Annual Report and Accounts 2012

Phoenix Group Holdings

PHOENIX GROUP

Phoenix has made significant progress in strengthening its balance sheet and simplifying the Group's structure. The Group has also delivered against its demanding financial targets.

Business overview

Phoenix Group is the UK's largest specialist closed life and pension fund consolidator with approximately 6 million policyholders and £68.6 billion of assets under management.

As a closed life fund consolidator, Phoenix Life focuses on the efficient run-off of existing policies, maximising economies of scale and generating capital efficiencies through operational improvements. Ignis Asset Management focuses on delivering strong investment performance and high quality service to its clients.

Our business model

Our business manages closed life funds in an efficient and secure manner, protecting and enhancing policyholders' interests whilst maximising value for the Group's shareholders.

Phoenix Life
Aims to deliver innovative financial management and operational excellence

Ignis Asset Management
Targets superior investment performance and client service

Phoenix Group
Delivery of strategic initiatives

2012 Key performance indicators

Operating companies' cash generation	Group MCEV	Group IFRS operating profit
£690m	**£2,122m**	**£410m**
IGD surplus (estimated)	PLHL ICA surplus (estimated)	Dividend per share
£1.4bn	**£1.0bn**	**47.7p**
Group assets under management	Ignis Asset Management IFRS operating profit	Gearing ratio – new methodology
£68.6bn	**£43m**	**55%**

Introduction

Business and strategy

Business review

Risk management

Governance

Corporate responsibility

Financial information

IFRS financial statements

Asset disclosures

MCEV supplementary information

Additional information

Chairman's statement

After joining Phoenix in October 2012 the overriding message I heard from our shareholders was the need for the Group to re-term its bank debt facilities. We have now achieved that and can look forward to the future with confidence.

Sir Howard Davies
Chairman

I joined Phoenix as Chairman at an important time for the Group. Since joining, I have been impressed by the depth of knowledge within the Group and I look forward with confidence to the next phase of Phoenix's development.

The comprehensive fund raising and refinancing package that we announced on 30 January 2013 allows us to reduce our borrowings substantially, extend our debt maturities and increase shareholder dividends. Importantly, the transaction also provides the Group with a longer-term capital structure and puts Phoenix in a stronger position, both financially and strategically.

This transaction has taken a great deal of work and a substantial commitment from our key stakeholders and it is to their credit that we have been able to deliver it successfully. We benefited from valuable advice from our prudential regulators. Phoenix has the operating platform in place for the next stage of the Group's development and from which to explore, in due course, further consolidation opportunities.

The scale and predictability of the Group's cash flows underpin our ability to deliver value to our shareholders. Since the financial restructuring in 2009, Phoenix has consistently achieved its cash generation and other financial targets, and has continued to deliver on its programme of management actions.

Millions of individuals have a substantial portion of their savings invested in closed life funds. These funds can face an increasingly uncertain future of escalating administrative costs and diminishing expertise to maintain these policies. Phoenix's consolidation approach is therefore important to both policyholders and shareholders. As the largest specialist UK consolidator, the Group's scale and operating platform provide a unique opportunity to realise economies and provide responsive services to policyholders.

I am confident that given our strategy, the quality of our people and our record of performance, we will be able to deliver our longer term aim of being the saver-friendly solution for the safe, innovative and profitable management of closed funds.

I am pleased to report to shareholders that the Board has decided to recommend a final dividend of 26.7p per share, bringing the total dividend for the financial year to 47.7p per share.

Ian Ashken and Charles Clarke have decided not to stand for re-election at the AGM in May 2013. Both Directors have been with the Company since before its July 2010 Premium Listing, Ian Ashken since 2 September 2009 and Charles Clarke since 18 February 2010. Now that the Group has successfully re-termed its bank debt and raised new equity, both Directors believe the time is right for them to stand down. I wish to thank them on behalf of the Board for their significant contributions. As a key recommendation from the November 2012 Board Evaluation Report was to reduce the size of the Board, it is proposed not to replace the outgoing Directors.

On behalf of the Board, I would also like to thank all of our employees for their contribution to the significant successes of the past 12 months and I look forward to 2013 with confidence.

Howard Davies
Chairman
21 March 2013

Group Chief Executive Officer's report

Phoenix delivered strong financial performance in 2012. The debt re-terming and equity raising announced in January 2013 has significantly strengthened our balance sheet, improved our capital structure and allows for increased dividends.

Clive Bannister
Group Chief Executive Officer

Introduction

I am delighted with what we have achieved in the last 12 months.

In January 2013 we announced the re-terming of the Impala facility and an equity raising of £250 million. This refinancing brings the Group greater strategic and financial flexibility and better aligns our debt repayment profile to our longer-term cash flows. This transaction also provides us with greater flexibility over our dividend policy, allowing us to propose a significant increase in the dividend per share for 2012.

The re-terming of our bank debt follows a successful year of management actions which enabled us to conclude this transaction on the right terms and at the right time on behalf of our stakeholders.

Importantly, in November 2012 we entered into a new agreement with the Trustee of the Pearl Group Staff Pension Scheme. In return for a re-phasing of contributions, the new agreement delivers greater certainty and allows for a lower risk investment strategy. This new agreement improved our PLHL ICA surplus by £0.3 billion and reduced its sensitivity to external market stresses.

We also made significant progress in simplifying the Group's structure and enhancing our capital strength through further consolidation of life companies within the Group. Since the Group's Premium Listing in July 2010, the number of UK life companies has been reduced from seven to three.

In June 2012 we entered into an agreement to transfer approximately £5 billion of annuity in-payment liabilities to Guardian Assurance Limited ('Guardian'). This transaction accelerated the release of capital, improved the Group's solvency position and reduced our exposure to longevity risk.

We remain focused on our strategy to deliver shareholder value and continue to develop our business model to further improve the financial and operational efficiency of the Group's underlying businesses. These achievements are particularly pleasing in light of the uncertain market conditions during the first half of 2012.

Despite this uncertainty, Phoenix Life and Ignis Asset Management have provided good customer service and investment returns and we continue to work with our outsource partners to improve our proposition for policyholders.

Group Chief Executive Officer's report
continued

Cash generation

£690m
2011: £810m

Gearing (new methodology)

55%
2011: 57%

Group highlights

Equity raising and debt re-terming

I am pleased that 93% of our existing shareholders took up their open offer entitlement under the equity raising.

This equity raising enabled the re-terming of the Impala debt and allowed the £450 million prepayment on 22 February 2013. Following the re-terming the bullet repayments which were due in 2014, 2015 and 2016, and which had previously posed a refinancing challenge, have been replaced by a single tranche repayable by June 2019, subject to exercising our extension option from December 2017. The mandatory repayments on the Impala debt have been reduced from £125 million per annum to £60 million per annum which improves our resilience during periods of stress.

The amended Impala facility allows for increased dividends and the recommended 2012 final dividend of 26.7p per share is 27% higher than the 2011 final dividend.

As a result of this transaction, gearing under our existing methodology reduced from 42% to 37% at 31 December 2012 on a pro forma basis. We are, however, adopting a new gearing calculation which is more closely aligned to market practice.

Under the existing methodology, gearing was calculated using net shareholder debt (i.e. net of Holding Companies' cash) and also included the future profits of Ignis Asset Management. Under our new gearing calculation, we use gross shareholder debt and no longer include the future profits of Ignis.

On this new basis our gearing reduced from 55% to 48% as a result of the transaction. We have also announced a new gearing target of 40% by the end of 2016, in line with our desire to access the debt capital markets prior to the maturity of the new Impala facility.

Delivery of financial targets

In 2012, Phoenix Group achieved or exceeded its three financial targets.

We generated cash flows of £690 million from our operating companies. At the time of our interim results, we announced a £100 million increase in our cash generation target to £600 million – £700 million for 2012 so I am pleased that we have achieved a full year result at the upper end of this increased target range.

To have outperformed the challenging target set at the beginning of the year demonstrates the cash generative strength of our business model. Earlier this year, we also announced an increased long-term cash generation target for the period from 2011 to 2016 of £3.3 billion (previously £3.2 billion).

Our year end MCEV remained stable at £2,122 million and included an incremental £167 million delivered through management actions, compared to our average annual target of £100 million. The equity raising and debt re-terming has further increased MCEV by £211 million in 2013.

We achieved our target to reduce our level of gearing under our existing methodology to 43% or below by the end of 2012.

Our capital position

Our estimated IGD surplus was £1.4 billion at 31 December 2012 with headroom over our IGD capital policy of £0.6 billion. This compared to an estimated surplus of £1.3 billion at 31 December 2011, representing headroom of £0.4 billion. During 2012 we undertook several management actions to strengthen our IGD position through the simplification of the Group's structure. The Group expects to realise in excess of £0.2 billion additional IGD benefits when the annuity liabilities are transferred to Guardian though the Part VII transfer expected to take place in the second half of this year.

The debt re-terming and equity raising reduced the IGD surplus by £0.2 billion in 2013, reflecting the impact of using existing cash resources held in the Holding Companies of the PLHL sub-group to part-fund the prepayment.

As a result of the evolving regulatory environment, which is increasingly risk-focused across the industry, the Group undertakes a further group solvency calculation, the 'PLHL ICA', calculated for Phoenix Life Holdings Limited ('PLHL'), the same level at which we perform our IGD calculation. This is an assessment on an economic basis of the capital resources and requirements arising from the obligations and risks which exist outside the life companies. At 31 December 2012, our PLHL ICA surplus was estimated to be £1.0 billion (30 June 2012: £0.4 billion) benefiting by £0.3 billion from the new agreement with the Trustee of the Pearl Group Staff Pension Scheme, mainly as a result of revisions to the funding basis and investment strategy. The sensitivity of the PLHL ICA surplus to external market stresses is also reduced. The debt re-terming and equity raising reduced the PLHL ICA surplus by £0.2 billion in 2013.

Group assets under management

Group assets under management were £68.6 billion as at 31 December 2012, compared to £72.1 billion as at 31 December 2011. In addition, it is anticipated that a further £1.6 billion of assets will transition to Ignis from Guardian during 2013. The remaining decline was due to the natural run-off of the life company assets and the restructuring of Ignis' former joint ventures.

IFRS operating profit

Finally, the Group achieved increased IFRS operating profits of £410 million (2011: £387 million) despite life company run-off and the annuity transfer. One-off benefits were generated from modelling and policy harmonisations across the business as part of our ongoing programme of system and modelling improvements. These enhanced Phoenix Life's operating profit by £117 million.

Phoenix Life highlights

Phoenix Life contributed IFRS operating profit of £399 million, compared to £395 million in 2011, reflecting the above-mentioned one-off benefits.

One of the key successes for Phoenix Life during 2012 was the reinsurance of approximately £5 billion of annuity in-payment liabilities to Guardian. This increased the free surplus within the Group's life companies by £252 million. The reinsurance agreement is expected to be replaced by a formal Part VII transfer of the annuity in-payment liabilities in the second half of 2013.

Group Chief Executive Officer's report
continued

In addition to this important transaction, Phoenix Life made strong progress across several other areas in 2012. The Part VII transfer of the business of NPI Limited into Phoenix Life Limited ('PLL') was completed in the first half, strengthening the Group's IGD position by £84 million and consolidating all the UK life business in the Impala silo within PLL. In the second half of the year, the transfer of the business of London Life Limited to Pearl Assurance Limited was completed, with the enlarged Pearl Assurance Limited being renamed Phoenix Life Assurance Limited following completion of the business transfer. This increased the Phoenix Life free surplus by £192 million and increased the IGD surplus by £157 million.

Following these funds mergers, Phoenix Life now comprises three UK life companies: PLL, Phoenix Life Assurance Limited and National Provident Life Limited.

During 2012, the Group made considerable progress with its strategy to exit from its residual, non-core general insurance business. In January 2012, the business of PA(GI) Limited was transferred under a Part VII scheme to RSA, to whom the business had previously been reinsured. In April 2012, the general insurance business of Phoenix Life Assurance Limited was transferred under a Part VII scheme to BA(GI) Limited ('BAGI'), a fellow group company – which resulted in all of the Group's residual general insurance liabilities being held in the same entity. The Group expects to complete a sale of its entire interest in BAGI during 2013 which will remove the Group's remaining general insurance liability exposure of £39 million, net of reinsurance.

During 2012, preparations for the implementation of Solvency II made significant progress until October, when the FSA announced changes to the timetable for bringing this into force. Since then, the Group has been monitoring the FSA's proposals for development of the existing ICA regime into an 'ICA+' regime to leverage the investment made in preparing for Solvency II. At the same time, the Group has been continuing to progress its Actuarial Systems Transformation programme to drive efficiency improvements in its financial reporting processes.

Ignis Asset Management highlights

In a year of significant change, Ignis delivered an IFRS operating profit of £43 million for 2012 (2011: £46 million). Operating profit was impacted by lower performance fees generated by one of the joint ventures managing life company assets, the restructuring of the former joint ventures and life company run off, partly offset by growth in third party business.

Ignis finished 2012 with AUM of £66.0 billion, down on 2011 (£70.7 billion) owing mainly to life company run-off and the restructuring of former joint ventures. Ignis will retain an interest in the former joint ventures which will, in future, be managed independently with their own sales and administration functions. In addition, it is anticipated that a further £1.6 billion of assets will transition to Ignis from Guardian during 2013.

Ignis' financials must be seen in the context of major transformation in the Ignis operating platform while building momentum in investment and distribution performance.

Overall investment performance was good, with 79% of assets under management performing above benchmark for the year driven by fixed income, property and advisors.

The Ignis Absolute Return Government Bond Fund ('ARGBF') continues to perform strongly with 128 clients from 14 countries investing a net amount of £436 million and impressive performance – the Sterling I share class returned 6.28% over benchmark in 2012. ARGBF won best performing fund over two years at the Hedge Fund Journal UCITS Hedge awards in 2013. Alongside this Ignis launched its second product in this suite: the Ignis Absolute Return Credit fund.

Ignis' strength in Liquidity continues, with the Sterling Liquidity Fund's £14.2 billion assets under management seeing top decile performance in the year. The fund has just received an iMoneyNet Award for the top performing offshore Sterling fund for 2012.

A critical milestone for the business was the formal transfer of back office functions, including approximately 140 roles, to its new partner HSBC Bank plc. As with Phoenix Life, the use of scalable outsource partners allows Ignis to focus on its key areas of investment management and distribution, whilst providing a more predictable and lower cost operating model for the Group. Ignis also continued its strategy of moving away from joint ventures, enabling it to focus on its core activities more effectively.

Ignis continues to develop as a manager of third party assets. In 2012, it attracted new third party inflows of £1.6 billion, excluding inflows related to the annuity transfer from Guardian, realigned its distribution capability to better fit its chosen channels and markets, and strengthened its sales teams. Ignis' continued management of £4.7 billion of assets on behalf of Guardian as part of the annuity transfer by Phoenix Life was a significant win. It reinforced Ignis' position as one of the largest managers of annuity assets in the UK.

Since the end of 2009, and taking into account the remaining £1.6 billion of assets relating to the annuity transfer transaction, third party assets as a proportion of total Group assets under management has almost doubled to 19%.

Customers

'Treating Customers Fairly' is crucial to how we run our business. We are always seeking, where possible, to improve returns for our policyholders through the distribution of the estate within the life funds. For example, maturity payouts are being enhanced in the Pearl with-profit fund of Phoenix Life Assurance Limited by up to 16%. This is 7% higher than the previous year.

We continually aim to improve customer service. In 2012, we migrated 780,000 in-force policies from legacy systems to the BaNCS utility platform with our outsource partner Diligenta. This brings to three million the total number of in-force policies migrated onto BaNCS. This migration will help bring improvements and long-term stability to our customer offering.

Group Chief Executive Officer's report
continued

We also launched a new website for a number of our life funds to enhance the online customer experience, which includes a new Customer Centre Area with 'how to' guides and online forms. Furthermore, we continue to seek initiatives that may be of benefit to our customers and, in 2012, we identified a number of small, externally-managed unit-linked funds for closure where it is in the customers' interest so to do. This programme was completed, with 66 small external funds closed and £51 million of customers' investments switched into internally managed funds benefiting from lower fees.

In March 2012, in response to the Government's consultation on improving pension transfers and dealing with small pension pots, Phoenix called for the Government to exclude legacy business from any revisions to pension transfer legislation, in order both to protect policyholder interests and avoid an unnecessary administrative burden on the industry. The Government published the results of this consultation exercise in July and confirmed that only new, auto-enrolled business would be included in the legislation, thereby avoiding policyholder detriment and administrative costs to the Group. In addition, Phoenix provided evidence to the Work and Pensions Select Committee to highlight and explain the valuable benefits and guarantees in some of the older with-profit pension products. Phoenix is working to ensure that these valuable benefits to policyholders are not overlooked when the Government is considering any future pension reforms.

People

Phoenix Group's achievements are the result of the skill and hard work of all its 1,200 employees.

Phoenix is able to attract specialist asset management and life fund expertise which sets the Group apart. Low levels of staff turnover and high levels of employee engagement demonstrate the Group's ability to retain expertise. Phoenix was included on the list of 'Britain's Top Employers 2012'.

In embedding Phoenix's Corporate Responsibility programme, staff have had the opportunity to shape the Group's approach to the workplace and the communities in which we operate. This has contributed to our engagement survey results comparing very favourably with the Financial Services benchmark.

Economic and industry overview

Financial markets in 2012 were uncertain and global economic growth was subdued. I expect the economic uncertainty to continue during 2013. Although Phoenix is not immune to further negative developments in the Eurozone and elsewhere, we have carefully managed our exposure to certain jurisdictions and we are well positioned to react to further changes to help ensure policyholder and shareholder investments are secure.

The UK Government is in the process of implementing its reform of the framework for financial regulation in the UK through the Financial Services Act, which comes into force on 1 April 2013. The Financial Services Act provides for the dual supervision of UK insurance companies by two new regulators: the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA'). The Group's UK insurance subsidiaries will be regulated by both the PRA and the FCA. Whilst there are uncertainties as to how the two bodies will interact with each other, I believe our good relationship with our regulators will help us manage this transition.

During 2012, the Association of British Insurers ('ABI') launched a compulsory Code of Conduct on Retirement Choices which aims to ensure people approaching retirement receive greater support in the annuity process and get the best possible retirement income. Representatives of Phoenix Life were active members of the working group implementing the code which was put into effect on 1 March 2013.

Going forward, we will provide policyholders with comparison tables on annuity pricing which will show the competitive position of our standard annuity rates. For policyholders who may be eligible for non-standard annuity rates we can help them find a specialist annuity provider.

2013 Outlook and prospects

Financial targets

Whilst financial markets continue to generate uncertainty, the Group's cash flow and MCEV have remained resilient. Despite the challenging market conditions we are pleased to set an increased cash generation target for 2011 to 2016 of £3.5 billion.

By 31 December 2012, cash generation of £1.5 billion since 1 January 2011 had already been achieved against this target. We are aiming to deliver cash generation of between £650 million and £750 million in 2013. In addition, we maintain our annual average target of £100 million of MCEV enhancements through management actions over the period 2011 to 2014. At 31 December 2012, we had already delivered £332 million of this cumulative target.

The combination of cash flow generation and enhancement to MCEV will allow us to reduce gearing. We have set ourselves a new target to reduce gearing as calculated under our new methodology to 40% by the end of 2016.

Conclusion

I look to the future with confidence and believe that we can continue to build and deliver value for all our stakeholders through continued organic improvements and a renewed focus on growth.

On behalf of the Board, I was delighted to welcome Howard as Chairman of the Group. His intellect and judgement are great assets.

I would like to thank my colleagues for their hard work during a challenging period. Although it is difficult to predict how the economic climate will develop, the quality of the teams within Phoenix, the discipline with which the Group manages risk and capital and the proven resilience of its business model will stand us in good stead going forward.

Clive Bannister
Group Chief Executive Officer
21 March 2013

2012 highlights

Key highlights

- Successful debt re-terming and equity raising of £250 million announced in January 2013 significantly enhanced strategic and financial flexibility
- Bank debt reduced from £2.5 billion at end 2011 to £1.9 billion on a pro forma basis at 31 December 2012. Gearing reduced under our new methodology from 57% at 31 December 2011 to 48% on a pro forma basis taking into account the debt re-terming and equity raising
- £690 million cash generation – at the upper-end of the target range
- 27% increase in recommended final dividend to 26.7p per share
- Delivered £167 million of MCEV enhancement through management actions
- Agreed to transfer approximately £5 billion of annuity in-payment liabilities to Guardian
- Further simplified life company structure through consolidation of life companies, enhancing the cash and capital position of the Group
- Reached new agreement with Trustee of the Pearl Group Staff Pension Scheme increasing PLHL ICA headroom by £0.3 billion
- Increased policyholder payouts through inherited estate distribution

Other achievements

- Continued investment outperformance at Ignis with 79% of funds under management performing above benchmark for the year
- Ignis achieved net third party sales of £1.6 billion, excluding Guardian inflows
- Transferred a further 780,000 in-force policies onto the BaNCS administration platform
- Completed the transfer of Ignis' back office functions to HSBC Bank plc
- Made considerable progress in strategy to exit from residual, non-core general insurance business

"Our business brings together complementary skills to deliver improved performance for our life company and asset management customers. With a simple mission and a clear strategy we are well positioned to capitalise on opportunities to deliver value as they arise in the future."

Howard Davies,
Chairman

Business and strategy

In this section

Our business

Phoenix Group combines the financial and operational expertise of Phoenix Life with the investment management capabilities of Ignis to create value for policyholders and shareholders.

What we do

PHOENIX LIFE

Aims to deliver innovative financial management and operational excellence.

Life assurance

Through Phoenix Life we manage life assurance funds which no longer actively sell new life assurance policies and which run-off gradually over time. These 'closed life funds' within the Group consist of approximately 6 million policyholders and a total of approximately £65 billion of financial and property assets.

Phoenix Life manages these funds using its skills and expertise in the areas of capital, financial, risk and cost management.

Policyholders

6m

Cash generation

£661m

IGNIS

ASSET MANAGEMENT

Targets superior investment performance and client service.

Asset management

Through Ignis, the Group both manages the funds that back the investments of our policyholders and develops investment propositions for third party clients in the institutional, retail and UK and international markets.

Ignis aims to maximise risk-adjusted returns on the assets it manages for the benefit of policyholders, third party clients and shareholders.

Assets under management, oversight and advice

£66.0bn

IFRS operating profit

£43m

How we create value

Unlike open life businesses, we are not required to allocate significant capital to support the writing and distribution of new insurance products. This means that the capital requirements of our operating life companies decline as policies mature, releasing excess capital as free surplus in the form of cash.

We create value from our in-force book of closed life funds, generating profits from participation in investment returns, policyholder charges and management fees earned on assets (to the extent they exceed expenses). These additional profits from the in-force policies can also be released by the Group's life companies as free surplus in the form of cash.

External outsource partners are used for policy administration thereby minimising fixed costs.

Ignis generates revenues from managing the investments of the Group's life companies as well as third party clients.

Ignis is incentivised to maximise investment performance for the Group's policyholders through performance fee arrangements. In addition, Ignis is seeking to grow the assets it manages for third party investors in both the retail and institutional markets.

To support future strategy, Ignis has transformed its operating model through the completion of outsourcing of back office functions to HSBC Bank plc.

PHOENIX GROUP

– Value generated by Phoenix Life and Ignis is distributed to the Holding Companies in the form of cash. The Holding Companies use this cash to fund group expenses, pension contributions, debt interest and repayments and shareholder dividends.

– The Group functions provide support for, and coordination and delivery of the Group's strategic objectives and manage our relationships with our external stakeholders, including shareholders, our lenders, our Group pension schemes and the Financial Services Authority ('FSA').

Operating structure

Our structure is aligned to the market sectors in which we operate.

The Group has two core segments: life assurance – Phoenix Life; and asset management – Ignis. In addition, our Group functions provide support and coordination for the delivery of the Group's strategic initiatives.

Group functions

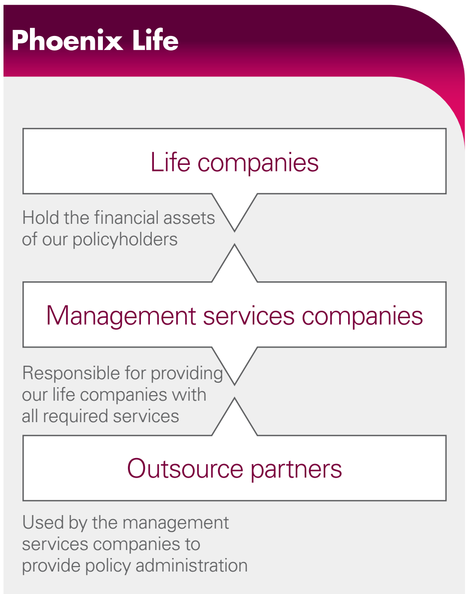
At Group level, Phoenix operates centralised functions that provide Group-wide and corporate-level services and manage corporate activity. These operations include Group Finance, Treasury, Group Tax, Group Actuarial, Group Risk, Legal Services, HR, Corporate Communications, Strategy and Corporate Development, Investor Relations, Company Secretariat and Internal Audit.

Phoenix Life

Phoenix Life is responsible for the management of the Group's life funds. Phoenix Life's experienced and focused management team is led by its Chief Executive Officer, Mike Merrick. Based in Wythall, near Birmingham, it has a track record of successfully integrating life assurance businesses and is developing a leading-edge model and infrastructure into which future acquired funds can be integrated.

Manage capital

Phoenix Life continually manages the capital requirements of the Group's life companies, ensuring that policyholder security is protected whilst maximising the release of capital as cash to the Group's Holding Companies. We combine sophisticated asset liability matching techniques with a prudent approach to risk management to ensure the Group's life companies are capital efficient.



The Group has continued its programme of activity to further consolidate its life companies in order to optimise capital allocation and economies of scale. During 2012, the business of NPI Limited was transferred into Phoenix Life Limited and the business of London Life Limited was transferred to Pearl Assurance Limited. The enlarged Pearl Assurance Limited was renamed Phoenix Life Assurance Limited following completion of the business transfer.

As a result, the Group had three operating UK life companies at the end of 2012, being Phoenix Life Limited, Phoenix Life Assurance Limited and National Provident Life Limited. Together, they comprise 14 with-profit funds and two non-profit funds. Simplifying the number of life companies within the Group through such business transfers both reduces complexity and releases capital.

Drive value

Driving value consists of more than just targeting enhanced investment returns. The Group also aims to ensure that unrewarded exposure to market volatility is minimised or the risks from sudden market movements are managed through hedging. In addition, regular re-balancing of asset and liability positions is required to ensure that only those assets which deliver appropriate risk adjusted returns are held within life funds, taking into account any policyholder guarantees.

