are able to allocate to our participating members could need to be restricted in the short-term.

Project Chrysalis

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.

EEV income statement

	30 June 2014	30 June 2013 Restated	31 Dec 2013
	£m	£m	£m
Contribution from new business	**35**	34	70
Profit from existing business			
– Expected return	**45**	31	63
– Operating experience variances	**22**	16	29
– Operating assumption changes	**8**	19	48
Expected return on opening net worth	**24**	16	34
Profit on uncovered business	**4**	3	11
Strategic development costs and other items	**(28)**	(17)	(59)
Operating profit before tax and exceptional items	**110**	102	196
Gain arising on business combinations	**-**	-	150
Exceptional cost arising from regulatory change	**(61)**	-	-
Total operating profit before tax from continuing operations	**49**	102	346
Operating profit/(loss) before tax from discontinued operations	**-**	11	(40)
Total operating profit before tax	**49**	113	306
Economic experience variances	**104**	61	140
Economic assumption changes	**(17)**	76	83
Movement in RLGPS pension scheme surplus	**23**	38	8
Financing costs	**(20)**	(12)	(26)
Mutual dividend	**-**	-	(86)
EEV profit before tax from continuing operations	**139**	265	465
Attributed tax charge	**(12)**	(14)	(36)
EEV profit after tax from continuing operations	**127**	251	429
EEV profit after tax from discontinued operations	**-**	14	(38)
Total EEV profit after tax	**127**	265	391

EEV operating profit

In H1 2014 the Group achieved an EEV operating profit from continuing operations before exceptional items of £110m (H1 2013 £102m). This result reflects good contribution from new business and favourable operating experience.

Our H1 2014 EEV operating profit includes:

- £35m profits from continuing new business (H1 2013 £34m)
- £30m favourable operating variances (H1 2013 £35m)
- £(28)m of strategic development costs and other items which includes £27m to support initiatives, that we believe are important for our future competitiveness, and we expect will deliver good returns in the future (H1 2013 £6m).
- We also incurred a £61m one-off exceptional cost arising from the introduction of a charge cap on defined contribution group pension schemes.

EEV profit after reflecting the impact of economic variances

Our investment returns were better than we expected at the start of the year and the benefit of this is shown within economic experience. The Royal London Group Pension Scheme surplus increased in value by £23m over the period.

After reflecting the impact of economic variances, our EEV profit before tax from continuing operations was £139m (H1 2013 £265m). The decrease on the prior year was due to the impact of the £61m exceptional cost from the pensions charge cap, together with reduced economic variances and assumption changes in H1 2014 which, were lower than the large favourable variances and assumption changes experienced in H1 2013.

IFRS results

Our IFRS result before tax from continuing operations for the period was £136m (H1 2013 £267m). This result reflects many of the features described above within the EEV results. Note 11 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 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 £87m (H1 2013 £88m).

The table in Note 12 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 £3,112m at 30 June 2014.

Our balance sheet remains stable and we experienced no significant asset impairments in the period. Our total investment portfolio was £53,154m at 30 June 2014, an increase on 31 December 2013 of 1.6%. Our asset portfolio remains high quality, with the majority of our 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 Italy, Portugal, Ireland, Greece and Spain amounted to £48m, 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 H1 2014 the investments backing the asset shares of the Royal London Open Fund achieved a return of 3.8%, which was above our benchmark of 3.7%.

The Royal London with-profits investment performance for UK equities was 1.4% (benchmark 1.6%), overseas equities returned 2.5% (benchmark 2.9%), returns from corporate bonds were 6.2% (benchmark 4.5%), government bonds achieved a return of 4.8% (benchmark 4.8%) and our property portfolio returned 8.4% (benchmark 8.8%).

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.

IFRS consolidated statement of comprehensive income for the six months ended 30 June 2014

	Notes	**30 June 2014 £m**	30 June 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Revenues				
Gross earned premiums		**616**	446	1,092
Amounts paid to reinsurers		**(1,197)**	(208)	(366)
Net earned premiums		**(581)**	238	726
Fee income from investment and fund management contracts		**130**	96	217
Investment return		**2,287**	1,560	3,798
Gain arising on business combinations		**-**	-	125
Other operating income		**23**	26	37
Total revenues		**1,859**	1,920	4,903
Policyholder benefits and claims				
Claims paid, before reinsurance		**1,300**	839	2,229
Reinsurance recoveries		**(200)**	(119)	(290)
Claims paid, after reinsurance		**1,100**	720	1,939
Increase /(decrease) in insurance contract liabilities, before reinsurance		**489**	(1,015)	(1,054)
Reinsurance ceded		**(1,023)**	566	570
Decrease in insurance contract liabilities, after reinsurance		**(534)**	(449)	(484)
Decrease / (increase) in non-participating value of in-force business		**91**	(133)	(279)
Increase in investment contract liabilities		**636**	1,063	2,313
Total policyholder benefits and claims		**1,293**	1,201	3,489
Operating expenses				
Administrative expenses		**224**	207	424
Investment management expenses		**92**	68	175
Amortisation charges and impairment losses on acquired PVIF and other intangible assets		**22**	37	70
Investment return attributable to external unit holders		**27**	121	235
Other operating expenses		**44**	7	35
Total operating expenses		**409**	440	939
Finance costs		**21**	12	30
Result before tax		**136**	267	445
Tax charge	5	**65**	20	73
Transfer to the unallocated divisible surplus from continuing operations		**71**	247	372
Transfer from the unallocated divisible surplus from discontinued operations			(41)	(42)
Profit for the period		**-**	-	-

IFRS consolidated statement of comprehensive income for the six months ended 30 June 2014 (continued)

	30 June 2014 £m	30 June 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Other comprehensive income from continuing operations			
Items that will not be reclassified to profit or loss			
Remeasurements of defined benefit pension schemes	**36**	36	7
Transfer to the unallocated divisible surplus	**36**	36	7
Other comprehensive income for the period net of tax from continuing 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 30 June 2014