Although the life companies are closed and generally do not write new business, they do accept additional policyholder contributions on in-force policies and allow certain policies, such as pension savings plans, to be reinvested at maturity into annuities. The Group has a strong and steady stream of internal annuities vesting at a very low cost, and is therefore able to offer its policyholders competitive annuity rates. In 2012, £1.0 billion of vesting annuities were retained within the Group of which £0.5 billion related to policies with guaranteed annuity rates.

Management services

The Group's management services companies are charged with the efficient provision of financial and risk management services, sourcing strategies and delivering all administrative services required by the Group's life companies. By using management services companies, the life companies benefit from price certainty and a transfer of some operational risks.

As the number of policies held by the Group gradually declines over time, the fixed cost base of our operations as a proportion of policies will increase. Our management services team manages this risk by putting in place long-term arrangements for third party policy administration. By paying a fixed price per policy to our outsource partners we reduce the fixed cost element of our operations.

The Phoenix Way: Methodology

The Phoenix Way characterises an approach and infrastructure for the efficient and effective structuring, integration and management of closed life funds and the investments held within them.

The Phoenix Way aims to provide a consistent approach to managing each Group life company which, given their different histories, have previously all adopted different methodologies.

The Phoenix Way covers areas such as operational management, outsourcing, investment management, restructuring and risk management. Examples include establishing a standardised with-profit 'model fund', consolidating outsourcing arrangements, and developing standard systems for actuarial modelling as part of our AST project.

The Phoenix Way also provides a template which can then be applied in a consistent manner to newly acquired closed life funds within the Group.

Operating structure
continued

Deploying The Phoenix Way: Fund mergers

An important part of The Phoenix Way involves addressing legacy issues to improve capital and operational efficiency.

The Group has grown through the acquisition of a number of closed life businesses, resulting in a corporate structure in Phoenix Life which is sub optimal. To address this, Phoenix Life has been running a programme to reduce the number of life companies and to ensure those remaining are run in a similar manner. Such rationalisation is done through the 'Funds Merger programme' and is carried out under Part VII of the Financial Services and Markets Act.

During 2012, two fund transfers were completed under which all of the long-term business of NPI Limited and London Life Limited was transferred to Phoenix Life Limited and Phoenix Life Assurance Limited (previously Pearl Assurance Limited) respectively.

As a result, the Group benefits from:

- Improved capital efficiency, arising from greater diversification/offsetting of risks
- Simplification and standardisation of capital structures and capital policies
- Simplification of reinsurance arrangements
- Reduced operational risk and costs.

Policyholders' interests are protected by building a number of safeguards into the transfer process. Most importantly, the transfers required approval by the High Court. In order to decide whether the transfer is fair to affected policyholders, the Court requires a report from an Independent Expert and also the FSA are consulted. Following the transfers, both NPI and London Life policyholders benefit from the protection provided by a legal commitment to a clear capital policy set out in the Scheme document.

Following those fund mergers, all policyholders are now part of the Phoenix brand.

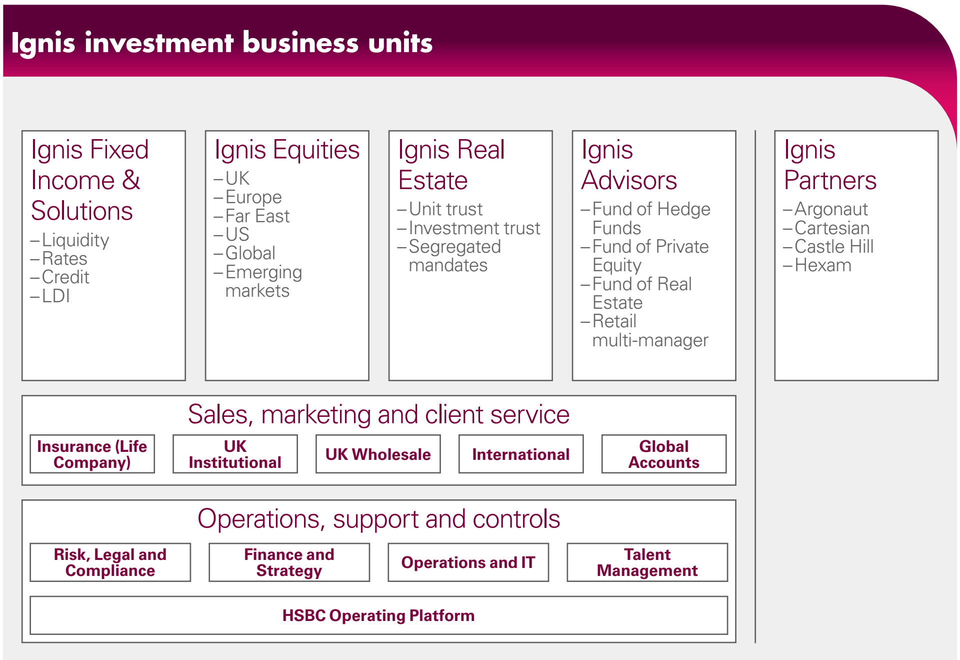
These outsource partners have scale and common processes, often across multiple clients, which provide several benefits for the Group, including converting fixed costs to variable costs, reducing investment requirements, improving the technology used within our administrative capability, and reducing our operational risk.

Specialist roles such as finance, actuarial and risk are retained in-house, ensuring Phoenix Life retains full control over the core capabilities necessary to manage and integrate closed life funds.

Ignis Asset Management

Ignis Asset Management is the Group's asset management business and is led by its Chief Executive Officer, Chris Samuel.

It provides investment management services to the Group's life companies as well as to third party clients, including both retail and institutional investors in the UK and overseas. Ignis is responsible for £66.0 billion of assets, including £54.1 billion of assets of the Group's life and Holding Companies.



With offices in London and Glasgow, and just under 400 employees (with approximately 140 additional roles outsourced to HSBC Bank plc in 2012), Ignis has investment capabilities across multiple asset classes organised into four investment business units and its former joint ventures, which have been restructured as a series of investments – now called Ignis Partners.

Ignis' vision is to become a leading asset management business committed to performance excellence and innovation where talented people want to work and most importantly, where clients want to invest their money.

The business strategy to develop this vision has four goals:

- Meeting or exceeding the investment performance expectations of Ignis' clients
- Working with clients to provide creative solutions to changing product needs
- Maintaining a well-controlled and efficient operating platform
- As a result, developing further as a leading asset manager.

Operating structure
continued

This strategy is underpinned by:

Innovative people focused on Ignis' clients and provided with the freedom to perform

A partnership culture that ensures clear accountability and supports both the work within Ignis and with Ignis' clients and counterparties

Processes and technology to identify risks and opportunities

Stability that comes from a strong governance and control culture, and being part of the Phoenix Group.

The formal transfer of back office and operational functions to HSBC Bank plc, was achieved in May 2012. The majority of transferred roles went to a newly created HSBC unit in Glasgow offering services including statutory reporting, tax, technology and performance measurement. This allows Ignis to focus on the key areas of investment and distribution and provides the Group with a more predictable and lower cost operating model.

Another key landmark was reached in the continuing strategy of the business when Ignis announced its intention to, in due course, sell its stake in the last of the joint ventures, Cartesian, paving the way for it to transition to a standalone business. This followed the establishment of Hexam and Argonaut as independent business partners and the transfer of people and responsibilities to Castle Hill. Transition away from the joint ventures model enables Ignis to focus on its core activities.

During the year Ignis realigned its distribution capability to better fit with its chosen channels and markets. It has also built upon its third party proposition by strengthening its sales teams and adding Global Accounts. There has been good progress in International over the year, with solid sales in Italy and Germany in particular. Meanwhile, the UK Wholesale channel has been driving strong net sales in Real Estate.

Ignis' ability to transform its operational platform whilst continuing to deliver good investment performance and attract net new third party assets – all under challenging market conditions – is a testament to its strengths as a business.

Deploying The Phoenix Way:
Development of absolute return funds

A key strand of The Phoenix Way is effective investment management, which Ignis Asset Management seeks to deliver for its customers leveraging its expertise in managing Phoenix Life's assets.

Investment strategy in this product space has recently focused upon the development of a range of absolute return funds. These draw upon Ignis' modelling tools created to meet the needs of Phoenix Life and its policyholders, and developed for third party investors.

To date, the highest profile of the absolute return funds is the Absolute Return Government Bond Fund ('ARGBF'). Its success has set a template for the development of the rest of the fund range.

ARGBF was developed internally and run as a paper portfolio by Ignis Fixed Income, before being launched with seeding from Phoenix Group shareholder funds.

2012 saw ARGBF's acceleration via Ignis distribution – notably in the international space and built upon strong performance.

- 2012 net sales of £436 million
- Sterling I share class returned 6.28% over benchmark in 2012.

To complement ARGBF, the Absolute Return Credit fund ('ARC') was launched in August 2012.

Planned for 2013 is the launch of a hedge fund modelled on ARGBF. Ignis will also apply this approach to market its absolute return emerging market debt fund, which has delivered positive investment performance for Phoenix policyholders since its inception in 2011.

Our strategy

Phoenix Group's strategic journey continues to build on its recent achievements. Phoenix aims to be the saver-friendly solution for the safe, innovative and profitable management of closed life funds.

Areas of strategic focus

Manage capital

Risk management is a key component of the Group's strategic agenda. The effective management of our risks and the efficient allocation of capital against them are critical in allowing us to achieve our strategic and operational objectives. This includes ensuring there are robust capital policies within the life companies.

We are well positioned to adapt to new requirements arising from regulatory changes. Simplifying our capital structure brings greater flexibility and is a fundamental enabler of the strategic growth ambitions of the Group.

Drive value

At Phoenix we drive value in many ways. There are a number of management actions undertaken by the Group such as fund mergers and de-risking which can accelerate cash or increase our MCEV.

Management of costs is also an important aspect of our value creation. Part of The Phoenix Way involves improving the efficiency of operational management through the standardisation and streamlining of key processes across the Group which will in turn reduce costs, improve performance and maximise value.

Improve customer outcomes

We have three key areas of focus in relation to our customers:

Value – we aim to optimise customer outcomes

Service – customers want to be treated fairly, with empathy and respect in a timely fashion

Security – customers expect their investment to be secure in a well managed company.

Engage people

Building its reputation as an employer of choice, the Group specifically targets, recruits and develops top quality people.

The Group invests in its people whose talent, enthusiasm and support makes its strategy and objectives achievable.

Developing the platform for growth

During 2012, the Group has made further progress in building a stable and simplified business. Results to date, both financial and non-financial, have continued to demonstrate the delivery of our strategy.

Delivering on our objectives

	Our objectives for 2012	Our achievements in 2012	Our priorities for 2013
PHOENIX GROUP	Maintain strong cash flow delivery	Achieved cash flow generation of £690 million – at the upper end of 2012 target	Full year cash generation target of £650 million – £750 million in 2013 and a cumulative cash flow target for 2011 to 2016 of £3.5 billion
	Reduce gearing to 43% or below (under the Group's existing methodology)	Reduced gearing under our existing methodology to 42%, below our 43% target. Gearing reduced under our new methodology from 57% at 31 December 2011 to 55%	Reduce gearing to 40% by end-2016
	Achieve £100 million of MCEV enhancing management actions each year on average from 2011 to 2014	Delivered £167 million of MCEV enhancements during 2012 through management actions	Achieve cumulative target of £400 million of MCEV enhancing management actions between 2011 and 2014
	Examine opportunities to refinance and/or restructure existing Group debt arrangements	In January 2013, we announced a comprehensive refinancing transaction which included a £250 million equity raising and a £450 million debt prepayment and re-terming of the Impala facility to June 2019. This refinancing reduces our gearing, on a pro forma basis as at 31 December 2012, to 48% under our new gearing methodology	
	Maintain high employee engagement and achieve employee retention above benchmark for each business unit	Employee engagement survey result of 73% compared favourably with the Financial Services benchmark of 70%. Achieved employee retention above benchmark for each business unit	
		Reached new agreement with Trustee of the Pearl Group Staff Pension Scheme which increased PLHL ICA headroom by £0.3 billion and reduced its sensitivity to external market stresses	
PHOENIX LIFE	Progress further funds mergers	Completed the transfers of the long-term business of NPI Limited to Phoenix Life Limited, and London Life Limited to Pearl Assurance Limited. Renamed Pearl Assurance Limited as Phoenix Life Assurance Limited enabling all Phoenix Life policyholders to be brought into the Phoenix brand	Complete formal transfer of annuity liabilities to Guardian
	Commence 'Use Test' period running Solvency II conformant processes in advance of the Internal Model Application	Significant progress made in preparations for regulatory change and development of the Actuarial Systems Transformation programme	Continue to progress the Actuarial Systems Transformation programme and regulatory change preparations to drive out efficiency improvements in financial reporting processes
		Agreed £5 billion annuity transfer to Guardian accelerating release of capital and reducing longevity risk exposure Made considerable progress in strategy to exit from residual, non-core general insurance business	Complete BaNCS migration
IGNIS ASSET MANAGEMENT	Continue to deliver strong investment performance	79% of assets under management performed above benchmark	Continue to deliver strong investment performance
	Develop proposition for third party clients, including for the institutional marketplace	Gained new third party business inflows of £1.6 billion, excluding Guardian inflows Realigned distribution capability; strengthened sales teams; added Global Accounts; and Absolute Return Credit ('ARC') fund launch	Maintain focus on developing proposition for third party clients, including institutional market place
	Complete outsourcing of investment administration and related back office services	Outsourced back office functions to HSBC Bank plc	Continue operations transformation and technology enhancements while maintaining well-controlled operating platform
		Transitioned away from joint ventures model	

"The Group has produced a strong operating performance in 2012, successfully delivering against all of its financial targets. Cash generation has been achieved at the top end of the target range, whilst the execution of the value enhancing management actions has seen embedded value remain resilient."

Jim McConville,
Group Finance Director

Business review

In this section

Key performance indicators

Operating companies' cash generation

£690m

2011: £810m

Maintaining strong cash flow delivery underpins debt servicing and repayment as well as shareholder dividends:

Analysis

Continued strong cash generation of £690 million by the Group's operating companies enabled the Group to achieve the upper end of its 2012 target for cash generation of £600 million to £700 million.

Management actions in themselves generated cash flows of £209 million, mainly relating to fund mergers and other de-risking activities.

Definition and calculation

Operating companies' cash generation is a measure of cash and cash equivalents remitted by the Group's operating companies to the Holding Companies and is available to cover dividends, debt servicing and repayment, pension scheme contributions and operating expenses.

Quantified target

The cumulative cash flow target for 2011 to 2016 is £3.5 billion, against which £1.5 billion had been achieved by 31 December 2012.

£650 million to £750 million of these cash flows are expected to be generated in 2013.

Group MCEV

£2,122m

2011: £2,118m

The Board considers that MCEV provides the most relevant and consistent means of assessing the Group's ability to increase value:

Analysis

MCEV remained stable in the period as value enhancing management actions delivered an incremental uplift to MCEV of £167 million against an average target of £100 million per annum, offset by the recognition of actuarial losses as the Pearl Group Staff Pension Scheme moved to an IFRS deficit, and the payment of the shareholder dividend.

Definition and calculation

The basis of calculation of Group MCEV is set out in note 1 of the MCEV supplementary information.

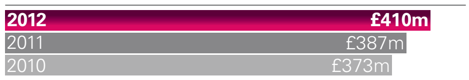
Quantified target

The Group's target is an average contribution to embedded value from management actions of £100 million per annum between 2011 and 2014.

Group IFRS operating profit

£410m

2011: £387m



The Board considers that Group IFRS operating profit is a more representative measure of performance than Group IFRS profit before tax as it provides long-term performance information unaffected by short-term economic volatility and gives an insight into the Group's ability to generate cash flows to support dividends[1]:

1 Phoenix Group Holdings is subject to Cayman Islands Companies Law. Under Cayman Islands Companies Law, distributions can be made out of profits or share premium subject, in each case, to a prescribed solvency test. The solvency test is broadly consistent with the Group's going concern assessment criteria.

Key performance indicators
continued

Analysis

Group IFRS operating profit has increased to £410 million (2011: £387 million) despite the natural life company run-off and the annuity transfer transaction, primarily due to one-off benefits generated from ongoing system and modelling improvements of £117 million (2011: £72 million).

Definition and calculation

The basis of calculation of Group IFRS operating profit is set out in note 5 of the IFRS financial statements.

IGD surplus (estimated)

£1.4bn

2011: £1.3bn

Insurance Groups' Directive ('IGD') surplus is the Pillar 1 regulatory assessment of capital adequacy on a Group-wide basis:

Analysis

The estimated IGD surplus has increased to £1.4 billion with capital generation items of £0.6 billion offsetting the recognition of the IFRS deficit on the Pearl Group Staff Pension scheme of £0.2 billion and the payment of dividends, debt interest and debt repayments of £0.3 billion. The surplus of £1.4 billion represents headroom of £0.6 billion (2011: £0.4 billion) over the Group's IGD capital policy.

Definition and calculation

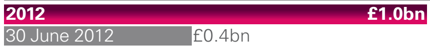
The IGD surplus is a regulatory capital measure which calculates surplus capital at the level of the ultimate insurance parent undertaking within the EEA, which is Phoenix Life Holdings Limited ('PLHL'). IGD surplus is defined as group capital resources less the group capital resource requirement.

IGD capital policy: The Group maintains group capital resources at the PLHL level at an amount in excess of 105% of the with-profit insurance capital component ('WPICC'), being an additional capital requirement of with-profit funds, plus 145% of the group capital resource requirement less the WPICC.

PLHL ICA surplus (estimated)

£1.0bn

30 June 2012: £0.4bn



PLHL ICA surplus is the economic regulatory assessment of capital adequacy on a Group-wide basis:

Analysis

The PLHL ICA surplus increased in the second half of the year reflecting a £0.3 billion benefit from the new funding arrangements entered into with the Trustee of the Pearl Group Staff Pension Scheme, capital generation and positive market movements of £0.4 billion, partly offset by the payment of dividends, debt interest and debt repayments of £0.1 billion.

Definition and calculation

PLHL ICA surplus represents an assessment on an economic basis of the capital resources and requirements arising from the obligations and risks which exist outside the life companies.

As agreed with the FSA, the Group aims to ensure that PLHL maintains an ICA surplus of at least £150 million.

Dividend per share

47.7p

2011: 42p

Analysis

The Board has recommended a final dividend of 26.7 pence per share bringing the total dividend for the year to 47.7 pence. The final dividend is due to be paid on 3 May 2013, subject to compliance with the processes set out in the Group's main credit facilities and shareholder approval at the Company's AGM.

Group assets under management

£68.6bn

2011: £72.1bn

2012	**£68.6bn**
2011	£72.1bn
2010	£69.6bn

Assets under management are a key driver of operating profit:

Analysis

Total Group assets under management decreased by £3.5 billion to £68.6 billion.

The decrease was driven by the run-off of the closed life business, the joint venture restructure and the annuity transaction, under which £5.1 billion of assets were transferred to Guardian Assurance Limited ('Guardian') under the terms of the reinsurance agreement during the period. Ignis have been selected to manage £4.7 billion of these assets and £3.1 billion had already been recaptured as at 31 December 2012 under agreed mandates. The remaining £1.6 billion is expected to be transferred to Ignis during 2013.

Partially offsetting the above reductions are net third party inflows of £1.6 billion (excluding inflows from Guardian) and the impact of positive market movements.

Definition and calculation

Group assets under management represent life company assets (excluding collateral on stock-lending arrangements), Holding Company cash, and third party assets managed by Ignis.

Ignis Asset Management IFRS operating profit

£43m

2011: £46m

2012	**£43m**
2011	£46m
2010	£46m

Analysis

Ignis' IFRS operating profit of £43 million (2011: £46 million) was impacted by lower performance fees generated by one of the joint ventures managing life company assets, the restructuring of the joint ventures and life company run-off, partly offset by growth in third party business.

Definition and calculation

Ignis' IFRS operating profit excludes non-recurring income and expenses.

Gearing ratio – new methodology

55%

2011: 57%

2012	**55%**
2011	57%
2010	58%

The gearing ratio is the Group's measure of its level of debt compared to its equity on a gross MCEV basis:

Analysis

The Group has revised its definition of gearing during the period in order to adopt a calculation that is more consistent with the gearing calculations typically used by credit rating agencies.

The Group's gearing was 42% under its existing methodology as at 31 December 2012 (2011: 46%), and the Group met its previously announced target of reducing gearing to below 43% on that basis.

Definition and calculation

The Group calculates its gearing under its new methodology as gross shareholder debt[1] as a percentage of the sum of the Group MCEV and the value of the shareholder and hybrid debt as included in the MCEV.

Quantified target

The Group's target is to reduce the gearing ratio under its new methodology to 40% by the end of 2016.

1 Gross shareholder debt is defined as the sum of the IFRS carrying value of shareholder debt and 50% of the IFRS carrying value of the Tier 1 Notes given the hybrid nature of that instrument.

Cash generation

Operating companies' cash generation

£690m

Cash generation

The Group's cash flows are generated from the interest earned on capital, the release of excess capital as the life funds run-off, policyholder charges and fees earned on assets under management. The Group's closed life funds provide predictable fund maturity and liability profiles, creating stable long-term cash flows for distribution to shareholders and for repayment of outstanding debt. Although investment returns are less predictable, some of the investment risk is borne by policyholders.

Holding Companies' cash flows

The statement of cash flows prepared in accordance with IFRS combines cash flows relating to policyholders and cash flows relating to shareholders, but the practical management of cash within the Group maintains a distinction between the two, as well as taking into account regulatory and other restrictions on the availability and transferability of capital. For this reason, the following analysis of cash flows focuses on the Holding Companies' cash flows, which reflect cash flows relating only to shareholders and which are, therefore, more representative of the cash that could potentially be distributed as dividends, or used for the repayment of debt. This cash flow analysis reflects the cash paid by the operating companies to the Holding Companies, as well as the uses of those cash receipts.

In 2012, the Group has delivered cash flows from its operating subsidiaries of £690 million, including cash flows of £209 million from management actions. The latter increased cash flows primarily through a reduction in the Group's capital requirements as a result of fund merger activities, benefits delivered from modelling improvement exercises and other investment and operational de-risking initiatives.

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Cash and cash equivalents at 1 January	**837**	486
Operating companies' cash generation:		
Cash receipts from Phoenix Life	**661**	778
Cash receipts from Ignis Asset Management	**29**	32
Total receipts of cash by Holding Companies[1]	**690**	810
Uses of cash:		
Operating expenses	**37**	52
Pension scheme contributions	**50**	35
Debt interest	**115**	122
Total recurring outflows	**202**	209
Non-recurring outflows	**21**	24
Uses of cash before debt repayments and shareholder dividend	**223**	233
Debt repayments	**165**	171
Shareholder dividend	**73**	55
Total uses of cash	**461**	459
Cash and cash equivalents at 31 December[2]	**1,066**	837

1 Includes amounts received by the Holding Companies in respect of tax losses surrendered to the operating companies.

2 Closing balance at 31 December 2012 includes required prudential cash buffer of £150 million (2011: £150 million).

Operating companies' cash generation

Cash remitted by Phoenix Life during 2012 was £661 million (2011: £778 million), reflecting the benefit of management actions implemented during the period. When combined with the £29 million of cash remitted by Ignis Asset Management (2011: £32 million), the Group has succeeded in achieving cash generation towards the top end of its target range of £600 million to £700 million for the year ended 31 December 2012.

Phoenix Life free surplus

The generation of free surplus, net of movements in required capital, underpins the cash remittances from Phoenix Life. The table below analyses the movement in free surplus of Phoenix Life:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Opening free surplus	**93**	750
IFRS operating profit	**399**	395
IFRS investment variances and non-recurring items	**105**	(336)
IFRS tax	**(14)**	(20)
Movements in capital requirements	**663**	84
Valuation differences and other[1]	**(71)**	(2)
Free surplus generated in the period	**1,082**	121
Cash distributed to Holding Companies	**(661)**	(778)
Closing free surplus	**514**	93

1 Includes differences between IFRS valuation of assets and liabilities and valuation for capital purposes.

The Phoenix Life operating profit is discussed in the Group IFRS operating profit section and reflects recurring margins and return on surplus assets, plus the effects of non-economic experience variances and assumption changes.

Contributing to the total free surplus generated in the period is the positive impact of management actions, including the Guardian annuity transfer transaction (£252 million) and the transfer of the business of London Life Limited to Phoenix Life Assurance limited (£192 million). The remainder of the free surplus generated in the period principally reflects the inherent release of capital requirements from the run-off of the life funds and the annual ICA refresh.

Cash generation
continued

Recurring cash outflows

Operating expenses of £37 million (2011: £52 million) decreased as a result of reduced corporate costs, reflecting the impact of cost management initiatives.

Pension scheme contributions of £50 million (2011: £35 million) increased as the Group Holding Companies are now bearing the entire cash cost of funding the Group's two pension schemes. In prior periods, Phoenix Life funded a proportion of the contributions made to the PGL Pension scheme.

Debt interest of £115 million (2011: £122 million) decreased, reflecting the lower opening value of the Group's debt and repayments made in the period.

Non-recurring cash outflows

Non-recurring cash outflows reflect investment in the Group's transformation programmes.

Debt repayments and shareholder dividend

Debt repayments of £165 million in the period comprise a £15 million voluntary debt prepayment and scheduled repayments totalling £150 million in respect of the Group's two main credit facilities.

The shareholder dividend of £73 million comprises the payment of the 2011 final and 2012 interim dividend.

Target cash flows

The Group is targeting operating companies' cash generation of £3.5 billion for the period from 1 January 2011 to 31 December 2016:

Sources of cash flows	1 January 2011 to 31 December 2016 £bn
Future cash flows:	
Emergence of surplus	**1.1**
Release of capital	**0.8**
Recurring cash receipts generated by life companies	**1.9**
Other[1]	**0.1**
Total future cash flows target	**2.0**
Achieved cash flows	**1.5**
Operating companies' cash generation target	**3.5**

1 Includes cash flows from Ignis and the management services companies.

£650 million to £750 million of these targeted cash flows are expected to be generated in 2013.

The resilience of the cash generation target is demonstrated by the following stress testing:

Stress testing	1 January 2011 to 31 December 2016 £bn
Base case 6-year target	**3.5**
20% fall in equity markets	**3.4**
15% fall in property values	**3.4**
75bps increase in yields[1]	**3.5**
Credit spreads widening with no change in expected defaults[2]	**3.3**

1 Represents a real yield reduction of 25bps, given a 75bps parallel increase in nominal yields.

2 10 year term: AAA – 46bps, AA – 77bps, A – 99bps, BBB – 140bps.

One-off shocks would be expected to lead to a deferral of cash emergence rather than a permanent diminution.