ASSETS	Notes	**30 June 2014 £m**	30 June 2013 Restated £m	31 Dec 2013 Restated £m
Property, plant and equipment		**35**	42	34
Investment property		**4,471**	2,310	4,074
Intangible assets		**1,001**	1,062	1,041
Reinsurers' share of insurance contract liabilities		**4,970**	593	3,947
Pension scheme asset	6	**179**	182	151
Deferred tax asset		**38**	109	61
Current tax asset		**-**	6	2
Financial assets				
Financial investments		**53,154**	33,156	52,323
Loans and receivables, including insurance receivables		**864**	352	510
Cash and cash equivalents	7	**2,349**	2,814	2,158
Total financial assets		**56,367**	36,322	54,991
Total assets		**67,061**	**40,626**	**64,301**

IFRS Consolidated Balance Sheet as at 30 June 2014

LIABILITIES	Notes	**30 June 2014 £m**	30 June 2013 Restated £m	31 Dec 2013 Restated £m
Participating insurance contract liabilities		**26,813**	11,252	26,365
Participating investment contract liabilities		**2,299**	2,015	2,284
Unallocated divisible surplus		**3,112**	2,910	3,005
Non-participating value of in-force business		**(1,244)**	(1,096)	(1,335)
		30,980	15,081	30,319
Non-participating insurance contract liabilities		**7,040**	3,542	6,999
Non-participating investment contract liabilities		**20,649**	18,840	19,148
		27,689	22,382	26,147
Subordinated liabilities	8	**640**	399	640
Payables and other financial liabilities		**4,331**	413	4,095
Provisions		**254**	248	248
Other liabilities		**300**	332	320
Liability to external unit holders		**2,798**	1,771	2,486
Deferred tax liability		**63**	-	46
Current tax liability		**6**	-	-
Total liabilities		**67,061**	**40,626**	**64,301**

IFRS Consolidated Statement of cash flows for the six months ended 30 June 2014

	30 Jun 2014 £m	30 Jun 2013 Restated £m	31 Dec 2013 Restated £m
Cash flows from operating activities			
Transfer to the unallocated divisible surplus	**107**	283	379
Adjustments for non-cash items	**208**	(44)	(1,070)
Adjustments for non-operating items	**20**	12	30
Acquisition of investment property	**(195)**	(66)	(325)
Net acquisition of financial investments	**(91)**	(612)	(788)
Proceeds from sale of investment property	**8**	177	353
Changes in operating receivables	**(354)**	(80)	(159)
Changes in operational payables	**220**	33	(31)
Change in liability to external unit holders	**312**	359	1,001
Net cash flows from operating activities before tax	**235**	62	(610)
Tax paid	**(17)**	(4)	(12)
Net cash flows from continuing operations	**218**	58	(622)
Net cash flow from discontinued operations	**-**	(50)	(42)
Total net cash flow from operating activities	**218**	8	(664)
Cash flows from investing activities			
Acquisition of group undertakings / associates	**-**	-	153
Acquisition of property, plant and equipment	**(3)**	(2)	(4)
Acquisition of intangibles	**-**	(4)	(4)
Proceeds on disposal of property, plant and equipment	**-**	-	4
Disposal of Group entities	**-**	-	(390)
Net cash flows from investing activities - continuing operations	**(3)**	(6)	(241)
Net cash flows from investing activities - discontinuing operations	**-**	-	7
	(3)	(6)	(234)
Cash flows from financing activities			
Proceeds on issue of subordinated debt	**-**	-	394
Repayments of other debt and finance lease liabilities	**-**	-	(229)
Payment / redemption of debt	**-**	(75)	-
Interest paid	**(20)**	(12)	(30)
Net cash flows from financing activities	**(20)**	(87)	135
Net increase / (decrease) in cash and cash equivalents	**195**	(85)	(763)
Cash and cash equivalents as at 1 January	**2,131**	2,894	2,894
Cash and cash equivalents at period end	**2,326**	2,809	2,131

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 purpose of the statement of cash flows.

1. Basis of preparation

The accounting policies adopted are consistent with IFRSs issued by the International Accounting Standards Board as adopted by the European Commission for use in the European Union. The Group has not applied International Accounting Standard 34, 'Interim Financial Reporting' in preparing the 2014 IFRS financial information, as this standard is not mandatory for the Group.

The IFRS financial information for the six months to 30 June 2014 and 2013 is unaudited, but has been reviewed by the auditors, PricewaterhouseCoopers LLP. The IFRS financial information for the full year 2013 has been taken from the Group's 2013 Annual Report and Accounts as delivered to the Registrar of Companies, except as restated for the effect of IFRS 10 as set out below. The auditors have reported on the 2013 Annual Report and Accounts and their report was unqualified and did not contain a statement under section 498 of the Companies Act 2006.

The IFRS financial information for the period ended 30 June 2014 has been prepared on the basis of the accounting policies that the Group expects to adopt for the 2014 year-end. The accounting policies adopted are consistent with those set out in the Group's Annual Report and Accounts for the year ended 31 December 2013, except as described below.

- IFRS 10, 'Consolidated financial statements' changes the definition of control that determines which entities are consolidated into 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 investment vehicles that were not previously consolidated. The Group has applied the standard retrospectively in accordance with the standard's transitional provisions and the impacts on the figures previously presented are set out below:
    - There was no material impact on the consolidated statement of comprehensive income for the year to 31 December 2013 or for the six months to 30 June 2013.
    - As at 31 December 2013, consolidated assets and liabilities both increased by £177m, as shown in the table below.

	31 December 2013		
	As previously reported	Impact of IFRS 10	Restated
Assets	**£m**	**£m**	**£m**
Investment property	3,998	76	4,074
Financial investments	52,231	92	52,323
Loans and receivables, including insurance receivables	505	5	510
Cash and cash equivalents	2,154	4	2,158
Assets not impacted by IFRS 10	5,236	-	5,236
	64,124	177	64,301
Liabilities	**£m**	**£m**	**£m**
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

1. Basis of preparation (continued)

- As at 30 June 2013, consolidated assets and liabilities both increased by £26m, as shown in the table below.

	30 June 2013		
Assets	**As previously reported £m**	**Impact of IFRS 10 £m**	**Restated £m**
Investment property	2,238	72	2,310
Financial investments	33,212	(56)	33,156
Loans and receivables, including insurance receivables	352	-	352
Cash and cash equivalents	2,804	10	2,814
Assets not impacted by IFRS 10	1,994	-	1,994
	40,600	26	40,626
Liabilities	**£m**	**£m**	**£m**
Payables and other financial liabilities	411	2	413
Liability to external unit holders	1,747	24	1,771
Liabilities not impacted by IFRS 10	38,442	-	38,442
	40,600	26	40,626

- The impact on the consolidated cash flow statements for the year to 31 December 2013 and the six months to 30 June 2013 are shown below.

	31 December 2013		
	As previously reported £m	**Impact of IFRS 10 £m**	**Restated £m**
Cash flows from operating activities			
Acquisition of investment property	(330)	5	(325)
Net acquisition of financial investments	(615)	(173)	(788)
Changes in operating receivables	(154)	(5)	(159)
Changes in operating payables	(37)	6	(31)
Changes in liability to external unit holders	830	171	1,001
Other operating cash flows not impacted by IFRS 10	(362)	-	(362)
Total net cash flows from operating activities	(668)	4	(664)
Total net cash flows from investing activities	(234)	-	(234)
Total net cash flows from financing activities	135	-	135
Net decrease in cash and cash equivalents	(767)	4	(763)
Cash and cash equivalents at 1 January	2,894	-	2,894
Cash and cash equivalents at 31 December	2,127	4	2,131

1. Basis of preparation (continued)

	30 June 2013		
	As previously reported £m	Impact of IFRS 10 £m	Restated £m
Cash flows from operating activities			
Acquisition of investment property	(67)	1	(66)
Net acquisition of financial investments	(629)	(17)	(646)
Changes in operating receivables	(75)	(1)	(76)
Changes in operating payables	38	2	40
Changes in liability to external unit holders	334	24	358
Other operating cash flows not impacted by IFRS 10	398	-	398
Total net cash flows from operating activities	(1)	9	8
Total net cash flows from investing activities	(6)	-	(6)
Total net cash flows from financing activities	(87)	-	(87)
Net decrease in cash and cash equivalents	(94)	9	(85)
Cash and cash equivalents at 1 January	2,894	-	2,894
Cash and cash equivalents at 30 June	2,800	9	2,809

We have also restated the June 2013 Income Statement to present the result of RL360° as discontinued. This is discussed in further in Note 4b.

Other new and amended standards applicable for the first time in the period are listed below. None of these have had a material impact on the IFRS financial information presented for the period to 30 June 2014.

- IFRS 11, 'Joint Arrangements';
- IFRS 12, 'Disclosures of Interests in Other Entities';
- IAS 27, 'Separate Financial Statements'
- IAS 28, 'Investments in Associates and Joint Ventures'
- Amendments to IAS 32, 'Financial Instruments: Presentation,' – Offsetting Financial Assets and Liabilities;
- Amendments to IAS 36, 'Impairment of Assets' – Recoverable Amount Disclosures for Non-Financial Assets;
- Amendments to IAS 39, 'Financial Instruments: Recognition and Measurement': Novation of Derivatives and Continuation of Hedge Accounting;
- IFRIC 21, 'Levies'.

2. Transfer to the unallocated divisible surplus

	30 June 2014 £m	30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Transfer included within profit for the period	**71**	206	330
Transfer included within other comprehensive income	**36**	36	7
Total transfer to the unallocated divisible surplus	**107**	242	337

3. Segmental information

The segmental disclosures required under IFRS are based on operating segments that reflect the level within the Group at which key strategic and resource allocation decisions are made and the way in which operating performance is reported internally.

(a) Segment profit

The profit measure used by the Group Board of Directors to monitor performance is European Embedded Value (EEV) operating profit before tax. The EEV operating profit by operating segment is shown in the following table, together with a reconciliation of the total EEV operating profit to the IFRS result before tax.

	30 June 2014	30 June 2013 Restated	31 Dec 2013 Restated
	£m	£m	£m
Intermediary			
- Pensions	**61**	58	73
- UK Protection	**17**	24	69
- Caledonian	**2**	1	8
Direct	**23**	20	39
Wealth	**22**	8	32
Central items:			
- Gain arising on business combinations	**-**	-	150
- Other	**(15)**	(8)	(25)
EEV operating profit before tax from continuing operations	**110**	103	346
Exceptional costs arising from regulatory change	**(61)**	-	-
EEV operating profit before tax from discontinued operations	**-**	10	(40)
Total EEV operating profit before tax	**49**	113	306
Amortisation of intangibles	**(6)**	(5)	(11)
Valuation differences between EEV and IFRS	**(17)**	(13)	(26)
Investment return variances	**158**	66	162
Economic assumption changes	**(17)**	76	83
Movement in pension scheme surplus (excluding amounts included in OCI)	**(10)**	1	-
Financing costs	**(21)**	(12)	(30)
Mutual dividend	**-**	-	(81)
IFRS result from discontinued operations	**-**	41	42
IFRS result before tax	**136**	267	445

(b) Geographical analysis

	Six months ended 30 June 2014		
	UK	**International**	**Total**
	£m	**£m**	**£m**
Revenues			
Net earned premiums	**(590)**	**9**	**(581)**
Fee income from investment and fund management contracts	**130**	**-**	**130**
Investment return	**2,240**	**47**	**2,287**
Other operating income	**24**	**(1)**	**23**
Total revenues from continuing operations	**1,804**	**55**	**1,859**

	Six months ended 30 June 2013 Restated		
	UK	International	Total
	£m	£m	£m
Revenues			
Net earned premiums	227	11	238
Fee income from investment and fund management contracts	92	4	96
Investment return	1,501	59	1,560
Other operating income	26	-	26
Total revenues from continuing operations	1,846	74	1,920

	Year ended 31 December 2013 Restated		
	UK	International	Total
	£m	£m	£m
Revenues			
Net earned premiums	702	24	726
Fee income from investment and fund management contracts	217	-	217
Investment return	3,743	55	3,798
Gain on business combinations	125	-	125
Other operating income	37	-	37
Total revenues from continuing operations	4,824	79	4,903