Group MCEV

Group MCEV

£2,122m

Group MCEV operating earnings[1]

The realisation of value from the delivery of management actions has seen the Group MCEV remain resilient during the period.

MCEV operating earnings after tax were lower at £307 million (2011 restated: £417 million) primarily due to a reduction in the long-term risk free rate and the non-recurrence of significant experience variances in 2011.

MCEV operating earnings	Year ended 31 December 2012 £m	Year ended 31 December 2011 Restated £m
Life MCEV operating earnings[2]	**360**	556
Management services operating profit	**28**	17
Ignis Asset Management operating profit	**43**	46
Group costs	**(25)**	(54)
Group MCEV operating earnings before tax	**406**	565
Tax on operating earnings	**(99)**	(148)
Group MCEV operating earnings after tax	**307**	417

1 The Phoenix Group Market Consistent Embedded Value methodology (referred to herein and in the supplementary information as MCEV) is set out in note 1 in the MCEV supplementary information.

The asset management and management services businesses are included in the Group MCEV at the value of IFRS net assets. The Group MCEV does not include the future earnings from their businesses.

2 Life MCEV operating earnings are derived on an after tax basis. For presentational purposes Life MCEV operating earnings before tax have been calculated by grossing up the after tax Life MCEV operating earnings. Life MCEV operating earnings before tax of £360 million (2011: £556 million) are therefore calculated as £272 million operating earnings (2011: £409 million) grossed up for tax at 24.5% (2011: 26.5%).

Life MCEV operating earnings after tax

Other than vesting annuities and increments to existing policies, the Group's life division is closed to new business. The principal underlying components of the life MCEV operating earnings are therefore the expected existing business contribution together with non-economic experience variances and assumption changes.

Life MCEV operating earnings after tax	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Expected existing business contribution	**184**	254
New business value	**20**	13
Non-economic experience variances and assumption changes:		
Experience variances	**13**	181
Assumption changes	**(37)**	(18)
Other operating variances	**92**	(21)
Total non-economic experience variances and assumption changes	**68**	142
Life MCEV operating earnings after tax	**272**	409

Expected existing business contribution

The Group uses long-term investment returns in calculating the expected existing business contribution. The expected contribution in 2012 of £184 million after tax is £70 million lower than in 2011, primarily due to a decrease in the long-term risk-free rate and a lower opening MCEV for life business. The long-term risk-free rate is based on the opening position at 1 January.

Group MCEV
continued

New business value

New business profits generated from vesting annuities during 2012 were £20 million after tax (2011: £13 million).

The new business margin is 5% after tax (2011: 5%) and represents the ratio of the net of tax new business value to the amounts received as new single premiums.

Non-economic experience variances and assumption changes

Non-economic experience variances and assumption changes increased MCEV by £68 million after tax (2011: £142 million). The main driver of this increase is other operating variances of £92 million (2011: negative £21 million), reflecting the benefits of modelling improvements and policy harmonisations undertaken in the period.

Experience variances of £13 million (2011: £181 million) principally reflect better than expected longevity experience during the year. Experience variances in 2011 included the benefits of improved asset allocations (£96 million), data cleansing projects (£30 million) and the resolution of legacy tax issues (£20 million).

Partially offsetting the above is negative assumption changes of £37 million (2011: negative £18 million), primarily driven by a reduction in assumed surrender rates in funds with valuable policyholder guarantees.

Management services and Ignis Asset Management operating profit

Commentary on the management services companies and Ignis Asset Management operating profit is provided in the Group IFRS operating profit section.

Group costs

Group costs were £25 million before tax in the period (2011 restated: £54 million) reflecting lower costs relating to group functions of £29 million (2011: £39 million) driven by a focus on cost management, partly offset by miscellaneous income. The 2011 Group costs comparative also included a £14 million net interest cost on the Pearl Group Staff Pension Scheme. As this scheme was in a surplus position as at 1 January 2012, no interest cost has been recognised in operating earnings in the current period in respect of this scheme.

During 2012, the Group amended its MCEV accounting policy for recognising contributions to pension schemes in an IFRS surplus position. Prior to 2012, these contributions were recognised in Group costs. These contributions are now recognised in other comprehensive income along with actuarial gains and losses on schemes that are in an IFRS deficit, such that these non-operating items are treated consistently.

The 2011 comparatives have been restated in this regard, increasing 2011 Group MCEV operating earnings after tax by £23 million, and reducing other comprehensive income by the same amount. There is no net impact on the MCEV.

Reconciliation of Group MCEV operating earnings to Group MCEV earnings

Group MCEV operating earnings are reconciled to Group MCEV earnings, as follows:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 Restated £m
Group MCEV operating earnings after tax	**307**	417
Economic variances on life business	**24**	(426)
Economic variances on non-life business	**(6)**	38
Other non-operating variances on life business	**39**	(12)
Non-recurring items on non-life business	**(39)**	(9)
Finance costs attributable to owners	**(123)**	(123)
Tax on non-operating earnings	**–**	169
Group MCEV earnings after tax	**202**	54

Economic variances on life business

Positive economic variances on life business of £24 million (2011: negative £426 million) reflect the positive impacts of narrowing credit spreads on corporate bonds, falling yields and rising equity markets. This has been partly offset by negative property returns and the difference between actual short-term rates and the long-term investment return assumption on which operating earnings is based.

Economic variances on non-life business

Economic variances on non-life business are £6 million negative (2011: £38 million positive), reflecting the increased market value of the Tier 1 bonds which has decreased MCEV earnings by £28 million before tax (2011: increase of £48 million before tax). This has been partly offset by fair value gains on interest rate swaps and excess returns on financial assets held by the Holding Companies.

Other non-operating variances on life business

Other non-operating variances on life business of positive £39 million before tax primarily relate to the net benefit of the annuity transfer transaction of £38 million, together with benefits from the fund merger and restructuring activities undertaken in the period. This has been partly offset by regulatory change, systems transformation and restructuring costs incurred by the life companies.

Non-recurring items on non-life business

Non-recurring items on non-life business reduced embedded value by £39 million before tax (2011: £9 million reduction). Non-recurring items include restructuring costs of £16 million (2011: £51 million) and regulatory change and systems transformation costs of £13 million (2011: £12 million). The comparative period included a gain of £19 million arising from closing the Pearl Group Staff Pension Scheme to future accrual and a gain of £35 million following the recovery of historic costs under the management services agreements with the life division.

Finance costs attributable to owners

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Debt finance costs[1]	**97**	96
Tier 1 coupon	**26**	27
Finance costs attributable to owners	**123**	123

1 Finance costs in respect of the Impala and Pearl facility agreements (and associated swap interest) and the Royal London Payment in Kind ('PIK') notes and facility.

Group MCEV

The movement from opening to closing Group MCEV is shown below:

Movement in Group MCEV	**Year ended 31 December 2012 £m**	Year ended 31 December 2011 Restated £m
Group MCEV at 1 January	**2,118**	2,104
Group MCEV earnings after tax	**202**	54
Other comprehensive income:		
Actuarial (losses)/gains on defined benefit pension scheme (net of tax)	**(131)**	9
Capital and dividend flows	**(67)**	(49)
Group MCEV at 31 December	**2,122**	2,118

Actuarial losses after tax of £108 million were recognised in the year reflecting the movement of the Pearl Group Staff Pension Scheme to an IAS 19 deficit as at 31 December 2012. As detailed above, pension contributions on Group schemes in surplus are now recognised in other comprehensive income and accordingly an amount of £23 million has been recognised in 2012 in respect of the PGL scheme (2011: £23 million).

Capital and dividend flows in 2012 mainly comprise external dividend cash payments of £73 million (2011: £55 million).

Group IFRS operating profit

IFRS operating profit

£410m

Group IFRS operating profit

The Group has generated an IFRS operating profit of £410 million (2011: £387 million).

Group operating profit	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Phoenix Life	**399**	395
Ignis Asset Management	**43**	46
Group costs	**(32)**	(54)
Operating profit before tax[1]	**410**	387

1 Operating profit is presented before adjusting items.

Phoenix Life

Operating profit for Phoenix Life is based on expected investment returns on financial investments backing shareholder and policyholder funds over the reporting period, with consistent allowance for the corresponding expected movements in liabilities (being the release of prudential margins and the interest cost of unwinding the discount on the liabilities). The principal assumptions underlying the calculation of the longer-term investment return are set out in note 5 to the IFRS consolidated financial statements.

Operating profit includes the effect of variances in experience for non-economic items, such as mortality and expenses, and the effect of changes in non-economic assumptions. Changes due to economic items which give rise to variances between actual and expected investment returns, and the impact of changes in economic assumptions on liabilities, are accounted for outside of operating profit. Phoenix Life operating profit is net of policyholder finance charges and policyholder tax.

Phoenix Life operating profit	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
With-profit	**75**	69
With-profit where internal capital support provided	**(14)**	66
Non-profit and unit-linked	**288**	206
Longer-term return on owners' funds	**22**	37
Management services	**28**	17
Phoenix Life operating profit before tax	**399**	395

The owners' one-ninth share of the policyholder with-profit bonus of £75 million increased by £6 million on the 2011 result, primarily due to higher terminal bonuses following an increase in maturities, and improved bonus rates in certain funds.

The with-profit funds where internal capital support has been provided experienced an operating loss of £14 million (2011: £66 million operating profit).The main driver of the loss is the impact of a reduction in the assumed surrender rates in funds with valuable policyholder guarantees of £28 million adverse (2011: £5 million adverse). The 2011 comparative result benefitted from the positive impacts of one-off modelling improvements (£21 million) and data cleansing activities (£18 million) recognised in that period.

The operating profit on non-profit and unit-linked funds was £288 million (2011: £206 million. This includes margin emergence of £133 million (2011: £162 million), return on surplus assets of £1 million (2011: £10 million), new business from vesting annuities of £40 million (2011: £27 million) and positive longevity experience of £19 million. Modelling improvements and policy harmonisations have had a net positive impact of £117 million in 2012 (2011: £33m). The net impact of demographic assumption changes is broadly neutral for the period, whereas the 2011 result was impacted by negative assumption changes of £29 million.

The longer-term return on owners' funds of £22 million (2011: £37 million) reflects the asset mix of owners' funds: primarily cash based assets and fixed interest securities. The reduction compared to the prior year reflects the upstreaming of dividends in the period and lower expected investment return assumptions for 2012 for non-cash assets (calculated by reference to the market yields on risk-free fixed interest assets at the start of the year). The investment policy for managing these assets remains prudent.

The operating profit for the management services companies of £28 million (2011: £17 million) comprises income from the life companies in accordance with the respective management service agreements less fees payable in relation to the outsourcing of services and other operating costs. The increase compared to the prior year reflects reduced outsourcer costs and the positive impacts of cost reduction activities.

Ignis Asset Management

Ignis Asset Management operating profit	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Life fund revenue	**108**	114
Third party	**32**	29
Other income	**3**	3
Total revenues	**143**	146
Staff costs	**(64)**	(64)
Other operating expenses	**(36)**	(36)
Total expenses	**(100)**	(100)
Ignis Asset Management operating profit before tax	**43**	46

Revenue of £143 million was lower in the period (2011: £146 million) primarily due to lower performance fees generated by one of the joint ventures managing life company assets, the restructuring of the joint ventures and life company run-off, partly offset by growth in third party business. Expenses remain flat and the reduction in staff costs following the transfer of the back office functions to HSBC Bank plc was offset by investment in additional management capability to support growth in third party business.

Group costs

Group costs were £32 million in the period of which costs relating to Group functions amounted to £29 million before tax (2011: £39 million) reflecting an increased focus on cost management. The balance of the charge in both periods relates primarily to IAS 19 pension scheme costs (which have reduced compared to the prior year as a result of a lower net interest cost), partly offset by miscellaneous income.

Group IFRS operating profit
continued

IFRS result after tax

The IFRS operating result is reconciled to the IFRS result after tax, as follows:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Operating profit before adjusting items	**410**	387
Investment return variances and economic assumption changes on long-term business	**1**	(338)
Variance on owners' funds	**(13)**	9
Amortisation of acquired in-force business and other intangibles	**(127)**	(139)
Non-recurring items	**130**	14
Profit/(loss) before finance costs attributable to owners	**401**	(67)
Finance costs attributable to owners	**(111)**	(110)
Profit/(loss) before the tax attributable to owners	**290**	(177)
Tax credit attributable to owners	**119**	79
Profit/(loss) for the period attributable to owners	**409**	(98)

Investment return variances and economic assumption changes on long-term business

Overall, the Phoenix Life business had positive investment return variances and economic assumption changes of £1 million in 2012 (2011: £338 million negative). The positive impact of narrowing credit spreads in the period was largely offset by the impacts of falling yields on short asset positions against the IFRS basis liabilities, negative property returns and fair value losses on equity hedging positions held by certain life funds on an economic basis.

Variance on owners' funds

The negative variance on owners' funds of £13 million for 2012 is driven by fair value losses on credit default swaps held in the shareholder funds.

Amortisation of acquired in-force business and other intangibles

Acquired in-force business and other intangibles of £2.7 billion were recognised on the acquisition of the Pearl businesses.

The acquired in-force business is being amortised in line with the run-off of the acquired businesses. Amortisation of acquired in-force business during the period totalled £109 million (2011: £121 million). Amortisation of other intangible assets totalled £18 million in the period (2011: £18 million).

Non-recurring items

Non-recurring items include £177 million in respect of the gain recognised upon entering into the reinsurance agreement with Guardian to transfer approximately £5 billion of annuity liabilities. This gain which reflects the prudence in the IFRS liabilities has been partly offset by regulatory change and systems transformation costs of £28 million (2011: £21 million) and restructuring costs of £19 million (2011: £37 million). The 2011 result was also impacted by a gain of £37 million arising from closing the Group's pension schemes to future accrual and implementing a pension increase exchange programme, and a £35 million recovery of historic costs under the management services agreements with the life division.

Finance costs attributable to owners

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Debt finance costs[1]	**97**	96
Other finance costs	**14**	14
Finance costs attributable to owners	**111**	110

1 Finance costs in respect of the Impala and Pearl facility agreements (and associated swap interest) and the Royal London PIK notes and facility.

Tax credit attributable to owners

The Company is exempt from tax in the Cayman Islands on any profits, income, gains or appreciations for a period of 30 years from 11 May 2010 (the previous exemption was for 20 years from 15 January 2008).

With effect from the acquisition of the Pearl businesses in the third quarter of 2009, the Company has been managed and controlled from Jersey, where its permanent office premises are located. As a Jersey resident holding company the Company is subject to a zero percent tax rate on its income. Consequently, tax charged in these accounts primarily represents UK tax on profits earned in the UK, where the principal subsidiaries, excluding Opal Re, have their centre of operations.

The Group tax credit for the period attributable to owners is £119 million (2011: £79 million) based on a profit before tax attributable to owners of £290 million. The difference between the actual credit of £119 million and the expected charge (based on the UK corporation tax rate of 24.5%) of £71 million is primarily driven by the valuation of previously unrecognised tax losses of £85 million, a £36 million benefit as a result of the ongoing reductions in UK corporate tax rates, and £64 million due to certain profits being non-taxable or taxed at a rate of less than 24.5%.

The new rules for the taxation of insurance companies effective from 1 January 2013 under the UK Finance Act 2012, are expected to increase Group IFRS net assets by £12 million.

Group assets under management

Group assets under management represents all assets actively managed or administered by or on behalf of the Group including life companies' funds managed by third parties. It includes Holding Company cash and cash equivalents but excludes stock lending collateral.

Group assets under management	Life and Holding Companies £bn	Third party £bn	Total Group assets under management £bn	Stock lending collateral £bn	Total including stock lending collateral £bn
As at 1 January 2012	**63.5**	**8.6**	**72.1**	**10.8**	**82.9**
Inflows	–	2.8	2.8	–	2.8
Outflows	(4.7)	(1.2)	(5.9)	(1.5)	(7.4)
Guardian Assurance transaction	(5.1)	3.1	(2.0)	–	(2.0)
Market movements	3.0	(0.3)	2.7	–	2.7
Other[1]	–	(1.1)	(1.1)	–	(1.1)
As at 31 December 2012	**56.7**	**11.9**	**68.6**	**9.3**	**77.9**

1 Includes £0.7 billion of third party assets under management in respect of Argonaut Capital Partnership which transferred from Ignis' administration in the second half of 2012.

Life company assets of £5.1 billion were transferred to Guardian under the terms of the Group's annuity transfer transaction undertaken in the period. Guardian has selected Ignis Asset Management to manage £4.7 billion of these assets (£0.4 billion will be managed by Castle Hill Asset Management LLC), with the total amount to be arranged as a series of mandates to be individually agreed with Guardian. As at 31 December 2012, £3.1 billion of these assets have been recaptured. The remaining assets of £1.6 billion are temporarily with a third party manager and are expected to transfer to Ignis during 2013, with the timing dependent on finalising the investment strategies and external factors such as the liquidity of the underlying assets.

Net inflows from third parties, excluding Guardian, were £1.6 billion in the period (2011: £1.7 billion) with positive inflows across all sales channels. Net inflows in the comparative period included £0.4 billion from a new rates liability driven investment mandate from a Group pension scheme.

Of the assets in the table above, Ignis manages, provides oversight and advisory services on or administers the following:

Ignis assets under management	Life and Holding Companies £bn	Third party £bn	Total Ignis assets under management £bn	Stock lending collateral £bn	Total including stock lending collateral £bn
Direct asset management[1]	47.1	11.9	59.0	9.3	68.3
Oversight and advice	7.0	–	7.0	–	7.0
Administration	–	–	–	–	–
As at 31 December 2012	**54.1**	**11.9**	**66.0**	**9.3**	**75.3**

1 The agreement with Castle Hill Asset Management LLC was renegotiated in October 2012 following which £1.1 billion of life companies' assets are no longer managed by Ignis.

Ignis assets under management	Life and Holding Companies £bn	Third party £bn	Total Ignis assets under management £bn	Stock lending collateral £bn	Total including stock lending collateral £bn
Direct asset management	54.7	8.6	63.3	10.8	74.1
Oversight and advice	7.2	–	7.2	–	7.2
Administration	0.2	–	0.2	–	0.2
As at 31 December 2011	**62.1**	**8.6**	**70.7**	**10.8**	**81.5**

Capital management

IGD surplus (estimated)

£1.4bn

PLHL ICA surplus (estimated)

£1.0bn

Capital management framework

The Group's capital management framework is designed to achieve the following objectives:

- Provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary excess capital
- Ensure sufficient liquidity to meet obligations to policyholders and other creditors
- Optimise the overall gearing ratio to ensure an efficient capital base
- Meet the dividend expectations of shareholders as set by the Group's dividend policy, within the restrictions in the Group's two main credit agreements.

The framework comprises a suite of capital management policies that govern the allocation of capital throughout the Group to achieve these objectives under a range of stress conditions. The policy suite is defined with reference to policyholder security, creditor obligations, dividend policy and regulatory capital requirements.

The capital policy of the Holding Companies ensures sufficient liquidity to meet creditor obligations. This is monitored at both Executive Committee and Board level.

Targets are established in relation to regulatory capital requirements and debt ratios and are used in managing capital in accordance with the Group's risk appetite and the interests of its stakeholders.

The capital policy of each life company is set and monitored by each life company board. These policies ensure there is sufficient capital within each life company to meet regulatory capital requirements under a range of stress conditions. The capital policy of each life company varies according to the risk profile and financial strength of the company.

Regulatory capital requirements

IGD surplus (estimated)

Each UK life company must maintain sufficient capital at all times to meet the regulatory capital requirements mandated by the FSA[1]. These measures are aggregated under the European Union Insurance Groups' Directive ('IGD') as implemented by the FSA, to calculate regulatory capital adequacy at a Group level.

The Group's IGD assessment is made at the level of the ultimate insurance parent undertaking within the EEA, which is PLHL. The estimated IGD surplus at 31 December 2012 is £1.4 billion (2011: £1.3 billion). The components of the estimated IGD calculation are shown below:

	31 December 2012 £bn	31 December 2011 £bn
Group capital resources ('GCR')	**5.6**	5.6
Group capital resource requirement ('GCRR')	**(4.2)**	(4.3)
IGD surplus (estimated)	**1.4**	1.3

The key drivers of the change in solvency position in the year are:

- Capital generation items of £0.6 billion, which included the benefits of the transfer of the NPI Limited business into Phoenix Life Limited ('PLL') (effective from 1 January 2012) and the transfer of the London Life Limited business into Phoenix Life Assurance Limited ('PLAL') offset by
- The movement to an IAS 19 deficit on the Pearl Group Staff Pension Scheme of £0.2 billion from a surplus position in 2011 and
- Dividend payments, debt financing and repayments of £0.3 billion.

1 Further details on the regulatory capital requirements of the individual life companies are included within note 41 of the IFRS financial statements.

Capital management
continued

The Group's capital policy, which is agreed with the FSA, is to maintain GCR at the PLHL level of:

– 105% of the with-profit insurance component ('WPICC'), being an additional capital requirement of with-profit funds plus

– 145% of the GCRR less the WPICC.

The Group's headroom at 31 December 2012 was £0.6 billion (2011: £0.4 billion).

Had the capital raising and £450 million debt prepayment of the Impala facility (which occurred in February 2013) taken place on 31 December 2012, the Group's IGD surplus and headroom over Group capital policy would have reduced by £0.2 billion.

Phoenix Life Pillar 1 capital

The largest components of the GCR and GCRR of the Group's IGD position are the Pillar 1 capital resources[1] and the individual capital resource requirements of Phoenix Life respectively. Both are adjusted to take account of specific rules pertaining to the IGD calculation. For example, due to the Group's current structure certain of the Group's subsidiaries are only included in the IGD calculation at 75% of their regulatory value.

At 31 December 2012 the aggregate unadjusted Pillar 1 Phoenix Life capital resources are £6.5 billion (2011: £6.8 billion) and the aggregate unadjusted Pillar 1 Phoenix Life capital requirements are £5.1 billion (2011: £5.3 billion). Due to the closed fund nature of the Phoenix Life business and the Pillar 1 rules for with-profits funds, the surplus estate of the Phoenix Life with-profit funds is treated as a policyholder liability. This has the effect of increasing capital requirements. If the funds were open to new business, it is estimated that the Phoenix Life Pillar 1 capital requirement would reduce to £3.5 billion (2011: £3.7 billion) and the capital coverage for Phoenix Life would be 186% (2011: 184%).

PLHL ICA surplus (estimated)

In accordance with FSA requirements, the Group undertakes an Individual Capital Assessment ('ICA') at the level of the ultimate insurance parent undertaking within the EEA, which is PLHL. This involves an assessment, on an economic basis, of the capital resources[2] and requirements arising from the obligations and risks which exist outside the life companies.

As agreed with the FSA, the Group aims to ensure that PLHL maintains an ICA surplus of at least £150 million. PLHL's ICA position at 31 December 2012 is set out below:

	31 December 2012 £bn	30 June 2012 £bn
Capital resources[2]	**1.3**	0.8
Capital resource requirements[3]	**(0.3)**	(0.4)
PLHL ICA surplus (estimated)	**1.0**	0.4

2 Capital resources includes the surplus over capital policy in the life companies, a prudent assessment of the present value of future profits of Ignis Asset Management and the net assets of the Holding Companies less pension scheme obligations calculated on an economic basis.

3 Capital requirements relate to the risks arising outside of the life companies including those in relation to the Group's staff pension schemes, offset by Group diversification benefits.

The key drivers of the increase in the PLHL ICA surplus in the second half of the year include:

– The agreement reached with the Trustee of the Pearl Group Staff Pension Scheme with regard to a framework for contributions to the scheme and a revised investment strategy which resulted in a £0.3 billion increase in the ICA surplus

– Capital generation items and positive market movements of £0.4 billion, which includes the impact of the transfer of the London Life Limited business into PLAL partly offset by

– Dividend payments, debt financing and repayments of £0.1 billion.

1 Further details of the Pillar 1 capital resources of the individual life companies are included within note 41 of the IFRS financial statements.

Had the capital raising and £450 million debt prepayment of the Impala facility (which occurred in February 2013) taken place on 31 December 2012, the Group's ICA surplus would have reduced by £0.2 billion.

Sensitivity and scenario analysis

As part of the Group's internal risk management processes, the regulatory capital requirements are tested against a number of financial scenarios. The results of that stress testing are provided below:

	Estimated IGD surplus	Estimated PLHL ICA surplus
Base: 31 December 2012	**1.4**	**1.0**
Following a 20% fall in equity markets	**1.4**	**0.9**
Following a 15% fall in property values	**1.4**	**0.9**
Following a 75bps parallel increase in yields	**1.3**	**1.0**
Following a 75bps parallel decrease in yields[1]	**1.5**	**0.9**
Following credit spread widening[2]	**1.5**	**0.8**

1 Represents a real yield reduction of 25bps, given a 75bps parallel decrease in nominal yields.

2 10 year term: AAA – 46bps, AA – 77bps, A – 99bps, BBB – 140bps.

The relative insensitivity of the Group's IGD surplus reflects the nature of Pillar 1 rules for with-profit funds which stipulate that the surplus estate is treated as policyholder liabilities. The PLHL ICA surplus sensitivities reflect the impact of market movements not only on the Group's life companies but also on its staff pension schemes. The sensitivity of the Group's PLHL ICA surplus to external market stresses is reduced as a consequence of the new agreement reached with the with the Trustee of the Pearl Group Staff Pension Scheme. The life companies' surpluses are most sensitive to movements in equity markets, property values and credit spreads.

Solvency II

The Group's Solvency II programme continued to make substantial progress during the year in developing its readiness for the implementation of the Solvency II regime in general and, more specifically, preparations for obtaining FSA approval of its planned partial internal model. In October 2012, the FSA announced that the implementation date for Solvency II was likely to be deferred until at least 1 January 2016 – with the result that the Group has revised its project plans accordingly. It will maintain dialogue with the FSA going forward as to how and when the Group's Solvency II model might be used to meet existing ICA requirements and when it will re-enter the internal model approval process ('IMAP'). In the interim period, the Group will continue to progress delivery of a single actuarial modelling platform across the business in order to drive improvements to its processes for all financial reporting bases.

Capital resources

The primary sources of capital used by the Group comprise equity shareholder funds as measured on an MCEV basis, the Tier 1 Notes and shareholder borrowings.

Leverage

In managing capital the Group seeks to optimise the level of debt on its balance sheet. The Group's closed book business model allows it to operate with higher leverage than life companies that are still writing new business, as it does not need to fund upfront capital requirements and new business acquisition expenses.

The Group has gross shareholder debt of £2,741 million (2011: £2,898 million). The gearing ratio[4] under the Group's revised methodology is 55% (2011: 57%).

4 Gross shareholder debt as a percentage of the sum of the Group MCEV and the value of the shareholder and hybrid debt as included in the MCEV.