4. Acquisitions and corporate transactions

(a) Acquisition of Royal London (CIS) Limited and Royal London Asset Management (CIS) Limited

On 31 July 2013, the Group acquired the life assurance and asset management business of the Co-operative Banking Group (CBG) by acquiring the entire issued share capital of The Co-operative Insurance Society Limited (CIS) and The Co-operative Asset Management Limited (TCAM). As part of the completion process CIS converted from an Industrial and Provident Society into a limited company and changed its name to RLG (CIS) Limited. On 1 August 2013 CIS was renamed as Royal London (CIS) Limited (RL CIS) and TCAM was renamed Royal London Asset Management (CIS) 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. The present value of the difference between these fixed charges and the operating costs for administering the business was recognised as acquired VIF assets totalling £128m. The recognition of these assets resulted in the fair value of the net assets acquired exceeding the consideration by £125m, which was recognised in the consolidated statement of comprehensive income as 'gain arising on business combinations'.

(b) Prior year disposal of Royal London 360° Insurance Company Limited

The Group's wholly owned subsidiary, Royal London 360° Insurance Company Limited, was sold on 14 November 2013 and has therefore been classified as a discontinued operation.

5. Tax charge

	30 June 2014 £m	30 June 2013 £m	31 Dec 2013 £m
Tax has been provided as follows:			
UK corporation tax charge			
- Current year	**16**	-	13
- Adjustments in respect of prior periods	**-**	1	-
	16	1	13
Foreign tax partially relieved against UK corporation tax	**9**	7	9
Deferred tax	**40**	12	51
	65	20	73

6. Pension scheme

The Group operates three funded defined benefit schemes, which are established under separate trusts. The main scheme is the Royal London Group Pension Scheme (RLGPS). On 1 September 2005, RLGPS was closed to new entrants. The Group has established a contributory, defined contribution arrangement for new employees joining the Group after that date.

(a) Amounts recognised in the balance sheet

	Total			RLGPS			Royal Liver UK			Royal Liver ROI		
	30 Jun 2014	30 Jun 2013	31 Dec 2013	**30 Jun 2014**	30 Jun 2013	31 Dec 2013	**30 Jun 2014**	30 Jun 2013	31 Dec 2013	**30 Jun 2014**	30 Jun 2013	31 Dec 2013
	£m	£m	£m	**£m**	£m	£m	**£m**	£m	£m	**£m**	£m	£m
Fair value of plan assets	**2,702**	2,571	2,634	**2,205**	2,091	2,155	**302**	285	290	**195**	195	189
Pension scheme obligation	**(2,503)**	(2,370)	(2,466)	**(2,092)**	(1,971)	(2,065)	**(244)**	(231)	(241)	**(167)**	(168)	(160)
Pension scheme surplus	**199**	201	168	**113**	120	90	**58**	54	49	**28**	27	29
Less: restrictions of surplus	**(20)**	(19)	(17)	**-**	-	-	**(20)**	(19)	(17)	**-**	-	-
Net pension scheme asset	**179**	182	151	**113**	120	90	**38**	35	32	**28**	27	29

In accordance with paragraph 64 of IAS 19, 'Employee Benefits' the value of the net pension scheme asset that can be recognised in the balance sheet is restricted to the present value of economic benefits available in the form of refunds from the scheme or reductions in future contributions. For the Royal Liver UK scheme, the benefit is only available as a refund, as no additional defined pension benefits are being earned. Under UK tax legislation an income tax deduction of 35% is applied to a refund from a UK pension scheme, before it is passed to the employer. This tax deduction has been shown above as a restriction to the value of the net pension scheme asset that can be recognised for this scheme.

7. Cash and cash equivalents

The cash and cash equivalents for the purposes of the statement of cash flows are shown net of bank overdrafts that are repayable on demand and form an integral part of the Group's cash management, as shown in the table below.

	30 Jun 2014 £m	30 Jun 2013 £m	31 Dec 2013 £m
Cash and cash equivalents	**2,349**	2,814	2,158
Bank overdrafts	**(23)**	(5)	(27)
Cash and cash equivalents in the statement of cash flows	**2,326**	2,809	2,131

8. Subordinated liabilities

	30 Jun 2014 £m	30 Jun 2013 £m	31 Dec 2013 £m	Effective interest rate 30 Jun 2014 %	30 Jun 2013 %	31 Dec 2013 %
Perpetual Cumulative Step-up Subordinated Guaranteed Notes	**245**	399	245	6.28	6.28	6.28
Fixed Rate Reset Callable Guaranteed Subordinated Notes due 2043	**395**	-	395	6.32	-	6.32
	640	399	640			

All of the balance shown above is expected to be settled more than 12 months after the balance sheet date. Subordinated liabilities are carried in the balance sheet at amortised cost. Their fair value at 30 June 2014 was £673m (31 December 2013 £648m).

Perpetual Cumulative Step-up Subordinated Guaranteed Notes

On 14 December 2005, RL Finance Bonds plc, a wholly owned subsidiary of the Parent company, issued the Perpetual Cumulative Step-up Subordinated Guaranteed Notes (Perpetual Notes). The issue price of the Perpetual Notes was 99.676% of the principal amount of £400m. The discount of £1m and the directly related costs incurred to issue the Perpetual Notes of £4m have been capitalised as part of the carrying value and are being amortised on an effective interest basis over the period to the first possible redemption date.

The Perpetual Notes are guaranteed by the Parent company. The proceeds of the issue were loaned to the Parent company on the same interest, repayment and subordination terms as those applicable to the Notes.

The Perpetual Notes have no maturity date but the issuer has the option to redeem all of them at their principal amount on 15 December 2015 and at three-monthly intervals thereafter. Interest is payable on the Perpetual Notes at a fixed rate of 6.125% per annum for the period to 15 December 2015, payable annually in arrears on 15 December each year. If the Perpetual Notes are not redeemed on 15 December 2015 the interest rate will be re-set on that date and at three-monthly intervals thereafter, at a rate equal to the offered three-month sterling deposit rate quoted on the interest re-set date, plus 2.45%.

Following the first interest re-set date, interest becomes payable three-monthly in arrears on 15 March, 15 June, 15 September and 15 December in each year.

On 29 November 2013, Perpetual Notes with a nominal value of £154m were purchased by way of a tender offer at a price equal to 101% of the nominal value. The premium and related transaction costs totalling £2m have been recognised within finance costs.

Fixed Rate Reset Callable Guaranteed Subordinated Notes due 2043

On 29 November 2013, RL Finance Bond No. 2 plc, a wholly owned subsidiary of the Parent company, issued the Fixed Rate Reset Callable Guaranteed Subordinated Notes due 2043 (the 2043 Notes). The issue price of the 2043 Notes was 99.316% of the principal amount of £400m. The discount of £3m and the directly related costs incurred to issue the 2043 Notes of £3m have been capitalised as part of the carrying value and are being amortised on an effective interest basis over the period to the first possible redemption date.

The 2043 Notes are guaranteed by the Parent company. The proceeds of the issue were loaned to the Parent company on the same interest, repayment and subordination terms as those applicable to the 2043 Notes.

The 2043 Notes mature on 30 November 2043. The issuer has the option to redeem all of the 2043 Notes at their principal amount on 30 November 2023 and on each interest payment date thereafter. Interest is payable on the Notes at a fixed rate of 6.125% per annum for the period to 30 November 2023, payable annually in arrears on 30 November each year. If the 2043 Notes are not redeemed on 30 November 2023 the interest rate will be re-set on that date and on the fifth anniversary of that date thereafter, at a rate equal to the five-year gilt rate plus 4.321%.

9. Contingent liabilities

During the year, the Group and Parent company continued to address issues from past inappropriate selling practices and other regulatory matters. The directors consider that they have made prudent provision for any liabilities arising across the Group and, as and when the circumstances calling for such provision arise, that the Group and Parent company have adequate reserves to meet all reasonably foreseeable eventualities.

10. Reconciliation of the IFRS unallocated divisible surplus to the European Embedded Value

	30 Jun 2014 £m	30 Jun 2013 Restated £m	31 Dec 2013 Restated £m
IFRS unallocated divisible surplus	**3,112**	2,910	3,005
Valuation differences between IFRS and EEV			
- Goodwill and intangible assets	**(278)**	(290)	(284)
- Deferred tax valuation differences	**(7)**	(79)	(21)
- Subordinated debt at market value	**(33)**	31	(16)
- Capital requirements of subsidiaries and other valuation differences	**(22)**	(57)	(20)
Add items only included on an embedded value basis			
- Valuation of asset management and service subsidiaries	**166**	128	143
Other valuation differences	**15**	57	19
European embedded value	**2,953**	2,700	2,826

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

	30 Jun 2014 £m	30 Jun 2013 Restated £m	31 Dec 2013 Restated £m
IFRS transfer to unallocated divisible surplus	**107**	242	337
Amortisation of intangible assets	**6**	5	13
Differences in valuation of subsidiaries	**21**	6	57
Change in realistic value of subordinated debt	**(17)**	(16)	(63)
Movement in valuation differences for deferred tax assets	**14**	21	78
Other movements in valuation bases	**(4)**	7	(31)
EEV profit for the year	**127**	265	391

12. Reconciliation of Operating Profit to IFRS result before tax

	30 Jun 2014 £m	30 Jun 2013 Restated £m	31 Dec 2013 Restated £m
Operating Profit from continuing operations before exceptional items	**87**	88	187
Exceptional cost arising from regulatory change	**(61)**	-	-
Gain arising on business combinations	**-**	-	125
Operating Profit	**26**	88	312
Investment return variances and economic assumption changes	**141**	190	244
Net gain on Group pension schemes recognised in result before tax	**(10)**	1	-
Finance costs	**(21)**	(12)	(30)
Mutual dividend	**-**	-	(81)
IFRS Profit before tax	**136**	267	445
Attributed tax charge	**65**	20	73
Discontinued operations	**-**	(41)	(42)
Other comprehensive income	**36**	36	7
Total transfer to unallocated divisible surplus	**107**	242	337

Consolidated income statement – EEV basis for the six months to 30 June 2014

	Notes	**30 Jun 2014 £m**	30 Jun 2013 Restated £m	Year ended 31 Dec 2013 £m
Continuing operating activities				
Contribution from new business	(g) (i)	**35**	34	70
Profit from existing business	(g) (ii)			
– Expected return		**45**	31	63
– Operating experience variances		**22**	16	29
– Operating assumption changes		**8**	19	48
Expected return on opening net worth	(g) (iii)	**24**	16	34
Profit on uncovered business	(g) (iv)	**4**	3	11
Strategic development costs and other items	(g) (v)	**(28)**	(17)	(59)
Operating profit before tax from continuing operations and exceptional items		**110**	102	196
Gain arising on business combinations	(g) (vi)	**-**	-	150
Exceptional cost arising from regulatory change	(g)(vii)	**(61)**	-	-
Total operating profit before tax from continuing operations		**49**	102	346
Operating profit/(loss) before tax from discontinued operations		**-**	11	(40)
Total operating profit before tax		**49**	113	306
Economic experience variances	(g) (viii)	**104**	61	140
Economic assumption changes	(g) (ix)	**(17)**	76	83
Movement in RLGPS pension scheme surplus	(g) (x)	**23**	38	8
Financing costs	(g) (xi)	**(20)**	(12)	(26)
Mutual dividend	(g) (xii)	**-**	-	(86)
EEV profit before tax from continuing operations		**139**	265	465
Attributed tax charge	(g) (xiii)	**(12)**	(14)	(36)
EEV profit after tax from continuing operations		**127**	251	429
EEV profit after tax from discontinued operations		**-**	14	(38)
Total EEV profit after tax		**127**	265	391