Capital management
continued

Shareholder debt (including hybrid debt) at 31 December 2012:

	31 December 2012 £m	31 December 2011 £m
Bank debt		
– Pearl facility	**351**	375
– Pearl loan notes	**75**	73
– Impala facility	**1,852**	1,993
Royal London PIK notes and facility	**116**	111
Unsecured loan notes	**–**	7
PLL subordinated debt	**143**	135
Tier 1 Notes at 50% of IFRS carrying value (see note 18 to the IFRS financial statements)	**204**	204
Shareholder debt (including hybrid debt)	**2,741**	2,898

Further detail on shareholder debt is included in note 21 to the IFRS financial statements.

The Group has two main credit agreements (the Pearl and Impala facilities), which have separate security arrangements

In February 2013, following a successful equity raising of £250 million, the Group made a £450 million prepayment against the Impala facility and entered into an agreement with the Impala lenders to extend the repayment terms to 2019 (the facility was previously scheduled to mature in the period from 2014 to 2016).

Had this transaction occurred on 31 December 2012, the Group's gearing calculated in accordance with the new definition would have reduced from 55% to 48%. Further details on the re-terming transaction can be found in note 48 to the IFRS financial statements.

The Pearl facility remains unchanged and will mature in 2016.

The Group's target is to reduce the gearing ratio in accordance with the new methodology to 40% by the end of 2016.

Liquidity management

Details of the Group's objectives and policies for the management of liquidity risk are included within the Risk management section and note 42 of the IFRS financial statements.

"Risk management lies at the heart of what we do and is a source of value creation, making it a key component of the Group's strategic agenda."

Clive Bannister,
Group Chief Executive Officer

Risk management

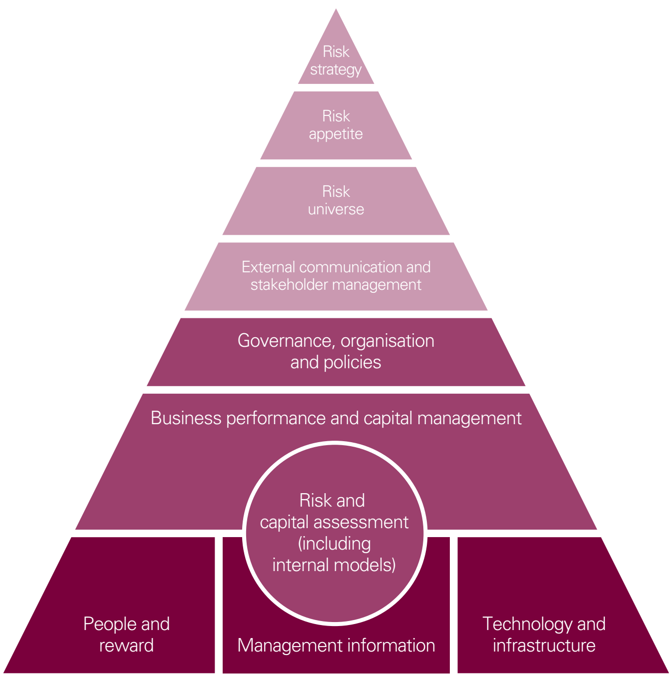
In this section

Risk management

The Board seeks to ensure that the Group identifies and manages all risks either to create additional value for its stakeholders or to mitigate any potentially adverse effects. A summary of the principal risks and uncertainties facing the Group is provided on page 46.

The Group's Risk Management Framework

The Group operates a Risk Management Framework ('RMF') which seeks to establish a coherent and interactive set of arrangements and processes to support the effective management of risk throughout the Group. The components of the framework are shown below.
The outputs of the RMF provide assurance that risks are being appropriately identified and managed and that an independent assessment of management's approach to risk management is being performed.



During the year, the Group has continued to strengthen and embed the components of the RMF to ensure that they are aligned with the evolving regulatory requirements and external best practice. This has included, for example, independent reviews by the Group Risk function of specific risk types and individual components of the overall RMF.

Risk strategy

The Group's risk strategy provides an overarching view of how risk management is incorporated consistently across all levels of the business, from decision-making to strategy implementation. It also sets out how overall risk management within the Group is proportionate to the nature, scale and complexity of the risks faced by the business.

Risk appetite

The Group's risk appetite framework consists of a set of statements and targets that articulate the level of risk the Group is willing to accept in pursuit of shareholder value and achievement of the Group's strategic objectives.
The statements encapsulate policyholder security, earnings volatility, liquidity, and the internal control environment as follows:

- **Capital –** The Group and each life company will hold sufficient capital to meet regulatory requirements in a number of asset and liability stress scenarios
- **Cash flow –** The Group will seek to ensure that it has sufficient cash flow to meet its financial obligations and will continue to do this in a volatile business environment
- **Embedded value –** The Group will take action to protect embedded value
- **Regulation –** The Group, and each life company, will, at all times, operate a strong control environment to ensure compliance with all internal policies and applicable laws and regulations, in a commercially effective manner.

The risk appetite framework supports the Group in operating within the boundaries of these statements by seeking to limit the volatility of key parameters, defined with respect to the above statements, under a range of adverse scenarios agreed with the Board. Risk appetite limits are chosen which specify the maximum acceptable likelihood for breaching the agreed limits and assessment against the appetite targets is undertaken through scenario testing. Breaches of appetite are corrected through management actions where appropriate.

Risk universe

A key element of effective risk management is to ensure that the business has a complete and robust understanding of the risks it faces. Within the Group, these are set out, categorised and defined in the risk universe.

These risks are monitored and reported across the organisation to ensure that they are adequately managed.

External communication and stakeholder management

The Group has a number of internal and external stakeholders, each of whom has an active interest in the Group's performance, including how it is managing its risks. Significant effort is made to ensure that our stakeholders have appropriate, timely and accurate information to support them in forming views of the Group.

Governance, organisation and policies

Overall responsibility for approving, establishing and maintaining the RMF rests with the Board. The Board recognises the critical importance of having an efficient and effective RMF and appropriate oversight of its operation. There is a clear organisational structure in place with documented, delegated authorities and responsibilities from the Group Board to the Board of Phoenix Life Holdings Limited ('PLHL'), the Boards of Phoenix Life, Ignis Asset Management and the Executive Committee.

The RMF is underpinned by the operation of a three lines of defence model with clearly defined roles and responsibilities for statutory boards and their committees, management oversight committees, Group Risk and Group Internal Audit.

First line: management of risk is delegated from the Board to the Group Chief Executive Officer, Executive Committee members and through to business managers. A series of business unit management oversight committees operate within the Group. They are responsible for ensuring the risks associated with the business's activities are identified, assessed, controlled, monitored and reported.

Second line: risk oversight is provided by the Group Risk function and business unit risk and compliance functions and the Board Risk Committee, which is responsible for the oversight of risk across the Group. The Board Risk Committee comprises five Non-Executive Directors, three of whom are independent. It is supported by the Chief Risk Officer and met seven times during the year.

Third line: independent verification of the adequacy and effectiveness of the internal controls and risk management is provided by the Board Audit Committee, which is supported by the Group Internal Audit function.

Risk organisation

The Chief Risk Officer manages the Group Risk function and has responsibility for the implementation and oversight of the Group's RMF. The Group Risk function has responsibility for oversight of financial and operational risk, risk governance, FSA relationship management and regulatory risk. Risk review functions across the Group manage the RMF in line with the Group's established standards. The risk functions ensure that business unit risk committees are provided with meaningful risk reports and that there is appropriate information to assess and aggregate risks.

Risk management
continued

Risk policies

The Group policy framework comprises a set of policies that support the delivery of the Group's strategy by establishing operating principles and expectations for managing the key risks to our business. The policy set contains the minimum control standards that each business unit must adhere to and report compliance against through the operation of local processes/procedures. The policies define:

– The individual risks the policy is intended to manage

– The degree of risk the Group is willing to accept (which is set out in the policy risk appetite statements)

– The minimum controls required in order to manage the risk to an acceptable level

– The frequency of the control's operation.

Each policy is the responsibility of a member of the Executive Committee who is charged with overseeing compliance with the policy throughout the Group.

Business performance and capital management

Business unit plans are assessed to ensure that they do not breach any of the Board's risk appetite statements over the planning horizon. Business performance is routinely monitored at a business unit executive level with consolidated reporting against the annual operating plan approved by the Board and reviewed by the Executive Committee.

The impact of any proposed changes to the Group's operating plan and ongoing compliance with the Group's risk appetite statements are reviewed on a quarterly basis by the Board Risk Committee.

The Group's business units operate capital management processes that meet the Group's Capital Management Policy. Under these processes, capital is allocated across risks where capital is held as a mitigant and, in turn, to individual risk owners who hold risk capital budgets. The amount of risk capital required is reviewed regularly to ensure the risk remains within budget. Any increases in capital allocation required by a risk owner are referred to the relevant business unit board for approval to assess whether the increased capital allocation requested is within appetite for that particular risk type or whether further risk mitigation is required.

Risk and capital assessment

The Group operates a standardised assessment framework for the identification and assessment of the different types of risk to which it may be exposed to and how much capital should be held in relation to those exposures. This framework is applicable across the Group and establishes a basis, not only for the approach to risk assessment, management and reporting but also for determining and embedding capital management at all levels of the Group.

Risk assessment activity is a continuous process and is performed on the basis of identifying and managing the significant risks to the achievement of the Group's objectives. Stress and scenario tests are used to support the assessment of risk and analysis of their financial impact.

A Group level risk assessment process determines the most significant risks to the Group and the options available for their management.

Management information

Overall monitoring and reporting against the risk universe is undertaken through business unit management committees through to the relevant business unit executive committee and reported to the Executive Committee, PLHL Board, the Board Risk Committee and the Board via regular risk reporting.

The Board Risk Committee receives a consolidated risk report on a quarterly basis, detailing the risks facing the Group and the overall position against risk appetite limits. The Board Risk Committee is also provided with regular reports on the activities of the Group Risk function.

People and reward

Effective risk management is central to the Group's culture and its values. Processes are operated that seek to measure both individual and collective performance and discourage incentive mechanisms which could lead to undue risk taking. Training and development programmes are in place to support employees in their understanding of the operation of the RMF and during 2012, Group Risk delivered training and awareness sessions across the Group.

Technology and infrastructure

The Group employs systems to support the assessment and reporting of the risks it faces as a business and to enable management to document its key risks and controls and evidence the assessment of them at a frequency appropriate to the operation of the control. The Group is continuing to assess the need for additional systems to further support the embedding of the RMF.

Principal risks and uncertainties facing the Group

Risk	Impact	Mitigation
In times of extreme market turbulence, the Group may not have sufficient liquid assets to meet its payment obligations or may suffer a loss in value.	The Group has ongoing obligations to meet payments to creditors which are funded by the release of capital and profits from its business units. The emerging cash flows of the Group may be impacted during periods of extreme market turbulence by the need to maintain appropriate levels of regulatory capital. The impact of market turbulence may also result in a material adverse impact on the Group's embedded value, financial condition and prospects.	The Group undertakes regular monitoring activities in relation to market risk exposure, including the monitoring of asset mixes, cash flow forecasting and stress and scenario testing. In response to this, the Group may implement de-risking strategies to mitigate against unwanted outcomes. The Group also maintains cash buffers in its Holding Companies to reduce reliance on emerging cash flows.
The potential limitation on distributions from the Group's FSA regulated companies may impair the ability of the Group to service its existing debt commitments.	The Group has ongoing principal repayment and interest obligations to its lending syndicates. In the event that transfers from the Group's insurance and investment management subsidiaries are limited by any law, regulatory action or change in established approach, this may impair the Group's ability to service these obligations. The implementation of directives and other legislative changes such as the ICA+ regime and eventually Solvency II could have this effect and may therefore have a material adverse effect on the Group's results, financial condition and cash flows.	The Group puts considerable effort into managing relationships with its regulators so that it is able to maintain a forward view regarding potential changes in the regulatory landscape. The Group assesses the risks of regulatory change and their impact on its operations and lobbies where appropriate.
Significant counterparty failure.	Assets held to meet obligations to policyholders include debt securities. Phoenix Life is exposed to deterioration in the actual or perceived creditworthiness or default of issuers of relevant debt securities or its trading counterparties failing to meet all or part of their obligations, such as reinsurers failing to meet obligations assumed under reinsurance arrangements or derivative counterparties or stock borrowers failing to pay as required. An increase in credit spreads on such securities, particularly if it is accompanied by a higher level of actual or expected issuer defaults, could have a material adverse impact on the Group's financial condition.	The Group regularly monitors its counterparty exposure and has specific limits relating to counterparty credit rating. Where possible, exposures are diversified through the use of a range of counterparty providers. All reinsurance and derivative positions are appropriately collateralised and guaranteed.
Adverse changes in experience versus actuarial assumptions.	The Group has liabilities under annuities and other policies that are sensitive to future longevity and mortality rates. Changes in assumptions may lead to changes in the assessed level of liabilities to policyholders. The amount of additional capital required to meet those liabilities could have a material adverse impact on the Group's embedded value, results, financial condition and prospects.	The Group undertakes regular reviews of experience and annuitant survival checks to identify any variances in assumptions.
The Group could be adversely affected if it is unable to repay or refinance its debt when it falls due.	The Group may not be able to refinance the outstanding amount on its debt facilities as they mature on terms which are as favourable as the existing terms or it may be unable to refinance those obligations at all.	The equity raising and debt re-terming announced in January 2013 removed the re-financing risk associated with the Impala facility bullet repayments that were previously due in 2014, 2015 and 2016. The Group has announced a gearing target of 40% by the end of 2016. At this lower level of gearing, a wider range of funding opportunities such as the debt capital markets will become available to the Group.

"Strong and effective governance is crucial to the Group's aim of delivering value to shareholders and policyholders. The Group's Board is committed to high standards of corporate governance."

Gerald Watson,
Group Company Secretary

Governance

In this section

Board of Directors

Howard Davies Chairman

Howard Davies was appointed Chairman of the Board of Directors of the Company on 1 October 2012. Howard is the Chair of the British Government's Airport Policy Review. He also is a Professor of Practice at the French School of Political Science in Paris (Sciences Po). He was previously a Director of the London School of Economics and Political Science from 2003 until May 2011. Prior to this appointment he was Chairman of the UK Financial Services Authority from 1997 to 2003. From 1995 to 1997 he was Deputy Governor of the Bank of England, after three years as the Director General of the Confederation of British Industry. Earlier in his career he worked in the Foreign and Commonwealth Office, the Treasury, McKinsey and Co. and as Controller of the Audit Commission. He has been an independent Director of Morgan Stanley Inc. since 2004, and chairs the Risk Committee. He also chairs the Risk Committee at Prudential plc, whose board he joined in 2010. He is a member of the Regulatory and Compliance Advisory Board of Millennium Management LLC, a New York-based hedge fund. He has also been a member of the International Advisory Council of the China Banking Regulatory Commission since 2003 and, from 2012, is Chairman of the International Advisory Council of the China Securities Regulatory Commission. He is Chairman of the Board Nomination Committee.

Clive Bannister Group Chief Executive Officer

Clive Bannister joined the Group in February 2011 as Group Chief Executive Officer. Prior to this, he was Group Managing Director of Insurance and Asset Management at HSBC. He joined HSBC in 1994 and held various leadership roles in Planning and Strategy in the Investment Bank (USA) and was Group General Manager and CEO of HSBC Group Private Banking. He started his career at First National Bank of Boston and prior to working at HSBC was a partner in Booz Allen Hamilton in the Financial Services Practice providing strategic support to financial institutions including leading insurance companies, banks and investment banks. Mr Bannister was appointed to the Board of Directors of the Company on 28 March 2011.

Jim McConville Group Finance Director

Jim McConville was appointed to the Board of Directors of the Company as Group Finance Director on 28 June 2012. Between April 2010 and December 2011, he was Chief Financial Officer of Northern Rock plc. Prior to that, between 1988 and 2010, he worked for Lloyds Banking Group plc (formerly Lloyds TSB Group plc) in a number of senior finance and strategy related roles latterly as Finance Director of Scottish Widows Group plc and Director of Finance for the Insurance and Investments Division. Mr McConville qualified as a Chartered Accountant whilst at Coopers and Lybrand.

Alastair Lyons Senior Independent Director

Alastair Lyons CBE was appointed to the Board of Directors of the Company as Senior Independent Director on 29 March 2010. He is also Chairman of Admiral Group plc, the FTSE 100 direct motor insurer, Chairman of Serco Group plc, the FTSE 100 international services company, Deputy Chairman of Bovis Homes Group plc and Chairman of the Towergate Insurance Group. In his executive career he was Chief Executive Officer of the National Provident Institution, Executive Director of Abbey National responsible for the insurance division and Chief Executive Officer of the National & Provincial Building Society. He is a Fellow of the Institute of Chartered Accountants and has been a Non-Executive Director of both the Department for Work and Pensions and the Department for Transport. He was awarded the CBE in the 2001 Birthday Honours for services to social security. Mr Lyons is Chairman of the Board Audit Committee.

Ian Ashken Non-Executive Director

Ian Ashken is Vice Chairman and Chief Financial Officer of Jarden Corporation, a NYSE listed Fortune 500 US diversified consumer products company. Mr Ashken has had extensive public company experience over the last 20 years, including as Chief Financial Officer of Benson Eyecare Corporation, Lumen Technologies and Bollé Inc. Mr Ashken is a Principal and Executive Officer of a number of private investment entities. He was appointed to the Board of Directors of the Company on 2 September 2009.

René-Pierre Azria Non-Executive Director

René-Pierre Azria is Chief Executive Officer of Tegris Advisors LLC, a US private advisory firm specialising in strategic financial analysis and mergers and acquisitions. Prior to founding Tegris, Mr Azria was a worldwide partner with Rothschild & Co. Before joining Rothschild in 1996, Mr Azria served as Managing Director of Blackstone Indosuez and President of Financiére Indosuez Inc. in New York. Mr Azria serves as a Director of two privately-held book publishers in France and the US. Mr Azria was appointed to the Board of Directors of the Company on 2 September 2009. He is a member of the Board Investment and Board Risk Committees.

David Barnes Non-Executive Director

David Barnes joined the RBS Group (then Williams & Glyn's Bank) in 1973 and remained there in various roles until his early retirement in February 2009. His roles included Relationship Banker in the then newly established Corporate Division, Managing Director of the Financial Institutions Relationship Management team and member and subsequently Chairman of RBS's Credit Committee. From 2005 he was responsible for all lending to financial institutions and for capital management for RBS's Financial Institutions Group. Mr Barnes was appointed to the Board of Directors of the Company on 2 September 2009. He is a member of the Board Audit and Board Remuneration Committees.

Charles Clarke Non-Executive Director

Charles Clarke is a Jersey-resident Chartered Accountant who spent some 30 years with KPMG. Having qualified in London, he was a financial sector audit partner/principal in London, Kuala Lumpur and Jersey. He was also senior partner of the KPMG Channel Island firm for seven years and, during his final year, Chairman of the grouping of KPMG member firms in offshore jurisdictions. Since retiring from KPMG at the end of 2005, he has acted as an independent Non-Executive Director ('NED') and established an offshore governance consultancy and NED recruitment service. His current NED appointments include SG Hambros Bank and Aberdeen Asian Income Fund Limited. Mr Clarke was appointed to the Board of Directors of the Company on 18 February 2010. He is a member of the Board Audit and Board Investment Committees.

Board of Directors
continued

Ian Cormack Non-Executive Director

Ian Cormack is Non-Executive Chairman of Maven Income & Growth VCT 4 plc and is a Non-Executive Director of Bloomsbury Publishing plc, Aspen Insurance Holdings, Arria NLG Limited and Xchanging plc. Mr Cormack was Chief Executive Officer of AIG, Inc. in Europe from 2000 to 2002 and was Chairman of Citibank International plc and co-head of the Global Financial Institutions Client Group at Citigroup. Mr Cormack served on the Board of Directors of the former Pearl Group Limited from May 2005 to September 2009. He was appointed to the Board of Directors of the Company on 2 September 2009. Mr Cormack is Chairman of the Board Remuneration Committee and a member of the Board Nomination Committee.

Tom Cross Brown Non-Executive Director

Tom Cross Brown was Global Chief Executive of ABN AMRO Asset Management (which managed some €160 billion of assets, with offices in 30 countries around the world) from 2000 to 2003, as well as Chairman of ABN AMRO Asset Management in the UK from 1997 to 2003. Prior to this, he spent 21 years with Lazard Brothers in London, latterly as Chief Executive Officer of Lazard Brothers Asset Management. Mr Cross Brown is Non-Executive Chairman of Just Retirement (Holdings) Limited and is a Non-Executive Director of Artemis Alpha Trust plc, as well as of other private companies and charities. Mr Cross Brown served on the Board of Directors of the former Pearl Group Limited from May 2005 until September 2009. He was appointed to the Board of Directors of the Company on 24 September 2009. He is Chairman of the Board Investment Committee and a member of the Board Nomination and Board Risk Committees.

Manjit Dale Non-Executive Director

Manjit Dale is a founding partner of TDR Capital, a private equity firm established in 2002. TDR Capital manages over €2.6 billion of assets on behalf of a variety of institutional pension funds, university endowments and wealthy private individuals. Mr Dale has over 20 years' experience in private equity, finance and consulting gained with Deutsche Bank, Bankers Trust, 3i plc, NM Rothschild and Andersen Consulting. Mr Dale graduated from Cambridge University with an Honours Degree in Economics. He served on the Board of Directors of the former Pearl Group Limited from December 2004 to September 2009. He has also served on the Boards of Pizza Express and Center Parcs and currently serves on the Board of Algeco Scotsman and Stonegate Pub Company. He was appointed to the Board of Directors of the Company on 2 September 2009 and is a member of the Board Investment Committee.

Isabel Hudson Non-Executive Director

Isabel Hudson is a former Executive Director of Prudential Assurance Company Limited. She was also Chief Financial Officer at Eureko BV. Ms Hudson is Non-Executive Chair of the National House Building Council and a Non-Executive Director of QBE Insurance, MGM Advantage and The Pensions Regulator. Ms Hudson is an ambassador to Scope, a UK charity, and has 31 years' experience in the insurance industry in the UK and mainland Europe. She was appointed to the Board of Directors of the Company on 18 February 2010. She is a member of the Board Risk and Board Remuneration Committees.

Hugh Osmond Non-Executive Director

Hugh Osmond founded Punch Group and served as its Executive Chairman between 1997 and 2001, during which time he built Punch Group into one of the UK's largest pub companies. He previously co-led the acquisition and market listing of Pizza Express in 1993 and helped build it into the UK's largest sit-down restaurant chain. He has also been a major investor in, and director of, many public and private companies across a wide variety of industries. He is a director and a shareholder of Sun Capital Partners Limited, formed in 2001, that specialises in identifying and advising on investment opportunities. Mr Osmond served on the Board of Directors of the former Pearl Group Limited from December 2004 until September 2009. He was appointed to the Board of Directors of the Company on 2 September 2009 and is a member of the Board Investment and Board Risk Committees.

David Woods Non-Executive Director

David Woods is a Fellow of the Institute of Actuaries and a Non-Executive Director of Standard Life UK Smaller Companies Trust plc, Murray Income Trust plc, Barbon Insurance Group Ltd and The Moller Centre for Continuing Education. He is also Chairman of the pension fund trustee companies responsible for the governance of all the UK pension schemes in the Steria Group and is a Trustee of the Santander (UK) Pension Fund. He was appointed to the Board of Directors of the Company on 18 February 2010 and is Chairman of the Board Risk Committee.

Our executive management team

Executive management of the Group is led by the Group Chief Executive Officer, Clive Bannister, who is supported by the Executive Committee ('ExCo'). ExCo oversees matters relating to the implementation of the Group's strategy.

Clive Bannister
Group Chief Executive Officer

- Leads the development of the Group's strategy for agreement by the Board
- Leads and directs the Group's businesses in delivery of the Group strategy and business plan
- Safeguards returns for policyholders and grows shareholder value
- Embeds a risk-conscious Group culture which recognises policyholder obligations in terms of service and security
- Manages the Group's key external stakeholders.

Jim McConville
Group Finance Director

- Develops and delivers the Group's financial business plan in line with strategy
- Ensures that the Group's finances and capital are managed and controlled
- Ensures the Group has effective processes in place to ensure all reporting obligations are met
- Supports the Group Chief Executive Officer in managing the Group's external stakeholders
- Maximises shareholder value through clear, rigorous assessment of business opportunities.

Mike Merrick
Chief Executive Officer, Phoenix Life

- Leads development and delivery of the Phoenix Life business strategy, including the continued integration of life businesses
- Ensures optimisation of outcomes for customers in terms of both value and security
- Ensures Phoenix Life deploys capital efficiently and effectively, with due regard to regulatory requirements and the risk universe and strategy.

Chris Samuel
Chief Executive Officer, Ignis Asset Management

- Leads development of Ignis' business strategy and plans
- Delivers, over the longer term, Ignis' vision of becoming a leading asset management business committed to performance excellence and innovation
- Ensures Ignis achieves its key goals of meeting or exceeding investment performance expectations, providing clients with creative solutions to changing product needs and maintaining a well controlled and efficient operating platform
- Ensures Ignis' chosen foundations of innovative people, a partnership culture, suitable processes and technology and stability are in place to support these plans.

Fiona Clutterbuck
Head of Strategy, Corporate Development and Communications

- Supports the Group Chief Executive Officer in the formulation of the strategy and the business planning for the Group
- Leads implementation of the Group's strategy as regards any potential acquisitions or disposals
- Leads external Group communications in liaison with the Group Finance Director and Head of Investor Relations.

Alan Jones
Group Human Resources Director

- Delivers high quality human resources ('HR') services to the Group
- Leads the implementation of the Group's employee strategy in order to recruit, retain, motivate and develop high quality employees
- Provides guidance and support on all HR matters to the Group Chief Executive Officer, ExCo and Group Board.

Jane MacLeod
General Counsel

- Leads provision of legal advice to the Group Board, other Group Company Boards, ExCo and senior management
- Oversees and co-ordinates adherence to appropriate corporate governance procedures across the Group
- Oversees the operation of the legal risk framework within the Group including compliance by Group companies and staff with relevant legal obligations.

Jean Park
Chief Risk Officer

- Leads the Group's risk management function, embracing changes in best practice and regulation
- Oversees and manages the Group's relationship with the FSA
- Supports the Board Risk Committee in the oversight of the Group's risk framework, in line with risk strategy and appetite.

Corporate governance report

Introduction

The Company is a member of the FTSE 250 Index, having achieved a Premium Listing on the London Stock Exchange in July 2010. The Board is committed to high standards of corporate governance and supports the UK Corporate Governance Code ('the Code') which sets standards of good practice for UK listed companies. The Code has applied to the Company from 1 January 2011 and the Company has implemented those new aspects of the Code which were not included in its predecessor, the Combined Code on Corporate Governance. In particular, in relation to the more notable new provisions of the Code, all Directors of the Company are subject to annual re-election by shareholders and evaluation of the Board will be externally facilitated at least every three years.