Consolidated Balance Sheet - EEV basis
as at 30 June 2014

	30 Jun 2014 £m	30 Jun 2013 Restated £m	31 Dec 2013 £m
Assets			
Assets held in closed funds	**9,481**	9,635	9,538
Assets backing non-participating liabilities	**20,075**	19,139	18,567
Reinsurance assets	**2,580**	2,209	2,466
Assets backing participating liabilities and net worth			
– UK equities	**1,945**	2,132	1,938
– Overseas equities	**648**	222	624
– Land and buildings	**712**	691	657
– Approved fixed interest securities	**1,669**	1,774	1,716
– Other fixed interest securities	**1,404**	1,205	1,353
– Other assets	**949**	638	910
Value of in-force business	**1,706**	1,499	1,701
Pension scheme surplus (RLGPS)	**113**	120	90
Total	**41,282**	39,264	39,560
Liabilities			
Liabilities in closed funds	**9,481**	9,635	9,538
Non-participating liabilities	**20,075**	19,139	18,567
Reinsured liabilities	**2,580**	2,209	2,466
Participating liabilities	**5,083**	5,000	5,062
Current liabilities	**1,110**	581	1,101
Total	**38,329**	36,564	36,734
Embedded Value			
Net worth	**1,134**	1,081	1,035
Value of in-force business	**1,706**	1,499	1,701
Pension scheme surplus (RLGPS)	**113**	120	90
Total	**2,953**	2,700	2,826

Value of in-force business - EEV basis
as at 30 June 2014

	30 Jun 2014 £m	30 Jun 2013 Restated £m	31 Dec 2013 £m
Value of in-force business before allowance for burn-through and capital costs	**1,747**	1,522	1,736
Burn-through cost	**(2)**	(1)	(2)
Cost of capital	**(39)**	(22)	(33)
Value of in-force business	**1,706**	1,499	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 6 months to 30 June 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 a consequence of the basis of preparing the Group EEV results, which is 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
ing. 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 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.

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.

Restatement of prior period figures

As set out above, an adjustment is made to the RBS to gross up for reinsured liabilities and assets. Units invested via reinsurance arrangements with external fund providers are treated as reinsured liabilities within the RBS but as directly held liabilities within the IFRS balance sheet. In the EEV balance sheet we have previously not grossed up for these externally reinsured units in line with the IFRS approach. With effect from December 2013, it was decided to treat these liabilities as reinsured in line with the RBS approach. This change in presentation increases the reinsurance assets and reinsured liabilities by the same amount and therefore has no net effect on the embedded value. The 30 June 2013 comparatives have been restated accordingly.

In addition, the Group's wholly owned subsidiary, Royal London 360° Insurance Company Limited, was sold on 14 November 2013 and has therefore been classified as a discontinued operation in the 31 December 2013 and 30 June 2013 results.

(b) EEV methodology

(i) Overview

The EEV basis of reporting is designed to recognise the economic value of a new policy at the point it is written. The total profit recognised over the lifetime of a policy is the same as that recognised under the IFRS basis of reporting, but the timing of recognition is different.

For the purposes of EEV reporting, the Group has adopted a market-consistent methodology. Within a market-consistent framework, assets and liabilities are valued in line with market prices and consistently with each other. In principle, each cash flow is valued using a discount rate consistent with that applied to such a cash flow in the capital markets.

(ii) Covered business

The EEV Principles require an insurance company to distinguish between covered and uncovered business according to whether the business is valued on EEV Principles. The covered business, in the case of Royal London, incorporates:

- life and pensions business defined as long-term business by UK and overseas regulators; and
- asset management business; both that derived from the life and pensions business and that arising from external clients (except that arising from cash mandates, which is treated as uncovered).

This business, which represents the vast majority of the Group's total business, is valued on an EEV basis.

(iii) Embedded value

The reported embedded value provides an estimate of the value of the covered business, including future cash flows expected from the existing business but excluding any value that may be generated from future new business. For covered business, it comprises the sum of the net worth calculated on an EEV basis and the value of the in-force business. For uncovered business, it comprises the IFRS net worth.

The net worth is the market-consistent value of the net assets (excluding the value of in-force business and pension scheme surplus) over and above those required to manage the business in line with the published Principles and Practices of Financial Management (PPFM). It is based on the RBS working capital in those funds within the Group that are open to new business and allows for the value of the sub-debt on a market-consistent basis.

The value of in-force business is the present value of the projected streams of future cash flows available from the existing business at the valuation date, on a best estimate basis allowing for risk, adjusted for the cost of holding the required capital.

(iv) Allowance for risk

The allowance for risk is a key feature of the EEV Principles. The table below summarises how each item of risk has been allowed for:

Type of risk	**EEV methodology**
Market-related risks	Allowed for explicitly in the EEV calculations
Non-market risks which are symmetrical in terms of the impact on EEV	Allowed for within the estimates of future operating experience
Non-market risks which are asymmetrical in terms of the impact on EEV	Allowed for in the calculation of VIF and financial options by way of an additional margin in the estimates of future operating experience

Market risk

The approach adopted to calculate the Market Consistent Embedded Value combines deterministic and stochastic techniques. Deterministic techniques have been used to value 'non-option cash flows'; that is cash flows whose values vary linearly with market movements. Stochastic techniques have been used to value cash flows with an asymmetric effect on profit, such as investment guarantees on with-profits products.

In principle, each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. For example, an equity cash flow is valued using an equity risk discount rate and a bond cash flow is valued using a bond risk discount rate. If a higher return is assumed for equities, the equity cash flow is discounted at this higher rate. In practice, it is not necessary to discount each cash flow at a different rate. For cash flows that are either independent or move linearly with the market, a method known as the 'certainty equivalent approach' will achieve the same results. Under this method all assets are assumed to earn the risk-free rate of return and all cash flows are discounted using the risk-free rate. This approach has been adopted to value the 'non-option cash flows' within a deterministic model.

Non-market risk

In general, the allowance for non-market risk is covered by the margin incorporated into the Group's estimates of future operating experience assumptions. However, there are certain situations in which the impact of fluctuations in experience is asymmetric, namely that adverse experience can have a higher negative impact on value than the positive impact generated by favourable experience.

In these cases, an additional margin over best estimate is incorporated into the experience assumptions. The methodology used to determine the appropriate allowance for non-market risk is based on the analyses undertaken as part of the development of the RBS and the Individual Capital Assessment.

(c) Cost of capital

The EEV Principles require capital allocated to the covered business to be split between required capital, the future distributions of which are restricted, and free surplus. We have defined the amount of required capital to be that necessary to meet the more onerous of the FSA Pillar 1 and Pillar 2 capital requirements, which for Royal London is currently Pillar 2.

The EEV includes a deduction for the frictional cost of holding the required capital. Frictional costs, being the tangible costs of holding capital, have been allowed for on a market-consistent basis. These consist of the total taxation and investment expenses incurred on the required capital over the period it is anticipated to be required. They reflect the cost to a member of having an asset held within a mutual insurance company, rather than investing in the asset directly.

No allowance has been made for any agency costs. These represent the potential markdown to value that members might apply because they do not have direct control over their capital. Any adjustment would be subjective and different members will have their own views of what adjustment, if any, should be made.

(d) Burn-through cost

Under adverse conditions the funds that remain open to new business may be required to make good any deficits that arise in the closed funds. The time value cost of this potential liability, known as the burn-through cost, is modelled stochastically, as it will only occur in adverse scenarios.

The burn-through cost is calculated as the average value of the capital support supplied in a large number of market-consistent scenarios. Allowance has been made under the different scenarios for management actions, such as altered investment strategy, consistent with the PPFM.

The stochastic model used to calculate this liability has been calibrated to market conditions at the valuation date. In addition, due to the asymmetric nature of this liability, an additional margin has been incorporated into the operating assumptions.

(e) Expenses
The EEV Guidance requires companies to perform an active review of expense assumptions, and include an appropriate allowance for corporate costs and service company costs.

Corporate costs
Corporate costs are those costs incurred at a corporate level that are not directly attributable to the covered businesses. To the extent that future corporate costs have not been anticipated within the EEV they are accounted for as they arise.

Service company costs
An in-house administration service company, that receives a fee in respect of each policy it administers, is responsible for the administration of the majority of Royal London's policies. A similar arrangement exists for asset management services, although the fee is applied as a percentage of assets. The value of the in-force life and pensions business has been calculated using the service company (including asset management) fees.

Costs within the in-house administration service company have been classified as either ongoing (including an element of development expenditure) or exceptional development costs. Exceptional development costs have not been anticipated within the EEV and instead are accounted for as they arise. For H1 2014, £6m (2013 £7m) of development costs were classified as exceptional. The profits expected to arise from life and pensions business within the administration service company from activities related to the maintenance of existing business and within Royal London Asset Management (RLAM) in respect of investment management services have been capitalised within the EEV. These calculations result in the recognition of further value in the in-force business. £17m (2013 £18m) is recognised in respect of the administration service company and £39m (2013 £39m) is recognised in respect of RLAM's investment management services.

No allowance has been made for future productivity gains.

(f) New business
New covered business includes:
- premiums from the sale of new contracts, (including any contractual future increments on new contracts);
- non-contractual increments (both regular and single premium) on existing policies; and
- premiums relating to new entrants in group pension schemes.

(g) Analysis of EEV profit

(i) Contribution from new business
The contribution from new business is calculated using economic assumptions at the end of the period. It is shown after the effect of required capital, calculated on the same basis as for in-force covered business.

New business sales are expressed on the present value of new business premiums (PVNBP) basis. PVNBP is calculated as total single premium sales received in the year plus the discounted value, at point of sale, of regular premiums expected to be received over the term of the new contracts. The premium volumes and projection assumptions used to calculate the present value of regular premiums for each product are the same as those used to calculate the new business contribution, so the components of the new business margin are on a consistent basis.

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.

30 Jun 2014	**Present value of new business premiums**	**New business contribution**	**New business margin**
	£m	**£m**	**%**
Pensions	2,077	19.1	0.9
Protection	161	5.9	3.6
Consumer	27	0.5	1.9
Continuing life and pensions business	2,265	25.5	1.1
Total life and pensions business	**2,265**	**25.5**	**1.1**
Wealth	1,855	14.0	0.8
Total	**4,120**	**39.5**	**1.0**

30 Jun 2013	Present value of new business premiums £m	New business contribution £m	New business margin %
Excluding DWP business:			
Intermediary:			
Pensions	1,466	18.7	1.3
Protection	242	12.1	5.0
Consumer	18	0.2	1.1
Continuing life and pensions business	1,726	31.0	1.8
Discontinued life and pensions business	224	8.3	3.7
Total life and pensions business	1,950	39.3	2.0
DWP business	1	-	-
Wealth	1,271	7.9	0.6
Total	3,222	47.2	1.5

(i) Contribution from new business (continued)

31 Dec 2013	Present value of new business premiums £m	New business contribution £m	New business margin %
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 42% on H1 2013 due mainly to the introduction of auto-enrolment. The phased nature of some of the auto enrolment business has resulted in a slight decrease in margin.

Protection comprises Bright Grey, Scottish Provident and Caledonian Life. Overall, volumes and margins are down reflecting the very competitive market.

Royal London Asset Management has performed well with new business volumes from new asset management mandates up 46% on H1 2013. This has been achieved with an increase in the margin.

(ii) Profit from existing business

Profit from existing business comprises:

- the expected return on the value of in-force business at the start of the period; plus
- profits and losses caused by differences between actual experience for the period and that assumed in the embedded value calculations at the start of the period; plus
- the impact of any changes in the assumptions regarding future operating experience.

The main reasons for the £8m impact of operating assumption changes are better assumed future persistency rates on pensions business and the recognition of lower GAO take up rates for trivial pension policies.

(iii) Expected return on opening net worth

The expected return on opening net worth represents the expected investment return on the net worth over the period.

(iv) Profit on uncovered business

Profit on uncovered business has been valued on an IFRS basis, as used in the primary financial statements. A breakdown of the profit reported on uncovered business is shown in the table below:

	30 June 2014 £m	30 June 2013 £m	31 Dec 2013 £m
General insurance commissions	**3**	3	7
Annuity and other commissions	**2**	3	6
Ascentric	**-**	(1)	1
Royal London Financial Planner	**(1)**	(2)	(3)
Total	**4**	3	11

(v) Strategic development costs and other items

Strategic development costs represent investments that we believe are important for our future competitiveness and we expect will deliver good returns in the future.