It is the Board's view that the Company has been fully compliant during 2012 with the provisions set down in the Code.

This report sets out details of how the Company has applied the principles and complied with the provisions of the Code during the period from 1 January 2012 to 31 December 2012.

The following table shows the trajectory of corporate governance steps taken by the Board since the London Premium Listing in 2010.

2010	2011	2012
Combined Code compliant in all but two matters	UK Corporate Governance Code compliant in all but one matter	UK Corporate Governance Code compliant in all matters
Held the Company's first Annual General Meeting ('AGM') at which all 22 resolutions were passed by a majority of at least 87% of votes cast	Undertook a successful AGM at which all 24 resolutions were passed by a majority of at least 96% of votes cast	Undertook a successful AGM at which all 21 resolutions were passed by a majority of at least 97% of votes cast
Established a Combined Code compliant Board consisting of at least 50% independent Non-Executive Directors	Adopted annual re-election of all Directors in accordance with the UK Corporate Governance Code	Appointment of Howard Davies as new Chairman
Established Audit, Nomination, Remuneration and Risk Committees, all consisting of Non-Executive Directors and in compliance with Combined Code requirements	Established an Investment Committee in response to the Board evaluation undertaken at the end of 2010	
Undertook the Board's first evaluation of the Board, Board Committees and individual Directors	Undertook an externally-facilitated Board, Board Committee and individual Director evaluation	Undertook an internally-facilitated Board, Board Committee and individual Director evaluation led by the new Chairman
	Enhanced the Board education programme in response to the Board evaluation undertaken at the end of 2010, in particular to include site visits to operational business units and presentations from management in those units	Enhanced and updated the Board induction programme for 2012 appointments
	Published a Chairman's statement on 'Women on Boards' in accordance with the Lord Davies Review	Attained over one-third female membership of the Group's Executive Committee

Corporate governance report
continued

The Board

The Board comprises the Non-Executive Chairman, the Group Chief Executive Officer, the Group Finance Director and eleven other Non-Executive Directors, seven of whom are independent. Biographical details of all Directors are provided on pages 48 to 51. The Board considers that the following Directors are independent as they do not have any interest or business and other relationship which could, or could be perceived to, interfere materially with their ability to act in the best interests of the Company: David Barnes, Charles Clarke, Ian Cormack, Tom Cross Brown, Isabel Hudson, Alastair Lyons and David Woods. The Board has considered the criteria proposed by the Code in assessing the independence of the Directors.

The remuneration of the Directors is shown in the Remuneration report on pages 62 to 78. The terms and conditions of appointment of Non-Executive Directors are on the Group's website. In accordance with the provisions of the Company's Articles of Association and the Code, all Directors (other than Ian Ashken and Charles Clarke who are standing down from the Board, as indicated in the Chairman's statement) will submit themselves for election or re-election at the Company's AGM on 2 May 2013.

All the Directors of the Company are FSA Approved Persons in respect of the Company's FSA regulated subsidiaries.

The Board is responsible to the shareholders for the overall governance and performance of the Group. Overall, the Board's role is to provide entrepreneurial leadership within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board has a schedule of matters reserved for its consideration and approval supported by a set of operating principles. These matters include:

– Group strategy and business plans

– Major acquisitions, investments and capital expenditure

– Financial reporting and controls

– Dividend policy

– Capital structure

– The constitution of Board Committees

– Appointments to the Board and Board Committees

– Senior executive appointments

– Key Group policies.

The schedule of matters reserved for the Board is available from the Group Company Secretary. Matters which are not reserved for the Board and also its Committees under their terms of reference (which are available on the Group website), or for shareholders in general meetings, are delegated to the executive management under a schedule of delegated authorities approved by the Board.

The head office of the Company is in Jersey and, as such, the Board and its Committees hold their meetings in Jersey.

The Chairman, Group Chief Executive Officer and Senior Independent Director

Howard Davies succeeded Ron Sandler as Chairman of the Board of Directors of the Company with effect from 1 October 2012. There is a division of responsibility, approved by the Board, between the Chairman, who is responsible for the leadership and effective operation of the Board and the Group Chief Executive Officer, Clive Bannister, who is responsible to the Board for the overall management and operation of the Group. The Chairman's other significant commitments are set out in his biographical details on page 48.

The Senior Independent Director, appointed by the Board, is Alastair Lyons. His role is to be available to shareholders whose concerns are not resolved through the normal channels or when such channels are inappropriate. He is also responsible for leading the annual appraisal of the Chairman's performance by the Non-Executive Directors and for leading the process for appointment of a new Chairman, as he did in 2012 for the appointment of Howard Davies.

Board effectiveness

In accordance with the Code, an evaluation of the performance of the Board and that of its Committees and individual Directors was undertaken in the latter part of 2012. The process involved completion by Directors of a questionnaire covering various aspects of Board and Director effectiveness followed by individual meetings between the Chairman and each Director, concluding in a Board report which was discussed by the Board in November 2012. The process and report focused on key aspects raised in the 2011 externally facilitated report and any other factors raised by Directors before or during the process. The following areas were covered:

- Board structure and composition
- Board dynamics and relationship
- Board performance
- Board processes
- Board Committees
- Individual Director performance which will be used in revising the training programme for Directors
- Director induction and training
- Company strategy and performance.

An action list, with senior executive accountability, has been established to address the recommendations from the evaluation.

The output from the Board and individual Director reviews informed the review of the Board composition and structure undertaken by the Board Nomination Committee in January 2013, leading to the Board's recommendations to shareholders regarding re-election of directors at the 2013 AGM.

All Directors receive a tailored induction on joining the Board in accordance with a process approved by the Board. To ensure that the Directors maintain up-to-date skills and knowledge of the Company, all Directors receive regular presentations on different aspects of the Company's business and on financial, legal and regulatory issues.

Corporate governance report
continued

Operation of the Board

The terms of appointment for the Directors state that they are expected to attend in person regular (at least six per year) and emergency Board meetings of the Company and to devote appropriate preparation time ahead of each meeting. The Board met eight times during 2012 and is scheduled to meet seven times in 2013 including a two-day strategy-setting meeting. Additional meetings will be held as required and the Non–Executive Directors will hold meetings with the Chairman, without the Executive Directors being present, as they did on several occasions in 2012.

Attendance by each of the Directors at Board meetings and at Committee meetings for Committees of which they were a member during 2012 was:

	Board meetings		Audit Committee		Nomination Committee		Remuneration Committee		Risk Committee		Investment Committee	
	Maximum	Actual	Maximum	Actual	Maximum	Actual	Maximum	Actual	Maximum	Actual	Maximum	Actual
Chairman												
Howard Davies[1]	3	3	–	–	–	–	–	–	–	–	–	–
Ron Sandler[2]	5	4	–	–	3	3	–	–	–	–	–	–
Executive Directors												
Clive Bannister	8	7	–	–	–	–	–	–	–	–	–	–
Jim McConville[3]	5	5	–	–	–	–	–	–	–	–	–	–
Non-Executive Directors												
Alastair Lyons	8	6	6	6	1	1	–	–	–	–	–	–
Ian Ashken	8	7	–	–	–	–	–	–	–	–	–	–
René-Pierre Azria	8	7	–	–	–	–	–	–	7	7	5	5
David Barnes	8	5	6	5	–	–	7	6	–	–	–	–
Charles Clarke	8	8	6	6	–	–	–	–	–	–	5	5
Ian Cormack	8	6	–	–	3	3	7	7	–	–	–	–
Tom Cross Brown	8	6	–	–	3	3	–	–	7	7	5	5
Manjit Dale	8	4	–	–	–	–	–	–	–	–	5	4
Isabel Hudson	8	6	–	–	–	–	7	7	7	7	–	–
Hugh Osmond	8	4	–	–	–	–	–	–	7	3	5	2
David Woods	8	7	–	–	–	–	–	–	7	7	–	–

1 Howard Davies was appointed to the Board on 1 October 2012.

2 Ron Sandler resigned from the Board on 30 September 2012.

3 Jim McConville was appointed to the Board on 28 June 2012 having started his executive duties on 6 June 2012.

The Board attendance in 2012 was impacted by the inability of many Directors to attend the 28 June meeting, on account of travel difficulties to Jersey, and the 11 December meeting being called at short notice. Those Directors with lower attendance records in 2012 will be required to improve their attendance at Board meetings in 2013.

Board Committees

The Board has delegated specific responsibilities to five standing Committees of the Board. The terms of reference of the Committees can be found on the Company's website.

Audit Committee

Alastair Lyons, Chairman
David Barnes
Charles Clarke

The composition of the Committee is in accordance with the requirements of the Code that the Audit Committee should consist of at least three independent non-executive directors of whom at least one has recent and relevant financial experience. The Audit Committee met six times during 2012.

The Audit Committee is responsible for making recommendations to the Board on such matters as the appointment of the external auditors and their terms of engagement and for reviewing the performance, objectivity and independence of the external auditors. The Audit Committee is also responsible for assessing the effectiveness of the internal audit function. The Audit Committee receives and reviews the Annual Report and Accounts and other related financial disclosures, the ultimate responsibility for these matters remaining with the Board. It monitors the overall integrity of the financial reporting by the Company and its subsidiaries and reviews compliance with legal and regulatory requirements and the effectiveness of the Group's internal controls. The terms of reference of the Audit Committee state that it shall meet the external auditor at least once a year without management being present.

The Company has adopted a Charter of Statutory Auditor Independence, which requires both the Company and the external auditors to take measures to safeguard the objectivity and independence of the external auditors. These measures include a prohibition regarding non-audit services in respect of specific areas, such as secondments to management positions, or those which could create a conflict or perceived conflict. It also includes details of the procedures for the rotation of the external audit engagement partner. The Charter can be found on the Company's website.

Audit Committee's principal activities during 2012

- Reviewed the Company's 2011 Annual Report and Accounts, 2012 interim financial statements and 2012 interim management statements, recommending their approval to the Board, as well as related disclosures and the financial reporting process, supported by reports from management and the external auditors
- Reviewed the financial forecasts prepared by management, supported by the sensitivity analysis on the key assumptions underpinning the forecasts, in support of the assumption that the Group will continue as a going concern and in support of dividend payments
- Reviewed the self-assessment of the internal audit function, undertaken in accordance with the Institute of Internal Auditors' International Standards
- Approved the Group Internal Audit Charter and the Group Internal Audit Plan (including its link to the Risk Management Framework), receiving regular reports to monitor progress against the plan
- Reviewed the Internal Audit macro-opinion report on the adequacy of risk management and control in the Group
- Reviewed the effectiveness, engagement and remuneration of the external auditors, recommending their re-appointment to the Board and thence to shareholders
- Reviewed and monitored the independence of the external auditors including their provision of non-audit services
- Reviewed arrangements for whistleblowing should an employee wish to raise concerns, in confidence, about any possible improprieties
- Reviewed the annual internal controls effectiveness report (and the half-year interim update) prior to its consideration by the Board
- Reviewed the Committee's performance, constitution and terms of reference, noting that all its duties had been addressed in accordance with its terms of reference.

Corporate governance report
continued

Nomination Committee

Howard Davies, Chairman (succeeded Ron Sandler who resigned as Chairman on 30 September 2012)
Ian Cormack
Tom Cross Brown

The composition of the Nomination Committee is in accordance with the requirements of the Code that a majority of its members should be independent non-executive directors. The Nomination Committee is responsible for considering the size, composition and balance of the Board; the retirement and appointment of Directors; succession planning for the Board and senior management; and making recommendations to the Board on these matters. The Nomination Committee met three times in 2012. Alastair Lyons, Senior Independent Director, chaired the Committee (in compliance with the UK Corporate Governance Code) when it considered the appointment of the Chairman.

The standard process used by the Committee for Board appointments involves the use of an external search consultancy to source candidates external to the Group (and may in the case of executive appointments also consider internal candidates). Detailed assessments of short-listed candidates are undertaken by the search consultancy, followed by interviews with Committee members and other Directors and the sourcing of references before the Committee recommends the appointments to the Board. This process was used for Board appointments (Chairman and Group Finance Director) in 2012.

Nomination Committee's principal activities during 2012

- Delivery of recommendations to the Board in connection with the appointments of the Chairman of the Board of Directors of the Company and the Group Finance Director. The outcome was the appointment of Howard Davies (as Chairman from 1 October 2012) and of Jim McConville (as Finance Director from 28 June 2012). Alastair Lyons, Senior Independent Director led the process for the appointment of the Chairman and chaired the Committee during its consideration of this matter. The Committee also consulted Mr Lyons, as Chairman of the Audit Committee, in its consideration of the Group Finance Director appointment
- Review of the balance of skills, knowledge and experience of the Board, taking account of the Board Evaluation Report
- Review of the structure, size and composition of the Board, taking account of the Board Evaluation Report, noting the conclusion that the Board was too big and recommending that its size should be reduced with effect from the 2013 AGM
- Review of the time spent by Directors in fulfilling their duties, noting that it was substantial in comparison with the FTSE 250 average but that certain Directors will be required to improve their attendance at Board meetings in 2013
- Review of the Committee's performance, constitution and terms of reference, noting that the Committee had performed its recruitment role successfully in 2012 and that all its duties had been addressed in accordance with its terms of reference
- Review of the non-executive directors of the Phoenix Life subsidiary Boards, in conjunction with the Chairman of the Phoenix Life Boards, prior to their re-appointment
- Assessment of Board succession planning with the agreement that a staggered programme of re-election of Directors should be implemented following the 2013 AGM when it was expected that Board numbers would reduce.

With regards to Board diversity, the statement by former Chairman Ron Sandler, released on the Phoenix Group website in October 2011 in response to the Lord Davies review of 'Women on Boards', concluded as follows: "As we already have a large Board of 14 Directors (including one female Director) and are unlikely to want to increase its size, it is difficult at this stage to commit to firm percentages regarding the number of women on our Board in 2013 and 2015. Nonetheless, we have set targets of two female Directors by 2013 and a further female Director by 2015. Our overriding aim remains the appointment of the most appropriate candidates to the Board."

Phoenix remains committed to increasing Board diversity following the proposed reduction in Board numbers at the 2013 AGM subject to the overriding aim of enhancing Board skills, experience and balance. A key factor in ensuring that there are women ready to fulfil Board roles generally is a sufficient number of women being in senior executive roles. At Phoenix three out of eight members of the Executive Committee are female, and two of them hold external appointments on listed company boards.

Remuneration Committee

Ian Cormack, Chairman
David Barnes
Isabel Hudson

The composition of the Remuneration Committee accords with the requirements of the Code that the Remuneration Committee should consist of at least three independent non-executive directors. The Remuneration Committee met seven times during 2012.

The Remuneration Committee is responsible for making recommendations to the Board on the Company's remuneration and compensation plans, policies and practices and for determining, within agreed terms of reference, specific remuneration packages for the Executive Directors. These include pension rights and executive incentive schemes to encourage superior performance. Details of the remuneration structure and the Committee's activities in 2012 are provided in the Remuneration report on pages 62 to 78.

The Remuneration Committee is aware that there may be proposals in 2013 to change the remuneration sections of the UK Corporate Governance Code which the Company will keep under review.

FIT Remuneration Consultants provided advice to the Remuneration Committee in 2012 and are independent of the Company.

Risk Committee

David Woods, Chairman
René Pierre Azria
Tom Cross Brown
Isabel Hudson
Hugh Osmond

The establishment of a Risk Committee is not a requirement of the Code. However, the Board believes such a Committee is important to ensure the robust oversight of the management of risk within the Group. The composition of the Committee, with a majority of independent Non-Executive Directors, is in accordance with the final recommendations of the report by Sir David Walker titled 'A review of corporate governance in UK banks and other financial industry entities'. The Risk Committee met seven times in 2012.

The Risk Committee advises the Board on risk appetite and tolerance in setting the future strategy, taking account of the Board's overall degree of risk aversion, the current financial situation of the Company and the Company's capacity to manage and control risks within the agreed strategy. It advises the Board on all high level risk matters. Details of the Risk Management Framework, for which the Risk Committee has oversight, are provided in the Risk Management section on pages 42 to 46.

Risk Committee's principal activities during 2012

- Recommending to the Board the Group's risk appetite
- Recommending to the Board the Group's overall risk management strategy
- Recommending to the Board the Group's principal risk policies
- Approval of the Group Risk function's 2012 plan
- Consideration of any breaches of the Group's risk appetite
- Monitoring of compliance with the Group's principal risk policies and satisfying itself that action plans to address significant breaches of those policies are sufficient
- Reviewing the Group's risk profile and monitoring it against the FSA risk categories of Market, Insurance, Credit, Liquidity and Operational with particular attention to risk appetite, risk trends, risk concentrations, provisions, experience against budget and key performance indicators for risk
- Consideration of risks, issues and matters escalated from principal business unit risk committees to ensure adequate coverage of the Group's significant business risks and systems of internal control
- Oversight of, and challenge to, the design and execution of the Group's stress and scenario testing, including any changes of assumptions.

Corporate governance report
continued

Investment Committee

Tom Cross Brown, Chairman
René Pierre Azria
Charles Clarke
Manjit Dale
Hugh Osmond

The Investment Committee was formed in May 2011 in response to a recommendation from the Board evaluation undertaken at the end of 2010 to provide greater focus on investment strategy and performance. It met five times in 2012, focusing on its key activities of reviewing investment performance and strategic asset allocation proposals. The Committee also received regular reports on actions being taken in respect of the Group's Eurozone exposure and reviewed how the Group monitored and managed its largest investment and counterparty exposures.

Communication with shareholders

The Company places considerable importance on communication with shareholders and regularly engages with them on a wide range of issues.

The Company's Investor Relations department is dedicated to facilitating communication with investors and analysts and an active investor relations programme is maintained. The Company continued its communication and engagement with the investment community during 2012. The Chairman, Senior Independent Director and Executive Directors are available to meet investors and analysts when required. At these meetings a wide range of relevant issues including strategy, performance, management and governance are discussed. Should major shareholders wish to meet newly appointed Directors, or any of the Directors generally, they are welcome to do so.

The Directors consider it important to understand the views of the market and in particular any issues which concern them. Board members regularly receive copies of the latest analysts' reports on the Company and the sector, as well as market feedback to further develop their knowledge and understanding of external views about the Company. The Chairman and the Non-Executive Directors provide feedback to the Board on topics raised with them by major shareholders. In addition, investor days are conducted periodically. The Company also undertakes perception studies designed to determine the investment community's view of the core business from both institutional fund managers and sell-side analysts.

The Company's AGM provides another opportunity to communicate with its shareholders. At the 2012 meeting, the Company complied with the Code provisions relating to voting and the separation of resolutions. Shareholders were invited to ask questions during the meeting. It is intended that the same processes will be followed at the 2013 AGM. In line with the Code, details of proxy voting by shareholders will be made available at the meeting and will be posted on the Company's website following the meeting.

The Company's Annual Report and Accounts, together with the Company's Interim Report, Interim Management Statements and other public announcements and presentations are designed to present a balanced and understandable view of the Group's activities and prospects. These are available on the Company's website at www.thephoenixgroup.com, along with a wide range of relevant information for private and institutional investors, including the Company's financial calendar.

Financial reporting and going concern

The Directors have acknowledged their responsibilities in the Statement of Directors' Responsibilities in relation to the IFRS financial statements for the year ended 31 December 2012 (as noted on page 91).

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business and strategy, Business review and Risk management sections on pages 11 to 21, 22 to 40 and 41 to 46 respectively.

The financial position of the Group, its cash flows and liquidity position are described in the IFRS financial statements and notes.

The Board's going concern assessment is included within the Directors' report on page 81.

Review of system of internal controls

The Code requires Directors to review the effectiveness of the Company's risk management and internal control systems which includes financial, operational and compliance controls. The Board has overall responsibility for the Group's risk management and internal control systems and for reviewing their effectiveness. The Group's systems of internal controls are designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. The Board's review of the period covered by this report, which was undertaken with the assistance of the Audit and Risk Committees, was completed on 21 March 2013. Where any significant weaknesses were identified, the actions required to address them have been taken, or are being taken and monitored.

The Board (and its subsidiary company boards) monitor internal controls on a continual basis, in particular through Audit and Risk Committees. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, which has been in place throughout the period covered by this report and up to the date of approval of the Annual Report and Accounts for 2012, in accordance with the 'Internal Control: Guidance to Directors' published by the Financial Reporting Council.

Additional assurance is provided by the internal audit function, which operates and reports independently of management. The internal audit function provides objective assurance on risk mitigation and control to the Audit Committee.

Remuneration report

Phoenix Group – Directors' Remuneration report

For the year ended 31 December 2012

Dear shareholder

I am pleased to introduce the Remuneration report for 2012. Following the changes to the senior executive remuneration arrangements made in 2010 as a result of the Company's Premium Listing in that year, the Remuneration Committee ('the Committee') has reaffirmed that the overall structure remains appropriate for 2013.

In considering the remuneration arrangements, the Committee has been mindful of developments in both regulatory and best practice. At the time of writing, implementation of Solvency II (with associated insurance specific remuneration guidelines) has been deferred although the Committee has regard to the Financial Services Authority ('FSA') Remuneration Code as being reflective of best practice. Similarly, the final position regarding the Department for Business, Innovation and Skills' ('BIS') proposed changes to the disclosure of executive remuneration remains outstanding although we have sought to include additional disclosures to comply with its recommendations as appropriate. The Committee will clearly review the current arrangements and relevant disclosures in light of such guidance.

No increases in basic salary have been awarded to the Directors for either 2012 or 2013.

The main elements of the Executive Directors' reward, which are set out in more detail in the report which follows, are:

– Base salary levels that are appropriate for the size and complexity of the business, given relevant market data

– Annual incentive maximum potential at 150% of base salary with 20% of potential based on personal and strategic measures and 80% of potential based on operating earnings, embedded value, cash generation and expense management targets with one-third of any incentive deferred into shares for three years. For 2013 onwards, two non-financial measures (customer satisfaction and employee engagement) will be added to create a more balanced scorecard of measures

– Consistent with best practice, a claw-back provision operates which permits the Committee to seek claw-back in appropriate cases. For 2013, the provisions have been amended to ensure they permit claw-back in a broader range of circumstances, including when reputational risk issues come to light

– Participation in a long-term incentive plan ('the LTIP') which uses embedded value and cash generation performance metrics in line with the Group's strategy. In addition, Total Shareholder Return ('TSR') was introduced as an element of the 2012 award. The current expectation is that awards to be granted in April 2013 will be at similar levels and be based on similar performance metrics to those granted in April 2012, with the precise targets set just prior to the awards being granted

– Share ownership guidelines consistent with best practice. Executive Directors are required to build and maintain a specified shareholding in the Company (200% of salary for the Group Chief Executive Officer and 100% of salary for the Group Finance Director) through the retention of all post-tax shares which vest under the Annual Incentive Plan ('AIP') deferral and the LTIP until target holdings have been achieved.

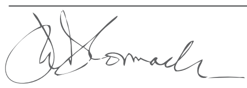
2012 represented a strong overall year for the Group with cash generation of £690 million at the upper end of the target announced to the market of £600 million to £700 million and embedded value up 4% before the dividend, and during the year. This resulted in an overall AIP award for the two Executive Directors of 69.14% of their potential in accordance with the rules.

The Committee has decided to voluntarily adopt a number of the key new reporting formats which will become mandatory in the Remuneration Report for 2013 under the BIS government proposals. We hope that the additional information which we have provided (including a 'single figure' for all Directors' emoluments, charts showing potential pay in different performance scenarios, the presentation of a summary of our remuneration policy within a table format, and a summary of the annual bonus out-turn for 2012) is useful for our shareholders.

At the Company's 2012 AGM, the Company secured the support of 97.91% of shareholders voting on the resolution to approve the Company's Remuneration report for 2011. Votes against represented 2.09%.

The Committee considers that the current arrangements are appropriate to the Group and its commercial situation and reflect UK best practice. I encourage shareholders to support the arrangements.

Ian Cormack
Remuneration Committee Chairman



21 March 2013

Introduction

Although not required by a non-UK incorporated company, this report has been prepared in accordance with the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and, where feasible, to the proposed BIS regulations. The report also meets the relevant requirements of the FSA's Listing Rules and describes how the Board has complied with the provisions set out in the UK Corporate Governance Code relating to remuneration matters. This report sets out the policy for the financial year just ended, for the forthcoming year and, subject to ongoing review, for subsequent financial years.

The auditors have reported on certain parts of the Remuneration report and stated whether, in their opinion, those parts of the report have been properly prepared in accordance with the Companies Act 2006. The report has therefore been divided into separate sections for unaudited and audited information.

Unaudited information

Remuneration Committee

The Group established the Committee in 2010. The terms of reference of the Committee are available at www.thephoenixgroup.com. During 2012 the Committee's main responsibilities were to:

- Review the framework for remuneration throughout the Group to confirm it remained appropriate, with particular emphasis on aligning the remuneration policy with the overall aims and risk appetite of the Group
- Determine an appropriate package for Jim McConville, the new Group Finance Director
- Determine and recommend to the Board the remuneration policy and the approval of all elements of pay for: the Chairman of the Board; Executive Directors; Executive Committee members; those individuals receiving a base salary greater than £200,000 or who have total target pay, or receive an award on joining to buy-out value from a former employer, which warrants the attention of the Committee even if their salary is below £200,000; and those individuals who perform a significant influence function and/or undertake activities which could have a material impact on the risk profile of the Group
- Review the design of, and agree targets for, any performance-related incentive schemes operated by the Group and approve the total annual payments made under such schemes
- Review the design of all share-based plans (or other plans requiring shareholder approval) for approval by the Board and shareholders, including the overall level of awards in any year; the individual award levels for Executive Directors and senior executives; and performance targets
- Select, appoint, and determine the terms of reference for independent remuneration consultants to advise the Committee
- Approve remuneration practices within Ignis Asset Management, applying similar overall principles as applied to the rest of the Group but relating these to an appropriate peer group of asset managers.

The table below shows the independent Non-Executive Directors who served on the Committee during 2012 and their date of appointment:

Member	From	To
Ian Cormack (Committee Chairman)	18 February 2010	To date
David Barnes	18 February 2010	To date
Isabel Hudson	18 February 2010	To date

The Committee meets at least twice a year but more frequently if required. During 2012, seven Committee meetings were held and details on attendance at meetings are set out in the Corporate governance report on page 56.

None of the Committee members has any personal financial interest (other than as shareholders), conflicts of interests arising from cross-directorships or day-to-day involvement in running the business.

The Committee makes recommendations to the Board. No Director plays a part in any discussion about his or her own remuneration.