Other items represent a combination of:

- exceptional development costs, which are typically investments made to improve future EEV profits (for example by reducing on-going expense levels or increasing new business volumes);
- corporate costs; and
- other exceptional items. As an example, this would include the impact of any changes in the way the business is modelled and improvements to valuation techniques.

A breakdown of these items is shown in the table below:

	30 June 2014 £m	30 June 2013 £m	31 Dec 2013 £m
Strategic development costs	**(27)**	(6)	(17)
Other development costs	**(6)**	(4)	(7)
Corporate costs	**(8)**	(13)	(34)
Modelling and other changes	**13**	6	(1)
Total	**(28)**	(17)	(59)

The 'modelling and other changes' component reflects a number of small modelling changes.

(vi) 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 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 is shown as Gain arising on business combinations.

(vii) Exceptional cost arising from regulatory change

In March 2013, 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 £(61)m impact on operating profit.

(viii) Economic experience variances

This shows the impact of actual investment returns relative to those expected. Economic experience variances have an impact on the value of in-force (VIF) business and on the net worth.

The economic experience variance on the VIF arises from the change in policy values in which Royal London has an interest. The economic experience variance on the net worth represents the impact that investment returns, being different to those anticipated, has on:
- the value of the opening net worth;
- the value of financial options and guarantees (*); and
- the value of the assets backing the financial options and guarantees (*).

(*) Excluding those movements due solely to changes in the yield curve, which have been netted off against the movement in the value of assets caused by the shift in the yield curve.

The value of the second and third items above is generally far more significant for Royal London, as a mutual insurance company, than would be the case for an equivalent proprietary company, whose interest in the surplus in its with-profits funds is restricted typically to 10% of the distributable surplus.

For assets held within the Royal London fund, property returned in excess of 12% while bond returns over 5% assisted by lower market yields. Equity returns were flat during H1 2014.

(ix) Economic assumption changes
Long-term economic assumptions were revised to take into account the financial conditions at the end of the period including the impact of related management actions. The effect of these changes contributed £(17)m (2013 £83m) to the pre-tax result. Further details of the economic basis used are provided in section (h).

(x) Pension scheme surplus
The principal scheme is the Royal London Group Pension Scheme, a final salary scheme that is closed to new entrants. On an International Accounting Standard (IAS) 19 basis, the scheme had a surplus of £113m at 30 June 2014 (December 2013 £90m).

The surplus in the two pension schemes acquired as part of the Royal Liver transaction, is part of the closed Liver sub-fund and so is not included in the EEV income statement.

(xi) Financing costs
In December 2005, Royal London raised £395m (after expenses) of subordinated debt, which carries a coupon of 6.125% per annum. On 29 November 2013, notes with a nominal value of £154m were purchased by way of a tender offer at a price equal to 101% of the nominal value and a further £397m (after expenses) of subordinated debt, which also carries a coupon of 6.125% per annum, was issued. The cost of servicing the debt has increased over H1 2014 to £20m (H1 2013 £12m) due to the larger debt in issue and is included as a financing cost.

(xii) Mutual dividend
In 2013, Royal London's Board exercised its discretion to allocate a proportion of the profits to certain asset shares by crediting an investment return in excess of the rate earned on the underlying assets, thereby directly increasing the value of the liabilities set aside to meet future payments to relevant policyholders.

(xiii) 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.

(h) EEV assumptions

(i) Principal economic assumptions – deterministic

Economic assumptions are reviewed actively and are based on the prevailing market yields on risk-free assets at the valuation date.

	30 June 2014 %	30 June 2013 %	31 Dec 2013 %
Risk-free rate	**3.15**	3.00	3.45
Retail price inflation	**3.25**	3.00	3.50
Expense inflation	**4.25**	4.00	4.50

(ii) Principal economic assumptions – stochastic

The value of financial options (including premium rate guarantees and guaranteed annuity options), smoothing costs and future deductions from asset shares are calculated using market-consistent techniques. Market consistency is achieved by running a large number of economically credible scenarios through a stochastic valuation model. Each scenario is discounted at a rate consistent with the individual simulation.

The economic scenarios achieve market consistency by:

- deriving the underlying risk-free rate from the forward gilt curve;
- calibrating equity and interest rate volatility to observed market data by duration and price, subject to interpolation/extrapolation where traded security prices do not exist. We attempt to achieve the best possible fit, although modelling restrictions prevent this from being perfect.

The tables below show the implied volatilities used in the modelling by asset class:

30 June 2014	**Term (years)**				
	5	**10**	**15**	**20**	**30**
15-year risk-free zero coupon bonds	**9.4%**	**6.9%**	**5.3%**	**4.7%**	**4.8%**
15-year AA-rated corporate bonds	**11.2%**	**8.9%**	**7.7%**	**7.1%**	**7.0%**
Equities	**18.3%**	**20.1%**	**21.4%**	**22.4%**	**25.5%**

30 June 2013	Term (years)				
	5	**10**	**15**	**20**	**30**
15-year risk-free zero coupon bonds	10.4%	7.5%	6.0%	5.4%	5.8%
15-year AA-rated corporate bonds	12.7%	10.3%	8.9%	8.1%	8.0%
Equities	22.6%	24.3%	25.6%	26.3%	28.2%

31 December 2013	Term (years)				
	5	**10**	**15**	**20**	**30**
15-year risk-free zero coupon bonds	10.3%	7.2%	5.3%	4.7%	4.8%
15-year AA-rated corporate bonds	12.3%	9.6%	8.1%	7.3%	7.2%
Equities	19.3%	21.7%	23.6%	24.9%	28.5%

(iii) Expected returns in reporting period

For the purposes of calculating the expected returns over the period, allowance is made for a risk premium as set out in the following table:

	30 June 2014 %	30 June 2013 %	31 Dec 2013 %
Risk premium – equities	**2.50**	2.50	2.50
Risk premium – property	**2.00**	2.00	2.00

All other assets are assumed to earn the risk-free rate.

(iv) Other assumptions

Demographic assumptions are regularly reviewed having regard to past, current and expected future experience, and any other relevant data. These are generally set as best estimate with an appropriate margin for adverse deviations.