During 2012, certain responsibilities of the Committee were assumed by a committee of the board of Phoenix Life Holdings Limited, the highest EEA level insurance group holding company within the Group. In particular, that committee oversees remuneration relating to UK-based employees other than the Chairman and the Executive Directors. The current members of the two Committees are the same and this does not impact the governance of remuneration from any external perspective, but it does simplify the oversight of remuneration matters affecting UK-based employees. Accordingly, this report does not distinguish between the activities of the two Committees.

Remuneration report
continued

Advice
The Committee received independent remuneration advice during the year from its appointed adviser, FIT Remuneration Consultants ('FIT'), which provides no other services to the Group. FIT is a member of the Remuneration Consultants Group (the professional body for consultants) and adheres to its code of conduct. FIT's fees in respect of 2012 were £117,188 (exclusive of VAT).

The Committee also consulted with the Group Chief Executive Officer, Group HR Director and General Counsel who attended, by invitation, various Committee meetings during the year, although no executive is ever permitted to participate in discussions or decisions regarding his or her own remuneration. Input is also sought from the Group Chief Risk Officer (without management present) and from representatives from the Group's finance function, as appropriate.

Remuneration policy

General policy
Executive remuneration packages are structured so that they:

– Are aligned to the Group's strategy

– Are aligned with the interests of shareholders, with a significant proportion being performance-related to areas which impact value

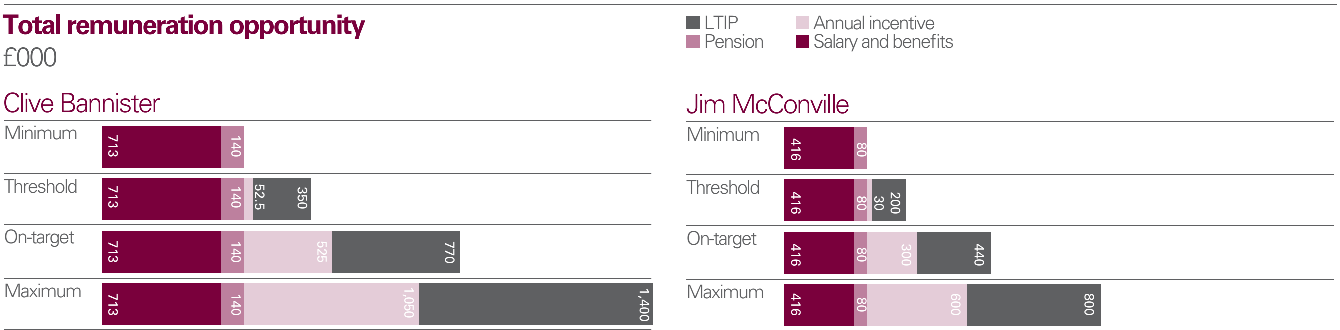
– Are competitive but not excessive, in relation to the UK life insurance and asset management markets

– Do not promote unacceptable behaviours or encourage unacceptable risk taking. In particular, the Committee designed the annual incentive targets with a clear bias towards the delivery of corporate targets for senior executives recognising the importance of good team behaviours and co-operation for an insurance business as part of an effective approach to risk management. Within Ignis, consistent with standard industry practice, targets are more focused on individual objectives (but subject to a pool linked to overall Ignis profitability)

– Take into account Group-wide pay and employment conditions. The Committee reviews the average Group-wide base salary increase and bonus costs and is responsible for all discretionary and all-employee share arrangements.

Potential rewards under various scenarios
The potential total rewards available to the Executive Directors, ignoring any change in share price and roll-up of dividends are:

Total remuneration opportunity
£000



The above chart aims to show how the remuneration policy set out above for Executive Directors is applied using the following assumptions:

Performance scenario			
Minimum	Threshold	On-target	Maximum
Only the fixed pay elements (salary, benefits and pension) of their package are included	Fixed pay elements plus threshold level of AIP and LTIP vesting	Fixed pay elements plus on-target AIP and LTIP vesting	Fixed pay elements plus maximum AIP and LTIP award vesting
Minimum performance targets for the AIP and LTIP are not achieved	Threshold performance is achieved, resulting in an AIP of 7.5% of base salary being earned	On-target performance is achieved, resulting in an AIP of 75% of base salary being earned	Stretch performance targets for the AIP and LTIP are met and/or exceeded
Minimum performance targets for the AIP and LTIP are not achieved	For the LTIP awards, threshold performance results in 25% of the total award vesting	For the LTIP awards, on target performance results in 55% of the total award vesting	This results in 100% of the maximum AIP being awarded and 100% of the LTIP award vesting

Notes

Total fixed pay comprises of base salary, benefits and pension contributions.

The maximum AIP is 150% of base salary for all Executive Directors. One-third of any AIP award is deferred into shares, contingent on employment for a further three years, to further align the interests of the executives with those of shareholders.

The face value LTIP award is 200% of base salary for all Executive Directors.

Actual vesting levels achieved will be disclosed following release of award shares.

Elements of the package

There are five main elements of the remuneration package for Executive Directors and senior executives:

- Base salary
- Benefits
- Pension
- Annual incentives
- Long-term incentives.

Remuneration report
continued

The remuneration policy for Executive Directors from the commencement of the 2012 financial year is summarised in the table below along with the position of the Chairman's and Non-Executive Directors' fees:

Element and purpose	Policy and opportunity	Operational and performance measures	Implementation of policy in year
Base salary This is the core element of pay and reflects the individual's role and position within the Group with some adjustment to reflect their capability and contribution	Base salaries are reviewed each year against companies of similar size and complexity and set by reference to the median data of suitable comparators The Committee does not slavishly follow data but uses it as a reference point in considering, in its judgement, the appropriate level having regard to other relevant factors including corporate and individual performance and any changes in an individual's role and responsibilities	Base salary is paid monthly in cash Base salaries are reviewed annually with any changes taking effect from 1 January	The current base salary of the Group Chief Executive Officer ('CEO') is £700,000; and of the Group Finance Director ('FD') is £400,000 No base salary increases were implemented for Executive Directors in January 2012 or in January 2013
Benefits To provide other benefits valued by recipient	Provide market competitive benefits in kind	Benefits received by Executive Directors comprise a car allowance, private medical insurance, relocation assistance and life assurance	No changes were made to this element of remuneration during 2012
Pension To aid retention and remain competitive within the market place	Provide a competitive employer sponsored pension plan	All Executive Directors are eligible to participate in the Group Personal Pension Plan ('GPPP') The Executive Directors (as at the date of this report) receive a contribution equal to 20% of base salary which they may choose to receive as a contribution or in cash if they are impacted by the relevant lifetime or annual limits	No changes were made to this element of remuneration during 2012 The Group CEO receives the payment into the GPPP. The Group FD received a cash supplement of 17.6% of salary (being 20% less employers' national insurance contributions) which is not taken into account as salary for calculating AIP, LTIP or other benefits

Element and purpose	Policy and opportunity	Operational and performance measures	Implementation of policy in year
Annual Incentive Plan To motivate employees and incentivise delivery of annual performance targets	The AIP potential is 150% of base salary with target levels at 75% of salary	AIP levels and the appropriateness of measures are reviewed annually to ensure they continue to support the strategy Personal and strategic objectives account for 20% of the AIP opportunity For the other 80%, performance over the financial year is measured against embedded value operating profit, cash flow, Market Consistent Embedded Value and cost management sliding scale targets One-third of any annual AIP award paid is to be deferred into shares for a period of three years	Paid in one tranche (less the deferred share award) following the year end The bonus out-turn for the 2012 financial year in respect of the Group CEO and Group FD was £725,970, and £237,052 (both being 69.14% of the maximum) The AIP remains unchanged for 2013 except that 20% of the bonus is now linked to non-financial (Customer Satisfaction and Employee Engagement) KPIs to provide a more balanced scorecard. The detailed weightings are set out on page 69. The element previously linked to financial measures now applies to 60% The previous claw-back provisions have been amended to widen the circumstances permitting claw-back to cover wider reputational issues facing the Group
Long-term incentives To motivate and incentivise delivery of sustained performance over the long-term, the Group operates the LTIP	The policy is to award Executive Directors shares with an initial face value equal to no more than 200% of base salary each year (within a formal limit of 300% and 400% in exceptional cases)	The performance conditions for the 2012 LTIP awards are described on page 70. The Committee approved these performance metrics as they are directly linked to the objectives set out in the Group's strategy, there is a direct link with shareholder value, and there is a clear line of sight for participants between performance and reward	For the 2012 LTIP awards, a third performance measure, Total Shareholder Return ('TSR') was introduced It is expected that the same performance measures will be used for the 2013 LTIP awards Annual awards set at the initial face value level of 200% of salary per annum

Remuneration report
continued

Element and purpose	Policy and opportunity	Operational and performance measures	Implementation of policy in year
Recruitment policy It is difficult to be overly prescriptive regarding the appropriate package for an unknown potential recruit. The following is the Committee's agreed policy but it reserves the ability to take such steps as it considers appropriate on a specific recruitment	In principle, the pay of any new recruit would be assessed following the same principles as for the current Executive Directors The Committee would be mindful of best practice guidelines in considering whether any enhanced LTIP or other award was necessary on recruitment (e.g. to buy-out awards forgone at the incoming executive's previous employer) and seek to avoiding paying more than it considers necessary to secure the preferred candidate	As necessary to secure the appropriate candidate	No special terms agreed on the recruitment of the new Group FD
Chairman and Non-Executive Director fees	The fees paid to the Chairman and the fees of the other Non-Executive Directors aim to be competitive with other listed companies of equivalent size and complexity Additional fees are paid to Non-Executive Directors who chair or sit on a Board Committee, to the Senior Independent Director ('SID') and for serving on the Model Governance Committee Non-Executive Directors will not normally participate in share incentive arrangements	Fees are paid monthly in cash Fee levels for Non-Executive Directors are reviewed annually with any changes taking effect from 1 January	In 2013, fee levels remain at the same levels as in 2012 at £325,000 for the Chairman of the Board, £90,000 for the role of Non-Executive Director with additional fees of: (i) £5,000 payable for the role of SID; and/or (ii) £10,000 payable where an individual also chairs the Audit, Investment, Remuneration or Risk Committee; and/or (iii) £20,000 payable where a Non-Executive Director also sits on the Board of a subsidiary company and/or (iv) sits on the Model Governance Committee. Non-Executive Directors in place in 2012, who are not paid for serving on subsidiary company Boards, had their base fees set at £100,000

Base salary and benefits

Base salary levels are as follows:

Name	Role	From 1 January 2012 (or date of appointment if later)	From 1 January 2013
Clive Bannister	Group CEO	£700,000	£700,000
Jim McConville[1]	Group FD	£400,000	£400,000

1 Appointed 28 June 2012.

Jim McConville joined with a slightly lower salary than his predecessor (£400,000 compared with £415,000) and did not receive any guaranteed or buy-out awards and his bonus for 2012 was pro-rated for the period of employment. Neither Executive Director received a salary increase in January 2013.

Benefits received by Executive Directors comprise a car allowance, private medical insurance, relocation assistance and life assurance.

Pension

The Executive Directors (as at the date of this report) receive a contribution equal to 20% of base salary to a defined contribution GPPP or a salary supplement in lieu.

Annual incentives

For 2012, AIP potential remained capped at 150% of base salary for Executive Directors. Performance targets were based on the achievement of personal and strategic objectives for 20% of the bonus opportunity and, for the other 80%, financial targets based on a sliding scale as follows:

Performance metric	% of 80% of incentive potential based on financial measures	% achieved against performance metric
Group MCEV	30%	4.5%
Operating Companies' Cash Generation	30%	30.0%
Group MCEV Operating Earnings after Tax	20%	20.0%
Expense Management	20%	16.3%

In addition to the above targets and in order for any incentive payment to be paid, the Committee confirmed that it was satisfied that management had identified and managed material business risks in an appropriate manner.

Details of the actual AIP payments awarded in respect of the 2012 financial year (due to be paid in March 2013) are presented in the emoluments table and notes on page 73. In summary, the AIP corporate out-turn was 70.8% of maximum. The table below shows the actual out-turn against the annual incentive maximum.

	(as a % of maximum)			
Name	Financials	Personal	Total	Maximum
Clive Bannister	70.8%	62.50%	69.14%	150%
Jim McConville	70.8%	62.50%	69.14%	150%

One-third of any AIP amount will be deferred into shares for three years. The shares comprising the deferred element will vest three years from the date of award and will normally be forfeited if the individual leaves the Group prior to vesting (unless designated as a good leaver).

For 2013, the on-target and maximum AIP potential remains at 75% and 150% of base salary for Executive Directors and the performance measures will be as follows:

Performance metric	% of 80% of incentive potential based on KPIs
Operating Companies' Cash Generation	30%
Group MCEV	20%
Expense Management	20%
Group MCEV Operating Earnings after Tax	10%
Customer Satisfaction	10%
Employee Engagement	10%

This is felt to be more consistent with the types of balanced scorecards adopted elsewhere within the sector.

Remuneration report
continued

Consistent with best practice, the Committee operates a claw-back provision which will permit the Committee to seek claw-back in appropriate cases. For 2013 awards, this has been extended to cover the discovery of reputational or risk concerns.

Long-term incentives

The LTIP is designed to retain executives and align their interests to the Group's long-term goals and, through those goals, to the delivery of superior returns to shareholders. For 2013, the population has been reduced to 24 participants who receive contingent awards of shares in the Group which will permit the participant to receive shares three years after they were awarded, but only if both suitably stretching performance conditions measured over the three-year period are met and they remain employed (or are designated a good leaver).

The Committee's policy is to award Executive Directors with an initial face value equal to no more than 200% of their respective base salary. This is below the formal plan limits of 300% of base salary or 400% in exceptional circumstances.

The LTIP awards made to the Executive Directors in April 2012 have performance measures of which 40% is based on MCEV growth and 40% is based on net cumulative cash generation (i.e. after taking into account certain operating and financing costs), with both targets measured over the three financial years commencing 1 January 2012. The remaining 20% is subject to TSR performance against the constituents of the FTSE 250 (excluding investment trusts) over the three years following grant. The LTIP awards are underpinned by a debt management assessment. A summary of the targets is set out below:

MCEV growth (40% of awards)	25% of the MCEV related component of the award will vest for MCEV growth in excess of the risk-free rate by 3% per annum rising on a pro rata basis until 100% vests for MCEV growth in excess of the risk-free rate by 6% per annum.
Cash generation (40% of awards)	25% of the cash generation component of the award will vest for cumulative cash generation of £1.330 billion rising on a pro rata basis until 100% vests for cash generation of £1.830 billion.
TSR (20% of awards)	25% of the TSR component of the award will vest for median performance against the constituents of the FTSE 250 (excluding investment trusts) rising on a pro rata basis until 100% vests for upper quintile performance.
Debt underpin	Notwithstanding the MCEV, cash generation and TSR performance targets, if the Committee determines that the Group's debt levels and associated interest costs have not remained within parameters acceptable to the Committee over the performance period and that the Group has not made progress considered to be reasonable by it in executing any strategy agreed by the Board on debt management and capital structuring, the level of awards vesting will either be reduced or lapse in full.

The Committee selected these performance metrics as they are directly linked to the objectives set out in the Group's strategy, there is a direct link with shareholder value, and there is a clear line of sight for participants between performance and reward.

The current expectation is that the above performance metrics will continue to be used for the 2013 awards, with performance targets (which will, in the view of the Committee, be no less challenging than those presented above) set in advance of the awards being granted.

Shareholding guidelines

The Company operates share ownership guidelines for Executive Directors. Under the guidelines, Executive Directors are expected to retain all shares (net of tax) which vest under the AIP deferral, LTIP (or any other discretionary long-term incentive arrangement introduced in the future) until such time that they hold a specified value of shares (200% of salary for the Group CEO, 100% of salary for other Executive Directors). Once shareholding guidelines have been met, individuals are expected to retain these levels as a minimum. The Committee will review shareholdings annually in the context of this policy. The Committee will keep compliance with the policy under review as awards approach maturity.

All-employee share plans

The Group operates a Sharesave scheme which is approved by HM Revenue & Customs ('HMRC'). All eligible employees, including Executive Directors, are invited to participate on similar terms to save up to a maximum of £250 each month for a fixed period of three or five years. At the end of the savings period, individuals may use their savings to buy ordinary shares in the Company at a discount currently capped at 15% (although the rules permit 20%) of the market price set at the launch of each scheme.

During 2012, the Committee launched an HMRC approved Share Incentive Plan. This offers all eligible employees, including Executive Directors, the opportunity to purchase, out of their pre-tax salary, shares in the Company (up to a value of £125 per month) and receive one matching share for every six shares purchased.

Ignis Asset Management

The Committee is responsible for approving the remuneration practices within Ignis. In structuring remuneration arrangements within Ignis, the Committee applies similar overall principles to those applied to the rest of the Group, but relating these to an appropriate peer group of asset managers.

Directors' service contracts

Executive Directors

Executive Director service contracts, which do not contain expiry dates, provide that compensation provisions for termination without notice will only extend to 12 months of salary, fixed benefits and pension (which may be payable in instalments and subject to mitigation). By excluding any entitlement to compensation for loss of the opportunity to earn variable pay, the Committee believes the contracts to be consistent with best practice. The Committee also has discretion to mitigate further by paying on a phased basis with unpaid instalments ceasing if the executive finds alternative employment. Contracts do not contain change of control provisions.

Name	Date of contract	Notice period from either party (months)
Clive Bannister	7 February 2011	12
Jim McConville	6 June 2012	12

Subject to Board approval, Executive Directors are permitted to accept outside appointments on external boards or committees as long as these are not deemed to interfere with the business of the Group. In 2012, following his appointment to the Board of the Group, Jim McConville earned £11,250 as a Non-Executive Director of the UK life companies of AEGON N.V.

Termination policy summary

In practice, the facts surrounding any termination do not always fit neatly into defined categories for good or bad leavers. Therefore, it is appropriate for the Committee to consider the suitable treatment on a termination having regard to all of the relevant facts and circumstances available at that time. This policy applies both to any negotiations linked to notice periods on a termination and any treatment which the Committee may choose to apply under the discretions available to it under the terms of the AIP and LTIP plans. The potential treatments on termination under these plans are summarised below.

Incentives	Good leaver	Bad leaver	Other events
	If a leaver is deemed to be a 'good leaver'; ie leaving through voluntary redundancy, serious ill health or death or otherwise at the discretion of the Committee	If a leaver is deemed to be a 'bad leaver'; typically voluntary resignation or leaving for disciplinary reasons	For example, change in control
AIP	Pro-rated amount plus retention of any deferred share awards	No awards made	Pro-rated amount plus retention of any deferred share awards
LTIP	Will receive a pro-rated award subject to the application of the performance conditions at the normal measurement date Committee discretion to disapply pro-rating	All awards will normally lapse	Will receive a pro-rated award subject to the application of the performance conditions at the date of the event Committee discretion to disapply pro-rating

Former Executive Directors

In December 2011, the Company announced that Jonathan Yates would leave the Group at the end of February 2012 having resigned as an Executive Director of Phoenix Group Holdings on 21 December 2011. As reported last year for 2012, he received his normal salary and benefits for the period he continued to be employed. He was not eligible for an AIP award for any part of 2012 and did not receive any termination payment in respect of his departure. However, the Committee confirmed that he was to be treated as a good leaver and, therefore, was entitled to early release, on departure, of the 16,259 shares held under the Deferred Bonus Share Scheme plus the associated shares earned in

Remuneration report
continued

respect of dividend roll-up (being the deferred element of the AIP) together with all of his 2011 AIP award being paid in cash. He retains his 2010 and 2011 LTIP awards which continue to vest until the normal vesting date (with performance conditions and time pro-rating applying).

Non-Executive Directors' contracts

The Non-Executive Directors, including the Group Chairman, have letters of appointment which set out their duties and responsibilities. Appointment is for a fixed term of three years, terminable by one month's notice on either side. Non-Executive Directors are not eligible to participate in incentive arrangements or receive pension provision or other benefits such as private medical insurance and life assurance.

Non-Executive Director	Date of letter of appointment	Commencement date of appointment	Expiry/notice terms	Current expiration date
Howard Davies (Chairman and Non-Executive Director)	19 October 2012	1 October 2012	Six months	1 October 2015
Alastair Lyons (Senior Independent Non-Executive Director)	26 January 2010	29 March 2010	One month	2 May 2013
Ian Ashken (Non-Executive Director)	2 September 2009	2 September 2009	One month	2 May 2013
René-Pierre Azria (Non-Executive Director)	2 September 2009	2 September 2009	One month	2 May 2013
David Barnes (Independent Non-Executive Director)	2 September 2009	2 September 2009	One month	2 May 2013
Charles Clarke (Independent Non-Executive Director)	23 December 2009	18 February 2010	One month	2 May 2013
Ian Cormack (Independent Non-Executive Director)	2 September 2009	2 September 2009	One month	2 May 2013
Tom Cross Brown (Independent Non-Executive Director)	24 September 2009	24 September 2009	One month	2 May 2013
Manjit Dale (Non-Executive Director)	2 September 2009	2 September 2009	One month	2 May 2013
Isabel Hudson (Independent Non-Executive Director)	11 December 2009	18 February 2010	One month	2 May 2013
Hugh Osmond (Non-Executive Director)	2 September 2009	2 September 2009	One month	2 May 2013
David Woods (Independent Non-Executive Director)	21 December 2009	18 February 2010	One month	2 May 2013

The remuneration of the Non-Executive Directors is a matter for the Chairman and Executive members of the Board and the remuneration of the Non-Executive Chairman is a matter for the Committee and the Board. Fees for both Non-Executive Directors and the Non-Executive Chairman are reviewed from time to time with regard to the complexity of the Group, the time commitment required and the level of fees paid by comparable companies.

Mr Sandler retired as Chairman on 30 September 2012, having received a pro-rated amount of his annual fee of £450,000 and nothing in respect of his termination. Howard Davies was appointed as Chairman on 1 October 2012 with an annual fee of £325,000.

In 2012, fee levels were set at £90,000 for the role of Non-Executive Director with additional fees of: (i) £5,000 payable for the role of SID; and/or (ii) £10,000 payable where an individual also chairs the Audit, Investment, Remuneration or Risk Committee; and/or (iii) £20,000 payable where a Non-Executive Director also sits on the Board of a subsidiary company. Non-Executive Directors in place in 2012, who are not paid for serving on subsidiary company Boards, had their base fees set at £100,000. In addition, David Woods receives a temporary fee of £10,000 per annum until 30 June 2013 for being a member of the Group's Model Governance Committee. No changes to these fee levels are proposed for 2013.

Audited information

Directors' emoluments

The emoluments of the Directors for 2012 based on the current disclosure requirements were as follows:

Name	Salaries/fees £	Benefits[1] £	Pension allowance[1] £	AIP[2] £	**Total 2012 £**	Total 2011 £
Non-Executive Chairman						
Howard Davies	81,250	–	–	–	**81,250**	–
Executive Directors						
Clive Bannister[3]	700,000[6]	16,635	–	725,970	**1,442,605**	1,228,061
Jim McConville[4]	203,333[6]	22,168	35,752	237,052	**498,305**	–
Non-Executive Directors						
Ian Ashken	100,000	–	–	–	**100,000**	100,000
René-Pierre Azria	100,000	–	–	–	**100,000**	100,000
David Barnes	110,000	–	–	–	**110,000**	110,000
Charles Clarke	100,000	–	–	–	**100,000**	100,000
Ian Cormack	120,000	–	–	–	**120,000**	120,000
Tom Cross Brown	120,000	–	–	–	**120,000**	120,000
Manjit Dale	100,000	–	–	–	**100,000**	100,000
Isabel Hudson	100,000	–	–	–	**100,000**	100,000
Alastair Lyons	125,000	–	–	–	**125,000**	125,000
Hugh Osmond	100,000	–	–	–	**100,000**	100,000
David Woods	130,000	–	–	–	**130,000**	125,000
Former Directors						
Jonathan Moss	–	–	–	–	**–**	1,670,966
Ron Sandler[5]	337,500				**337,500**	450,000
Jonathan Yates	–	–	–	–	**–**	879,545
Total	2,527,083	38,803	35,752	963,022	**3,564,660**	5,428,572

1 Benefits comprise car allowance, private medical insurance and, life assurance and for Jim McConville an allowance of £2,000 per month in respect of relocation payable until June 2013. Clive Bannister and Jim McConville each receive a Company contribution of 20% of base salary, which may at their own choice, be paid to a GPPP or received in cash. Pension contributions paid to a GPPP are disclosed on page 74.

2 Annual incentive amounts are presented inclusive of any amounts which must be deferred in shares for three years (i.e. one-third of the 2012 AIP award). Of the amounts presented above, £241,990 of Clive Bannister's incentive payment will be deferred in shares for a period of three years and £79,017 of Jim McConville's. Full details of the number of shares under award will be disclosed in the 2013 Remuneration report.

3 Clive Bannister joined the Phoenix Group on 7 February 2011 and was appointed to the Board as a Director on 28 March 2011. The detail shown for 2011 only relates to the period from his appointment as a Director to 31 December 2011, except for the AIP which includes the amount earned in respect of the period 7 February 2011 to 28 March 2011.

4 Jim McConville joined the Phoenix Group on 6 June 2012 and was appointed to the Board as a Director on 28 June 2012. The detail shown only relates to the period from his appointment as a Director to 31 December 2012, except for the AIP which includes the amount earned in respect of the period 6 June 2012 to 28 June 2012.

5 Retired from the Board on 30 September 2012.

6 The Executive Directors are entitled to adjust their salary/benefit combination under flexible benefits arrangements and the figures shown are before individual elections.

The emoluments of the Executive Directors for 2012 based on the new disclosure requirements were as follows:

Name	Salaries/fees £	Benefits £	AIP £	Share plan[3] gains £	Other[4] £	Pension[5] £	**Total[1] 2012 £**	Total[2] 2011 £
Executive Directors								
Clive Bannister[6]	700,000[8]	16,635	725,970	–	–	140,000	**1,582,605**	1,333,061
Jim McConville[7]	203,333[8]	22,168	237,052	–	–	35,752	**498,305**	–
Total	**903,333**	**38,803**	**963,022**	**–**	**–**	**175,752**	**2,080,910**	1,333,061

1 Prepared in accordance with the methodology outlined in draft BIS regulations.

2 The comparative figure for 2011 has been prepared on a consistent basis.

3 Share plan gains include the intrinsic gain on the grants of SAYE grants.

4 'Other' represents dividends accrued over the period to vesting under the LTIP.

5 Clive Bannister and Jim McConville each receive a Company contribution of 20% of base salary which may, at their choice, be paid to a GPPP or received in cash if the individual is impacted by the lifetime or annual allowance.

6 Clive Bannister joined the Phoenix Group on 7 February 2011 and was appointed to the Board as a Director on 28 March 2011. The detail shown for 2011 only relates to the period from his appointment as a Director to 31 December 2011, except for the AIP which includes the amount earned in respect of the period 7 February 2011 to 28 March 2011.

7 Jim McConville joined the Phoenix Group on 6 June 2012 and was appointed to the Board as a Director on 28 June 2012. The detail shown only relates to the period from his appointment as a Director to 31 December 2012, except for the AIP which includes the amount earned in respect of the period 6 June 2012 to 28 June 2012.

8 The Executive Directors are entitled to adjust their salary/benefit combination under flexible benefits arrangements and the figures shown are before individual elections.

Remuneration report
continued

Pensions

Clive Bannister receives a Company contribution of 20% of base.

During the year to 31 December 2012, the Group has made the following contributions:

	£
Clive Bannister	140,000

Share-based awards

As at 31 December 2012, Directors' interests under long-term share-based arrangements were as follows:

	Date of grant	Share price on grant	As at 1 Jan 2012	Shares granted	Shares vested	Shares lapsed	As at 31 Dec 2012	Vesting Date
Clive Bannister								
LTIP[1, 3]	12 April 2011	657.5p	212,927	–	–	–	212,927	12 April 2014
LTIP[2, 3]	2 April 2012	566.5p	–	247,131	–	–	247,131	2 April 2015
			212,927	**247,131**	**–**	**–**	**460,058**	
Jim McConville								
LTIP	23 August 2012	485.0p	–	164,948	–	–	164,948	23 August 2015
			–	**164,948**	**–**	**–**	**164,948**	

1 The performance conditions for the 2011 award are: MCEV growth (50% of award) with 25% of the MCEV related component of the award will vest for MCEV growth in excess of the risk-free rate by 2.5% per annum rising on a pro rata basis until 100% vests for MCEV growth in excess of the risk-free rate by 6% per annum; cash generation (50% of award) 25% of the cash generation component of the award will vest for cumulative cash generation of £1.217 billion rising on a pro rata basis until 100% vests for cash generation of £1.517 billion; and the same debt underpin as the 2012 award as set out in the Remuneration policy.

2 The performance conditions for the 2012 award are set out in the Remuneration policy section of this report.

3 In addition to the shares awarded under the LTIP presented above and the deferred bonus shares in the next table, participants received an additional number of shares (based on the number of LTIP awards which actually vest) to reflect the dividends paid during the vesting period.

Following the year end, the Committee has discretion to adjust the number shares subject to outstanding awards under the various share-based plans (including the deferred bonus shares in the next table) to reflect the open offer which occurred in February 2013 in accordance with the HMRC's established formulae for such events and is considering the impact, if any, on the LTIP performance conditions.

Deferred bonus shares	Date of award	Shares awarded	Share price on award	Lapsed	Outstanding	Vesting date
Clive Bannister	2 April 2012	40,412	562.5p	–	40,412	2 April 2015
Jim McConville	–	–	–	–	–	–

Notes

This is the arrangement pursuant to which one-third of the AIP for any year is deferred into the Company's shares. No performance conditions apply therefore other than generally being subject to continued employment.

During the year ended 31 December 2012, the highest mid-market price of the Company's shares was 590p and the lowest mid-market price was 405.3p. At 31 December 2012, the Company's share price was 545p.

Sharesave

At the end of the year, the Executive Directors' Sharesave share options were as follows:

	As at 1 Jan 2012	Options granted	Options vested	Options exercised	Options lapsed	As at 31 Dec 2012	Exercise price	Exercisable from	Date of expiry
Clive Bannister	1,577	–	–	–	–	1,577	£5.72	01 Jun 2014	30 Nov 2014
Jim McConville	–	–	–	–	–	–	–	–	–

Directors' interests

Name	As at 1 January 2012 or date of appointment if later	As at 31 December 2012	As at 21 March 2013 number of ordinary shares
Clive Bannister[1]	–	–	–
Jim McConville[2]	–	–	–
Ian Ashken	1,263,698	1,263,698	1,509,796
René-Pierre Azria	27,812	28,869	34,491
David Barnes	2,300	2,300	2,747
Charles Clarke	2,000	2,000	2,389
Ian Cormack	–	–	–
Tom Cross Brown	1,664	1,664	1,988
Manjit Dale[3]	–	–	–
Howard Davies	–	–	–
Isabel Hudson	3,249	3,249	3,880
Alastair Lyons	7,500	7,500	8,961
Hugh Osmond[4]	9,849,533	11,072,825	13,229,201
David Woods	–	–	–

Notes:

1 Clive Bannister holds options in respect of ordinary shares under the LTIP, the Deferred Bonus Share Scheme and the Sharesave Scheme, details of which are included in the 'Share-based awards' notes on page 74.

2 Jim McConville holds options in respect of ordinary shares under the LTIP, details of which are included in the 'Share-based awards' notes on page 74.

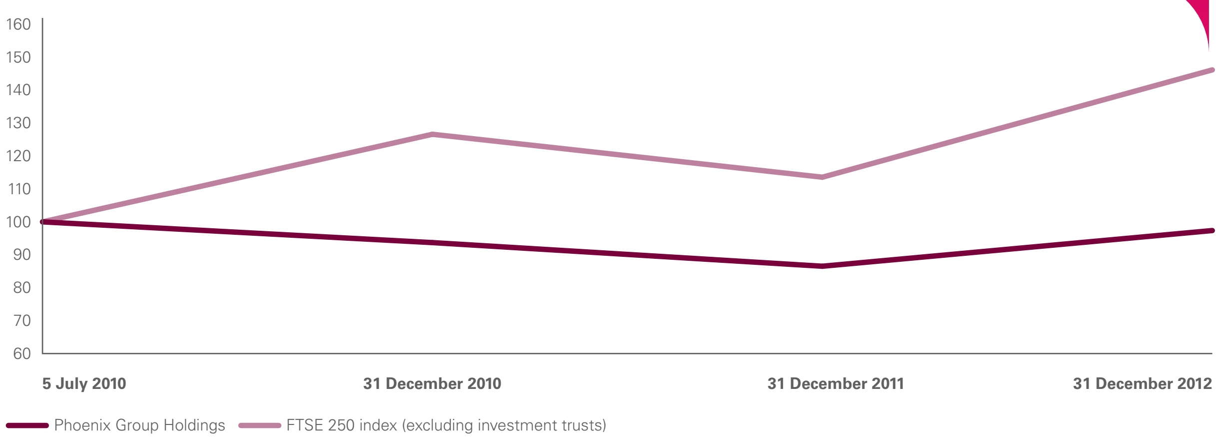
3 Manjit Dale is a director of TDR Capital Nominees Limited, Jambright Limited, Jambright Midco Limited and TDR Shares Limited and as such these companies are all considered as connected persons. Total interests held by these entities amount to 35,923,409.

4 Hugh Osmond is a director of Xercise2 Limited which is considered to be a connected person. Hugh Osmond has a total interest in 17,394,353 shares of which he has beneficial interest over 13,229,201.

Performance graph

The graph below shows the value by 31 December 2012, on a TSR basis, of £100 invested in Phoenix Group Holdings on 5 July 2010 (the date of the Company's Premium Listing) compared with the value of £100 invested in the FTSE 250 Index (excluding investment trusts).

Total shareholder return
Value of a 100 unit investment made on 5 July 2010



The FTSE 250 Index (excluding investment trusts) is considered to be an appropriate comparator for this purpose as it is a broad equity index of which the Company is a constituent.

Remuneration report
continued

Additional FSA disclosures

Code Staff
The Remuneration Committee has identified the Group's asset management subsidiary, Ignis, as a Code firm. By virtue of its influence over Ignis, the Committee has determined that Phoenix Group Holdings is also a Code firm. Both companies have been identified as Tier 4 (now renamed Tier 3) Code firms. The Committee has determined that 25 staff within Ignis qualify as Code Staff. The Committee has also determined that a further 26 Group employees, who have sufficient supervisory responsibility over Ignis' activities, qualify as Code Staff.

Whilst not all of Phoenix Group's activities are covered by the FSA Remuneration Code, the Committee anticipates broadly equivalent provisions will apply, in due course, via Solvency II. The Committee considers the FSA Code to reflect best practice and has due regard to it across the Group.

Code Staff criteria
The following groups of employees have been identified within the code firms as meeting the FSA's criteria for Code Staff:

– Certain members of the Group Board and Executive Committee

– Employees performing a Significant Influence Function in relation to the code firm

– Key control function roles.

Design and structure of remuneration
The individual elements of employees' remuneration packages at Phoenix Group Holdings comprise fixed pay (base salary, pension and other benefits) and performance-related pay (consisting of annual incentives, deferred awards and long-term incentives).

Taking into account the expected value of long-term incentives, the performance-related elements of the package make up a considerable proportion of the total remuneration of Code Staff, while maintaining an appropriate balance between fixed and variable elements.

Salary and fees
All Code Staff receive either a salary (employees) or fees (Non-Executive Directors) to reflect their experience, skills, competencies and contribution to the Group relative to the market for comparable roles. Phoenix Group Holdings ensures that fixed remuneration is sufficient to cover employees' key financial needs while generally seeking to pay around a mid-market range.

Phoenix Group Holdings also operates a fully flexible bonus policy which allows zero bonus payments to be made when appropriate.

Benefits
Code Staff receive benefits in line with other employees that includes pension, life assurance, staff discounts (for Ignis employees) and may include car allowance and private medical insurance. Non-Executive Directors who are listed as Code Staff do not receive any benefits.

Annual incentives
Rationale and eligibility criteria
All executive Code Staff are eligible to receive an annual incentive. Annual incentives are designed to reward good financial and non-financial performance that supports the business strategy, taking into account the Group's risk appetite and personal contribution in the context that it was delivered.

Non-Executive Code Staff are not eligible to receive annual incentives.

Performance measurement/assessment
For Group and life company employees, performance assessment is normally based upon a balanced scorecard of measures related to Group and individual targets. These targets typically include financial performance, risk, people and customer measures. Overall AIP costs are reviewed by the Remuneration Committee at the year end having regard to the Group KPIs and non-financial measures.

Ignis employees' bonuses are financed from a defined profit pool (subject to discretion being reserved to the Remuneration Committee to adjust the percentage available). Distribution of the pool has due regard to objectives similar to those in the Group and life companies.

For all Code Staff in control functions (Internal Audit, Regulatory Compliance and Risk) reward is linked to individual achievement against personal objectives and excludes any direct link to financial performance. A similar approach is also adopted in respect of the With-Profits Actuary.

In each case target levels of individual reward have regard to market levels for comparable roles internally and externally.

All incentive awards to Code Staff are subject to the review and support of the Committee.

Deferral and vesting

The Committee requires that one-third of annual incentives for the senior Group employees to be deferred into Phoenix Group Holdings shares. Equivalent rules apply to Ignis employees who are required to defer part of their bonus into phantom shares where the value of the outcome is determined by Ignis' financial performance.

This extends to the majority of Code Staff.

Long-term incentives

Group

To encourage the creation of value over the long-term and to align the rewards of the participants with the returns to shareholders, the Group provides employees in senior roles (executive level and selected senior management) the opportunity to receive annual awards of long-term incentives. The full details of the LTIP are given on page 70 of the report.

Ignis

Selected employees (executive level and selected senior management) are eligible to receive awards subject to the rules of the Ignis Long Term Phantom Option Plan ("LTOP"). Awards may be made annually but are typically one-off in nature and reward the growth in the notional value of Ignis over a six-year period (with one-third of the award vesting on the fourth, fifth and sixth anniversaries of the grant date). Awards take the form of a cash settled option. Where it has been necessary and as a part of the recruitment process, the Committee has provided an underpin to the value of the award to reflect the value forfeited, by employees due to leaving previous employers.

Risk adjustment

To manage the risk aspects of the remuneration policy, the Committee considers the performance of the Group and individual businesses against risk objectives in determining the bonus pool and requires the Group Chief Risk Officer to report to the Committee on this.

Remuneration report
continued

Quantitative remuneration disclosure

The Group is required to disclose aggregate quantitative remuneration information for its Code Staff.

As at 31 December 2012, there were 26 Code Staff that had been classified as Group and 25 as Ignis. Aggregate remuneration expenditure is broken down as follows:

	Number of Staff	£
Non-Executive Directors	18	1,759,105
Senior management	11	9,698,103
Others	22	11,399,457
Total	51	22,856,665

	Number of Staff	£
Ignis	25	11,321,705
Group	26	11,534,960
Total	51	22,856,665

Approval

This report in its entirety has been approved by the Committee and the Board of Directors and signed on its behalf by

Ian Cormack
Remuneration Committee Chairman

21 March 2013

Directors' report

Introduction

Principal activities and business review

The Company is incorporated in the Cayman Islands and has a Premium Listing on the London Stock Exchange. The Company is not required to comply with the requirements of the UK Companies Act 2006. However, the Directors support these enhanced standards for disclosure and have sought to comply voluntarily with these requirements.

The UK Companies Act 2006 requires a company to set out in this report a fair review of the business of the Group during the financial year ended 31 December 2012, including an analysis of the position of the Group at the financial year end and a description of the principal risks and uncertainties facing the Group (known as a 'Business review').

The information that fulfils the Business review requirements can be found in the Business and strategy, Business review and Risk management sections on pages 11 to 21, 22 to 40 and 41 to 46 respectively and is incorporated by reference into this Directors' report.

Shareholders

Dividends

Dividends for the year are as follows:

Ordinary shares
Paid interim dividend of 21p per share (2011: 21p per share)
Recommended final dividend of 26.7p per share (2011: 21p per share)
Total ordinary dividend of 47.7p per share (2011: 42p per share)

Share capital

The issued share capital of the Company was increased by 114,333 ordinary shares during 2012. 114,333 shares were allotted under the Group's scrip dividend scheme for the final 2011 dividend. At 31 December 2012, the issued ordinary share capital totalled 174,587,148. A further 50,000,000 ordinary shares were issued on 21 February 2013 increasing the total issued share capital to 224,587,148. Subsequently, 35,467 ordinary shares were issued in March 2013 in connection with the Company's Save As You Earn ('SAYE') Scheme to bring the total in issue at the date of this report to 224,622,615.

Full details of the authorised, issued and fully paid share capital as at 31 December 2012 and movements in share capital during the period are presented in note 15 to the IFRS financial statements.

The rights and obligations attaching to the Company's ordinary shares are set out in the Company's Articles of Association ('the Articles') which are available on the Company's website at www.thephoenixgroup.com/about-us/corporate-governance/articles-of-association.aspx.

Where the Employee Benefit Trust ('EBT') holds shares for unvested awards the voting rights for these shares are exercisable by the trustees of the EBT at their discretion, taking into account the recommendations of the Group. For shares that have vested into respective sub funds underneath the EBT, the voting rights are exercisable by the trustees of the respective sub funds at their discretion, taking into account the recommendations of the relevant participant of the respective sub funds.

Restrictions on transfer of shares

The orderly market arrangements which were entered into by certain shareholders and the Company on 22 June 2010 ended on 5 July 2012. For a period of 24 months from 5 July 2010 the orderly market arrangements restricted trading for certain shares if the disposal negatively affected the orderly market in ordinary shares.

In connection with the recent £250 million equity raising, TDR Capital Entities and Sun Capital Entities (as referred to in the Prospectus issued by the Company on 30 January 2013) have irrevocably and unconditionally agreed, in lock up deeds executed in favour of the Company, not to sell, transfer or otherwise dispose of their respective holdings of ordinary shares that they legally or beneficially held on 30 January 2013 for a period of six months from that date. The lock up deeds contain certain exceptions in respect of sales, transfers or other dispositions to relatives, holding companies, subsidiaries, other members of the same group of companies, affiliates and connected persons.

Under the Articles, the Directors may in certain circumstances refuse to register transfers of shares. In particular, the Board of Directors may refuse to register the transfer of shares to a person who is a Non-Qualified Person (as defined in the Articles).

Certain restrictions on the transfer of shares may be imposed from time to time by applicable laws and regulations (for example, insider trading laws), and pursuant to the Listing Rules of the Financial Services Authority ('FSA') and the Group's own share dealing rules whereby Directors and certain employees of the Group require the approval of the Company to deal in the Company's ordinary shares.

Directors' report
continued

Substantial shareholdings

Information provided to the Company pursuant to the FSA's Disclosure and Transparency Rules is published on a Regulatory Information Service and on the Company's website. As at 21 March 2013, the Company had been notified or was aware of the following significant holdings of voting rights in its shares.

	Number of voting rights in shares	Percentage of shares in issue
TDR Capital Nominees Limited[1]	35,923,409	15.99%
OZ Management LP and Och-Ziff Management Europe Ltd[2]	18,899,551	8.41%
Hugh Osmond[3]	13,229,201	5.89%
Xercise2 Limited[4]	11,952,611	5.32%
William Alan McIntosh	9,597,493	4.27%
Royal London Asset Management Limited	8,035,252	3.58%
Martin E Franklin	7,047,238	3.14%
Nicolas Berggruen Charitable Trust	7,028,190	3.13%

1 TDR Capital Nominees Limited is controlled by TDR Capital LLP, of which Manjit Dale is a Partner. The stated shareholding includes ordinary shares held by Jambright Limited, TDR Shares Limited and Jambright Midco Limited.

2 The number of voting rights in the shares held by OZ Management LP and Och-Ziff Management Europe Ltd presented in the table above includes voting rights attached to shares held by those entities as well as voting rights in relation to swap transactions in the shares notified by those entities.

3 7,787,459 ordinary shares held by Hugh Osmond are also included in the figure for Xercise2 Limited shown above.

4 Xercise2 Limited is controlled by affiliates of Sun Capital Partners, which comprises the following principals: Hugh Osmond, Matthew Allen, Edward Hawkes and Marc Jonas or, where the context requires, certain vehicles or entities controlled by or associated with such persons.

Annual General Meeting ('AGM')

The AGM of the Company will be held at 32 Commercial Street, St Helier, Jersey JE2 3RU on Thursday, 2 May 2013 at 1pm.

A separate notice convening this meeting will be distributed to shareholders in due course and will include an explanation of the items of business to be considered at the meeting.

Board

Board of Directors

The membership of the Board and biographical details of the Directors are given on pages 48 to 51 and are incorporated by reference into this report. Details of Directors and their connected persons' beneficial and non-beneficial interests in the shares of the Company are shown in the Remuneration report on pages 62 to 78.

During 2012 and up to the date of this report, the following changes to the Board took place:

– Howard Davies was appointed as Chairman of the Board with effect from 1 October 2012 in succession to Ron Sandler.

– Jim McConville was appointed to the Board on 28 June 2012 as Group Finance Director.

Details of related party transactions which took place during the year with Directors of the Company and entities where Directors are deemed to have significant influence, are provided in the Remuneration report and in note 45 to the IFRS financial statements.

The rules about the appointment and replacement of Directors are contained in the Company's Articles. These state that a Director may be appointed by an ordinary resolution of the shareholders or by a resolution of the Directors. If appointed by a resolution of the Directors, the Director concerned holds office only until the conclusion of the next AGM following the appointment.

In accordance with the UK Corporate Governance Code, Directors must stand for re-election annually. Ian Ashken and Charles Clarke will, as stated in the Chairman's statement, not be offering themselves for re-election at the AGM on 2 May 2013. The Board of Directors is unanimously recommending the re-election of the remainder of the Board and, in the case of Howard Davies and Jim McConville, their election to the Board.

The Articles give details of the circumstances in which Directors will be treated as having automatically vacated their office and also state that the Company's shareholders may remove a Director from office by passing an ordinary resolution.

The powers of the Directors are determined by Cayman Islands Company Law, Cayman Islands common law, the provisions of the Company's Memorandum and Articles and by any valid directions given by shareholders by way of special resolution.

The Directors have been authorised to allot and issue securities and grant options over or otherwise dispose of shares under Article 14.

At the Company's AGM held on 3 May 2012, shareholders granted the Company authority to purchase up to 10% of its issued ordinary shares. Any ordinary shares purchased under the authority would, subject to the Cayman Islands Companies Law (as amended), either be cancelled or held in treasury. These authorities were not used during the year or up to the date of this report.

Subject to obtaining shareholder approval for the renewal of this authority at the forthcoming AGM, the Company is authorised to make purchases of its own shares under Article 20 and make payment for the redemption or purchase of its own shares in any manner permitted by the Cayman Islands Companies Law (as amended), applicable law or regulation, including without limitation, out of capital, profits, share premium or the proceeds of a new issue of shares. The Company held no treasury shares during the year or up to the date of this report.

Directors' remuneration and interests

A report on Directors' remuneration is presented on pages 62 to 78 including details of their interests in shares and share options or any rights to subscribe for shares in the Company.

Directors' indemnities

Following shareholder approval on 15 March 2010, the Company entered into a deed of indemnity by way of deed poll with its Directors whereby the Company has agreed to indemnify each Director against all losses incurred by them in the exercise, execution or discharge of their powers or duties as a Director of the Company, provided that the indemnity shall not apply to the extent prohibited by any applicable law.

The deed of indemnity remains in force as at the date of signature of this Directors' report.

Directors' conflicts of interest

The Board has established procedures for handling conflicts of interest in accordance with Cayman Islands law and the Company's Articles.

On an ongoing basis, Directors are responsible for informing the Company Secretary of any new, actual or potential conflicts that may arise.

All Directors and employees of the Company and its subsidiaries are subject to the Group conflicts of interest policy which has been established to provide a clear framework for an effective system of internal control to manage conflicts of interest throughout the Group.

Directors' and Officers' liability insurance

The Company maintains Directors' and Officers' liability insurance cover which is renewed annually.

Governance

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business review. The Business review includes details on the Group's cash flow and capital management. Principal risks and their mitigation are detailed on page 46. In addition, the financial statements include, amongst other things, notes on the Group's borrowings (note 21), management of its financial and insurance risk including market, credit and liquidity risk (note 42), its commitments and contingent liabilities (notes 44 and 46) and its capital position and management (note 41).

The Board has followed the UK Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' when performing its going concern assessment. As part of its comprehensive assessment of whether the Group and the Company are a going concern, the Board has undertaken a review of the valuation and liquidity of its investments as at the date of the statement of consolidated financial position. The Board has also reviewed solvency and cash flow projections under both normal and stressed conditions. Having thoroughly considered the going concern assessment, including a detailed review of the solvency and cash flow positions of each subsidiary company and the availability across the Group of a range of management actions, the Board has concluded that there are no material uncertainties that may cast significant doubt about the Group and the Company's ability to continue as a going concern. The Directors have a reasonable expectation that the Group and the Company have adequate resources to continue in operational existence for the foreseeable future. Thus, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Directors' report
continued

Corporate governance statement
The disclosures required by section 7.2 of the FSA's Disclosure and Transparency Rules can be found in the Corporate governance report on pages 53 to 61 which is incorporated by reference into this Directors' report.

Financial controls
The Group operates a Risk Management Framework ('RMF') consisting of several components, as detailed in the Risk management section on page 42. The RMF provides a consistent approach to highlighting and controlling key risks throughout the organisation. This is achieved primarily through review and compliance, at a functional level, with the risk universe and related policies (and the risk appetites therein). At its highest level the RMF considers the following risks: strategic, market, credit, insurance, financial soundness and operational. As a result, in preparing the consolidated financial statements, assessment is given to a broad range of risk categories.

Memorandum and Articles
Changes to the Company's Memorandum and Articles require prior shareholder approval and in some cases, approval of the Group's main lenders.

The Memorandum and Articles are available on the Company's website at www.thephoenixgroup.com/about-us/corporate-governance/articles-of-association.aspx.

Re-appointment of the Auditors
Ernst & Young Accountants LLP has indicated its willingness to continue in office and a resolution that it be re-appointed will be proposed at the AGM. There is a liability cap in place in relation to audit work that is carried out by Ernst & Young Accountants LLP on the consolidated IFRS financial statements. For the MCEV supplementary information and the Group's UK subsidiaries' individual financial statements, which are audited by Ernst & Young LLP, there is no cap on auditor liability.

Details of fees paid to Ernst & Young during 2012 for audit and non-audit work are disclosed in note 10 to the IFRS financial statements.

Disclosure of information to Auditors
The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware and that each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Group Company Secretary
The Group Company Secretary throughout the period was Gerald Watson.

Contractual/other

Significant agreements impacted by a change of control of the Company
Details of the change of control provisions contained in the amended contingent rights agreements dated 22 June 2010 are set out in note 14 to the IFRS financial statements.

There are change of control clauses contained in certain of the Group's financing agreements. Upon a change of control of the Company, the principal amounts outstanding and the accrued interest under the Pearl and Impala facility agreements, the Pearl loan notes, the Royal London PIK facility and Royal London PIK notes would become immediately repayable or be required to be immediately redeemed.

In addition, certain provisions of the Articles relating to the City Code on Takeovers and Mergers apply in connection with a takeover bid. The Articles are available on the Company's website at www.thephoenixgroup.com/about-us/corporate-governance/articles-of-association.aspx.

All of the Company's employee share and incentive plans contain provisions relating to a change of control. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions and pro rata reduction as may be applicable under the rules of the employee share incentive plans.

Apart from the aforementioned, there are a number of agreements that take effect, alter or terminate upon a change of control of the Company, such as commercial contracts and joint venture agreements. None is considered to be significant in terms of their potential impact on the business of the Group.

Essential contracts or arrangements

There are a number of relationships with third parties which are of significant value to the Group. Apart from the two main credit facilities, no single relationship is considered to be essential to the Group.

Supplier payment policy

The Company and its subsidiaries have signed up to the Prompt Payment Code, signatories to which undertake to pay suppliers on time, give clear guidance to suppliers and encourage good practice. It remains the policy of the Group to pay suppliers within 30 days of the invoice date or, if different, in accordance with any terms agreed with suppliers.

Group employees

The Group is committed to achieving equality of opportunity and the equal treatment of all our people and those applying to join us. To this end, all our people share an obligation to their colleagues, customers and business partners to provide a safe, fair and equitable working environment in which every individual can seek, obtain and continue employment without experiencing any unfair or unreasonable discrimination.

The Group recognises the need to treat people with disabilities fairly and equally. Full and fair consideration is given to applications for employment by people with a disability. Applicants are asked if they have any special requirements when invited to attend an interview and reasonable provisions are made to meet the applicant's request. Applicants are considered on the basis of the job requirements and the individual's ability and competencies, also taking into consideration any appropriate reasonable workplace adjustments.

Employee practice

Phoenix Group continues to communicate with staff across a variety of channels, including regular news bulletins via the intranet, staff magazines and newsletters, Executive Committee presentations and other face-to-face briefings. At these regular staff briefings and Executive Committee presentations the next stage of the Company's strategy/development is outlined, and information provided to staff on the economic factors which could affect the Company's strategy and performance. Regular feedback mechanisms are also in place, ensuring communication at Phoenix is a continuous two-way dialogue.

The views and opinions of staff are sought through Phoenix's annual Engagement Survey and more regular 'temperature check' surveys and forums. Phoenix undertakes meaningful consultation with staff representatives on all major organisational changes and other matters affecting employees.

Political donations

No political donations were made during the year ended 31 December 2012. The Company and its subsidiaries do not intend to make donations to political parties or independent election candidates nor have they made or do they intend to make any donations to EU political organisations or incur EU political expenditure.

Charitable contributions

During the year the Group made charitable donations of over £80,000 details of which are presented in the Corporate responsibility section on pages 84 to 89.

Clive Bannister

Clive Bannister
Group Chief Executive Officer

James McConville

James McConville
Group Finance Director

St Helier, Jersey
21 March 2013

"At Phoenix Group we are committed to managing our business in a responsible manner, taking seriously the impact we have on our employees, our stakeholders, the communities in which we operate and the wider environment. We believe that operating responsibly creates value for our business through building the trust and confidence of our stakeholders."

Lucy Symonds,
Corporate Responsibility Manager

Corporate responsibility

In this section

Corporate responsibility

We are delighted with the new links we have forged during the year, be it with other businesses, charities or educational institutions. These together with existing relationships are helping to shape where we go with our corporate responsibility offering, so together we are making a difference in the communities in which we are based.

Governance

Corporate responsibility ('CR') is sponsored at the highest level by the Group Chief Executive Officer. A 'CR Working Group', including two Executive Committee members, meets quarterly to discuss CR activity from across the Group.

All staff can access the Group's CR Policy and accompanying Code of Business Ethics and Ethical Conduct, and complete annual refresher training in this regard.

2012 summary

Following a Group-wide employee CR survey in 2011, it was communicated that the focus for 2012 would be to raise the profile of CR internally. Considerable progress was made during 2012.

The 2012 CR survey revealed positive scores in relation to the internal promotion of CR, increased understanding and commitment from staff, and an appreciation of a collective responsibility to ensure that the Group remains sustainable into the future.

The Group employed over 1,200 staff at the end of 2012. The Group's core sites are Wythall, near Birmingham, Glasgow, and two offices in London. CR is reported collectively, however initiatives are driven by site, and relevant to the local community.

CR is categorised and reported in four areas: Environment, Workplace, Community and External stakeholders, similar categorisation to that used by Business in the Community ('BITC'). The Group has continued its membership with BITC, and values the support and resources it makes available. The Group completed the Responsible Business Check-up and achieved an improved score on the previous year's submission, demonstrating the successes achieved on the CR programme during the year.

Environment – *our commitment to monitoring and reducing our environmental footprint*

The Group's environmental impact is relatively low, when compared to other industry sectors. However, it is accepted that steps can be taken to further reduce this impact.

The Group has forged links with Cass Business School, part of City University London. One of Cass's MBA students undertook an internship within the Group, to work on a real-life business project focusing on environmental reporting. The Group subsequently launched an 'Environmental Statement' and 'Environmental and Sustainability Tracker' for its core sites, measuring energy consumption, print statistics, and a variety of recycling data. Once the Group has tracked a full year, measures can then be put in place to identify areas for improvement.

During the year, a facility named 'The Link' was launched which provides information about the CR programme. The facility promotes the 3Rs – Reduce, Re-use and Recycle, and includes a book swap facility, and various recycling options. This has proved very popular and the proceeds actively support local charitable fundraising.

In 2011 the Group committed to sourcing paper from sustainable, managed forests. This is paper that has been accredited 'Programme for the Endorsement of Forest Certification' ('PEFC') and 'Forest Stewardship Council' ('FSC'). The Group achieved this, and reduced the number of suppliers in this area. In addition to the cost-saving and environmental benefits, this simplifies the supply chain and reduces the quantity of invoices and deliveries.

The Group's IT system has gone through a period of transition and we have moved to a new service provider. Newly installed printers are eco-friendly, consume less energy, and produce lower CO2 emissions. Print statistics are being tracked, and employees are reminded of the environmental impact of printing.

Video conferencing facilities have been improved at all sites, reducing the extent of business travel, and a conferencing facility has opened at Wythall lessening the need for hiring offsite meeting facilities. Staff will shortly have the added benefit of instant messaging and teleconferencing facilities available from their desktops. All former IT equipment has been re-used, recycled or disposed of via a registered 'Waste Electrical and Electronic Equipment' scheme.

Corporate responsibility
continued

Workplace – *how we treat our employees, including how we attract, develop and retain the best talent*

The Group was voted one of 'Britain's Top Employers 2012', which is a certification awarded only to organisations that meet the highest standards in Human Resources policy benchmarking. Companies awarded this accreditation are independently recognised as being amongst the best companies to work for in the UK.

A one-day CR event, focusing on employee wellbeing was held at the Wythall site. It included a low-impact exercise class, free cholesterol testing and blood pressure monitoring, and access to an array of information on diet, health and exercise.

Employee engagement and benefits

96% of employees participated in the 2012 employee survey, which achieved an overall employee engagement index of 73% (2011: 74%). 39 questions were asked, and when ranked against either the Financial Services or Private Sector benchmarks, the Group achieved 32 questions which were either equal to or above benchmark.

The Group values the contribution its employees make to the business, so in return offers a wide range of policies and benefits, designed to attract, develop and retain the best and most talented individuals. Staff have access to:

A robust reward and remuneration framework, ensuring market-related pay whilst enabling flexibility to recognise individual contribution;

A flexible benefits scheme for Phoenix Group and Life employees involving 24 options. Last year 80% of staff opted for at least one benefit. Ignis has a similar scheme in operation. Alongside this, staff can sign up to 'Give as you Earn', to donate a portion of their monthly salary to charitable causes;

A Share Save Scheme and / or Share Incentive Plan. At the end of 2012, 53% of staff participated in the Share Save Scheme, and 22% of eligible staff participated in the Share Incentive Plan;

An Annual Incentive Plan. Phoenix Group and Life reward both personal and Company performance. It looks at 'what' has been achieved by the individual, and 'how' they achieved it. The weighting of personal versus Company performance varies by grade. This scheme is discretionary and does not form part of an individual's contract. A similar plan is also in operation within Ignis;

A recognition scheme within Phoenix Group and Life actively encourages and recognises performance that is above and beyond an individual's remit, or considers the manner in which they conducted a piece of work worthy of recognition; and

An employee assistance scheme within Phoenix Group and Life, which incorporates legal, financial and medical assistance.

The Group supports a range of flexible working arrangements, both formal and informal, including homeworking. In a recent employee survey 80% of respondents agreed with the statement, 'My work-life balance is acceptable to me' against a Financial Services benchmark of 73%.

Employee metrics

The Group employs a diverse workforce as evidenced by the percentage of ethnic minority employees compared to our peers, and relatively high numbers of female employees compared to the financial services sector as a whole.

The Group recognises the importance of continued staff development and manages a variety of external and in-house training programmes, ranging from induction, through to coaching and leadership skills. Voluntary staff turnover and absence rates compare very favourably with industry benchmarks.

New starter survey responses continue to generate positive results, an example being 95% of respondents agreeing with the statement 'I would tell people this is a great place to work', against a Financial Services benchmark of 61%.

	2012	2011	2010
Total staff across all sites	1,229	1,394	1,298
Total full time equivalent across all sites	1,191	1,351	NC
Workforce that is of non-white British origin	16%	11%	13%
Workforce that is female	44%	40%	NC
Staff turnover (employees choosing to leave voluntarily)	7.1%	7.5%	9.9%
Annual new starter turnover (employees leaving voluntarily within 12 months of starting)	10%	10%	13%
Percentage of days lost through sickness	1.8%	1.4%	1.3%
Percentage of employees sponsored on a professional qualification	25.2%	22.6%	17.4%
Total number of external staff training days	2,266	1,961	NC
Total spend on external staff training	£0.7m	£1.1m	NC

NC – not collected

Community – *the contribution we make to the communities in which we operate and our obligations to the broader society*

The Group continues to work with existing contacts, whilst forging new links with local charities, educational establishments and youth groups to give greater support to the communities in which we are based.

Charitable donations

The Group actively encourages its staff to support local charities, and makes clear the types of charity it will support, and those with which it does not actively engage. The Group does not support any religious or political causes. It primarily supports local charities that are registered in the UK, and which are chosen by employees.

Charitable donations include:

- staff fundraising events held at our offices
- matched donations for employees participating in charitable activity
- donations to selected causes.

Additional information on all staff fundraising activity is included within the CR section of the Group website, together with charity partner information.

During 2012, over £80,000 was donated by the Group to charitable causes. In addition, £23,000 was raised through fundraising activities onsite. Due to the number of causes supported, details are only provided on the largest donations and any Group-wide activity.

Staff at the Wythall site voted to support the Willow Foundation as part of an extended fundraiser, which was aptly named 'Challenge 2012' in the spirit of the year's wider sporting achievements. In excess of £25,000 was raised. Staff were involved in various challenges, ranging from a static triathlon, a mile run around the site, a bike ride from Wythall to the London office, and participation in the Bupa Great Birmingham Run. Willow provides positive and life-enhancing special day experiences for seriously ill 16-40 year olds.

In lieu of sending printed Christmas cards, the Group donated £5,000 to the Anthony Nolan charity. This charity was chosen by way of a Group-wide staff vote. Anthony Nolan charity saves the lives of people with blood cancer by matching donors who are willing to donate their blood stem cells to people who need lifesaving transplants.

Two fundraising events were supported Group-wide, engaging staff across all business divisions. Movember raised awareness and funds for men's health partners – Prostate Cancer UK and Institute of Cancer Research. In excess of £7,500 was donated by the Group. Macmillan Cancer Research coffee mornings were also held during September at offices in Glasgow and London, raising £2,500.

Corporate responsibility
continued

Volunteering

Staff at the Wythall office participated in BITC's national day of employee volunteering, named 'Give and Gain', which involved 10,091 employees from 202 companies.

The Group has recently partnered with the Credit Action charity to roll out their financial education training to 11-16 year olds at schools within the vicinity of Wythall. 20 members of staff have been trained, and will visit schools from March 2013 as part of the year-long volunteering programme.

Community links

Ignis staff in Glasgow have forged close links with Glasgow Arts School. Activities have included resident artist Anna Sundt producing artwork for the workplace, and student mentoring. A staff photography competition took place with12 winning entries being included in a 2013 charity calendar. Proceeds from calendar sales were donated to Yorkhill Children's Foundation – a charity providing medical equipment and resources to sick children and babies being treated at Yorkhill Hospital within NHS Greater Glasgow and Clyde. Ignis plans to continue its support over the next few years by raising funds for a new 'play and dining room' at the new children's hospital, part of the New South Glasgow Hospitals Project.

From the Wythall site, support has continued with Wythall Community Association, and £3,000 was donated to a local Scout Group to assist them with extending their Scout HQ, within Wythall Park's grounds.

In December, links were forged with a local hotel and Age UK branches in Redditch & District, Solihull and Bromsgrove & District to offer Christmas lunches for their clients and support workers. Three lunches were paid for and co-ordinated by the Group with around 320 attending.

External stakeholders – *our relationships with customers, investors, lenders, outsource and other business partners, suppliers, regulators, Government and the media*

Customers

The Group continues to recognise the responsibility it has to all customers. In today's difficult financial climate it remains committed to providing a safe and helpful environment upon which customers can rely.

A programme of customer research continues – in particular telephone surveys are used which reach an average of 1,500 customers each month. The results are positive, with customers scoring all aspects of service highly. Research of this type is invaluable as it helps the Group provide a responsible, fair and helpful service, and creates an opportunity for customers to recommend improvement.

The launch of the renewed customer-facing website www.phoenixlife.co.uk has benefitted customers since they view the site as a channel where they can contact Phoenix when it suits them, in order to obtain information about products and services. It also provides customers with valuable information across some of the key lifecycle events, such as planning for retirement and saving, as well as providing downloadable 'how to' guides.

The Group is a corporate member of the Plain English Campaign, demonstrating its commitment to provide customers with communications that are fair, clear and not misleading. The 'All Formats' charter mark is referenced on customer communications, highlighting that information is available in alternative formats, such as large print, Braille, on cassette or CD.

The Group treats all customer complaints seriously and aims to ensure fair and prompt treatment. Ownership of each complaint is clearly identifiable, with trust and confidence being built throughout the process.

Procurement

During the year, the Group signed up to the UK Government's Prompt Payment Code. The Code was introduced four years ago, with the aim of transforming the culture of late payment in the business community. The Group undertakes to pay suppliers on time, provide clear guidance to suppliers, and encourages good practice.

The due diligence process for suppliers has been enhanced and now includes Health and Safety, Information Security and CR criteria.

At the Wythall site the procurement of consumables for the staff restaurant continues to support local businesses as part of its 'buy local initiative'.

Media

The Group continues to keep local media up-to-date with CR initiatives and fundraising, which helps to raise awareness of the Group in the communities in which we are based.

Investors

Investors are kept informed of the Group's financial results and announcements with regular communications through the Investor Relations team.

Responsible investment

The Group continues to support the principles of good stewardship as set out on Ignis' website www.ignisasset.com. The Group takes its responsibilities seriously and considers the environmental, social and governance procedures of any companies in which it invests.

Conclusion

We continue to be committed to our CR agenda, and seek to remain a responsible organisation and employer in the communities in which we are based.

For more information on the Group's CR programme, please contact Lucy Symonds, Corporate Responsibility Manager, at corporateresponsibility@thephoenixgroup.com

IFRS financial statements

In this section

Statement of Directors' responsibilities

Board Responsibility Statement according to section 5:25c(2)(c) of the Dutch Financial Markets Supervision Act.[1]

The Board of Directors of Phoenix Group Holdings hereby declares that, to the best of its knowledge:

- the Directors are responsible for the preparation of the Annual Report and Accounts;
- the IFRS financial statements for the year ended 31 December 2012 give a true and fair view of the assets, liabilities, financial position and results of Phoenix Group Holdings and its consolidated subsidiaries taken as a whole;
- the Annual Report and Accounts gives a true and fair view of the state of affairs of Phoenix Group Holdings and its consolidated subsidiaries as at 31 December 2012 and their development in the financial year to which the Annual Report and Accounts relate; and
- the Annual Report and Accounts describes the principal risks facing Phoenix Group Holdings.

Clive Bannister
Group Chief Executive Officer

James McConville
Group Finance Director

St Helier, Jersey
21 March 2013

1 The Company's home member state is the Netherlands as a result of its original listing on Euronext Amsterdam and is therefore governed by the Dutch Financial Markets Supervision Act.

Independent Auditor's report

To: The Meeting of Shareholders of Phoenix Group Holdings

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements 2012 of Phoenix Group Holdings, Cayman Islands, and its subsidiaries ('the Group'), which comprise the statement of consolidated financial position as at 31 December 2012, the consolidated income statement, the statement of consolidated comprehensive income, the proforma reconciliation of Group operating profit to result attributable to owners, the statement of consolidated changes in equity and the statement of consolidated cash flows for the year then ended, and notes, comprising a summary of the significant accounting policies and other explanatory information.

Directors' responsibility

The Directors are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and for the preparation of the Directors' report. Furthermore the Directors are responsible for such internal control as they determine necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion with respect to the consolidated financial statements

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2012 and of its result and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Matters on which we are required to report by exception

We have nothing to report in respect of the following items that we are required to review under the Listing Rules:

- the Directors' statement, set out on page 81, in relation to going concern;
- the part of the Corporate Governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the Directors' report to the shareholders on Directors' remuneration.

Opinion on other matters because of voluntary compliance with the UK Companies Act 2006

- The part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.
- In our opinion the information given in the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group consolidated financial statements.

Matters on which we report by exception because of voluntary compliance with the UK Companies Act 2006

We have nothing to report in respect of the following items that we are required to report to you under the UK Companies Act 2006 if, in our opinion:

- adequate accounting records have not been kept by the Group, or returns adequate for our audit have not been received from branches not visited by us; or
- the consolidated financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

The Hague, 21 March 2013

Ernst & Young Accountants LLP
signed by
S. B. Spiessens

Consolidated income statement
For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Gross premiums written		**1,609**	1,473
Less: premiums ceded to reinsurers	6	**(5,173)**	(85)
Net premiums written		**(3,564)**	1,388
Fees	7	**157**	170
Net investment income	8	**4,581**	4,920
Total revenue, net of reinsurance payable		**1,174**	6,478
Other operating income		**13**	12
Net income		**1,187**	6,490
Policyholder claims		**(5,166)**	(4,968)
Less: reinsurance recoveries		**364**	224
Change in insurance contract liabilities		**645**	(1,338)
Change in reinsurers' share of insurance contract liabilities		**5,142**	222
Transfer (to)/from unallocated surplus	20	**(45)**	16
Net policyholder claims and benefits incurred		**940**	(5,844)
Change in investment contract liabilities		**(750)**	260
Acquisition costs		**(3)**	(13)
Change in present value of future profits	32	**–**	(19)
Amortisation of acquired in-force business	32	**(122)**	(134)
Amortisation of customer relationships	32	**(18)**	(18)
Administrative expenses	9	**(585)**	(606)
Net (expense)/income attributable to unitholders		**(111)**	131
Total operating expenses		**(649)**	(6,243)
Profit before finance costs and tax		**538**	247
Finance costs	11	**(215)**	(251)
Profit/(loss) for the year before tax		**323**	(4)
Tax attributable to policyholders' returns	12	**(33)**	(173)
Profit/(loss) before the tax attributable to owners		**290**	(177)
Tax credit/(charge)	12	**86**	(94)
Add: tax attributable to policyholders' returns	12	**33**	173
Tax credit attributable to owners	12	**119**	79
Profit/(loss) for the year attributable to owners		**409**	(98)
Attributable to:			
Owners of the parent		**392**	(131)
Non-controlling interests	18	**17**	33
		409	(98)
Earnings per ordinary share			
Basic earnings per ordinary share	14	**226.3p**	(76.2p)
Diluted earnings per ordinary share	14	**226.2p**	(76.2p)

Statement of consolidated comprehensive income
For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Profit/(loss) for the year		**409**	(98)
Other comprehensive income:			
Actuarial (losses)/gains of defined benefit pension schemes	31	**(422)**	251
Foreign exchange rate movements		**(8)**	–
		(430)	251
Tax credit on actuarial (losses)/gains of defined benefit pension schemes	12	**110**	1
		(320)	252
Total comprehensive income for the year		**89**	154
Attributable to:			
Owners of the parent		**72**	121
Non-controlling interests		**17**	33
		89	154

Pro forma reconciliation of Group operating profit to result attributable to owners
For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Operating profit			
Phoenix Life		**399**	395
Ignis Asset Management		**43**	46
		442	441
Group costs		**(32)**	(54)
Total operating profit before adjusting items		**410**	387
Investment return variances and economic assumption changes on long-term business	5	**1**	(338)
Variance on owners' funds	5	**(13)**	9
Amortisation of acquired in-force business		**(109)**	(121)
Amortisation of customer relationships		**(18)**	(18)
Non-recurring items	4.2	**130**	14
Profit/(loss) before finance costs attributable to owners		**401**	(67)
Finance costs attributable to owners		**(111)**	(110)
Profit/(loss) before the tax attributable to owners	4.2	**290**	(177)
Tax credit attributable to owners		**119**	79
Profit/(loss) for the year attributable to owners		**409**	(98)

Statement of consolidated financial position
As at 31 December 2012

	Notes	2012 £m	2011 £m
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	15	**–**	–
Share premium		**982**	1,054
Other reserves		**5**	5
Shares held by employee trust and Group entities	16	**(10)**	(11)
Foreign currency translation reserve		**85**	93
Retained earnings		**596**	511
Total equity attributable to owners of the parent		**1,658**	1,652
Non-controlling interests	18	**724**	714
Total equity		**2,382**	2,366
Liabilities			
Pension scheme deficit	31	**197**	–
Insurance contract liabilities			
Liabilities under insurance contracts	19	**45,730**	51,800
Unallocated surplus	20	**893**	848
		46,623	52,648
Financial liabilities			
Investment contracts		**8,096**	7,978
Borrowings	21	**3,046**	3,152
Deposits received from reinsurers	22	**454**	472
Derivatives	23	**3,026**	4,292
Net asset value attributable to unit holders		**4,671**	3,209
Obligations for repayment of collateral received	24	**10,458**	13,005
	25	**29,751**	32,108
Provisions	26	**67**	59
Deferred tax	27	**409**	673
Reinsurance payables		**47**	33
Payables related to direct insurance contracts	28	**393**	707
Current tax	27	**71**	105
Accruals and deferred income	29	**166**	175
Other payables	30	**509**	627
Liabilities classified as held for sale	3	**5,479**	–
Total liabilities		**83,712**	87,135
Total equity and liabilities		**86,094**	89,501

Statement of consolidated financial position
As at 31 December 2012
continued

	Notes	2012 £m	2011 £m
ASSETS			
Pension scheme surplus	31	**137**	314
Intangible assets			
Goodwill		**96**	115
Acquired in-force business		**1,622**	1,882
Customer relationships		**384**	402
Present value of future profits		**23**	23
	32	**2,125**	2,422
Property, plant and equipment	33	**24**	28
Investment property	34	**1,727**	1,816
Financial assets			
Loans and receivables		**1,914**	3,529
Derivatives	23	**3,665**	6,099
Equities		**11,005**	11,078
Fixed and variable rate income securities		**40,892**	42,010
Collective investment schemes		**6,044**	6,251
	35	**63,520**	68,967
Insurance assets			
Reinsurers' share of insurance contract liabilities	19	**3,204**	3,153
Reinsurance receivables		**64**	257
Insurance contract receivables		**10**	14
		3,278	3,424
Current tax	27	**6**	8
Prepayments and accrued income		**500**	599
Other receivables	38	**439**	200
Cash and cash equivalents	39	**9,028**	11,723
Assets classified as held for sale	3	**5,310**	–
Total assets		**86,094**	89,501

Statement of consolidated cash flows
For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Cash flows from operating activities			
Cash (utilised)/generated by operations	40	**(2,291)**	3,692
Taxation paid		**(70)**	(16)
Net cash flows from operating activities		**(2,361)**	3,676
Cash flows from investing activities			
Purchase of property, plant and equipment		**–**	(7)
Net cash flows from investing activities		**–**	(7)
Cash flows from financing activities			
Proceeds from issuing shares in subsidiaries to non-controlling interests		**33**	1
Proceeds of new policyholder borrowings		**90**	98
Ordinary share dividends paid		**(72)**	(55)
Coupon on Perpetual Reset Capital Securities paid		**(26)**	(26)
Dividends paid to non-controlling interests		**(23)**	(21)
Repayment of policyholder borrowings		**(43)**	(825)
Repayment of shareholder borrowings		**(172)**	(174)
Interest paid on policyholder borrowings		**(18)**	(21)
Interest paid on shareholder borrowings		**(103)**	(111)
Net cash flows from financing activities		**(334)**	(1,134)
Net (decrease)/increase in cash and cash equivalents		**(2,695)**	2,535
Cash and cash equivalents at the beginning of the year		**11,723**	9,188
Cash and cash equivalents at the end of the year	39	**9,028**	11,723

Statement of consolidated changes in equity
For the year ended 31 December 2012

	Share capital (note 15) £m	Share premium £m	Other reserves £m	Shares held by the employee trust and Group entities (note 16) £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 18) £m	Total £m
At 1 January 2012	–	1,054	5	(11)	93	511	1,652	714	2,366
Profit for the year	–	–	–	–	–	392	392	17	409
Other comprehensive income for the year	–	–	–	–	(8)	(312)	(320)	–	(320)
Total comprehensive income for the year	–	–	–	–	(8)	80	72	17	89
Dividends paid on ordinary shares	–	(73)	–	–	–	–	(73)	–	(73)
Dividends paid to non-controlling interests	–	–	–	–	–	–	–	(23)	(23)
Coupon paid to non-controlling interests, net of tax relief	–	–	–	–	–	–	–	(19)	(19)
Shares issued in lieu of cash dividends	–	1	–	–	–	–	1	–	1
Credit to equity for equity-settled share-based payment	–	–	–	–	–	5	5	–	5
Shares in subsidiaries subscribed for by non-controlling interests	–	–	–	–	–	–	–	35	35
Shares sold by employee trust	–	–	–	1	–	–	1	–	1
At 31 December 2012	–	982	5	(10)	85	596	1,658	724	2,382

Statement of consolidated changes in equity
For the year ended 31 December 2011

	Share capital (note 15) £m	Share premium £m	Other reserves £m	Shares held by the employee trust and Group entities (note 16) £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 18) £m	Total £m
At 1 January 2011	–	1,109	5	(13)	93	386	1,580	720	2,300
(Loss)/profit for the year	–	–	–	–	–	(131)	(131)	33	(98)
Other comprehensive income for the year	–	–	–	–	–	252	252	–	252
Total comprehensive income for the year	–	–	–	–	–	121	121	33	154
Dividends paid on ordinary shares	–	(72)	–	–	–	–	(72)	–	(72)
Dividends paid to non-controlling interests	–	–	–	–	–	–	–	(21)	(21)
Coupon paid to non-controlling interests, net of tax relief	–	–	–	–	–	–	–	(19)	(19)
Shares issued in lieu of dividends	–	17	–	–	–	–	17	–	17
Credit to equity for equity-settled share-based payments	–	–	–	–	–	6	6	–	6
Shares in subsidiaries subscribed for by non-controlling interests	–	–	–	–	–	–	–	1	1
Shares distributed by employee trust	–	–	–	2	–	(2)	–	–	–
At 31 December 2011	–	1,054	5	(11)	93	511	1,652	714	2,366

Phoenix Group Holdings is subject to Cayman Islands Companies Law. Under Cayman Islands Companies Law distributions can be made out of profits or share premium subject, in each case, to a solvency test. The solvency test is broadly consistent with the Group's going concern assessment criteria.

Retained earnings comprise the owners' interest in the post acquisition retained earnings of the subsidiary companies and the retained earnings of the Company. Distribution of the retained earnings held within the long-term business funds and surplus assets held within the owners' funds of the life companies is subject to retaining sufficient funds to protect policyholders' interests.

There is a restriction on the ability of certain subsidiary companies to distribute funds to Phoenix Group Holdings as a result of restrictions imposed by the Group's two main credit agreements, namely the Pearl Facility and the Impala Facility (as described in note 21).

Notes to the consolidated financial statements

1. Accounting policies

(a) Basis of preparation

The consolidated financial statements for the year ended 31 December 2012 comprise the financial statements of Phoenix Group Holdings ('the Company') and its subsidiaries (together referred to as 'the Group').

The consolidated financial statements have been prepared on a historical cost basis except for investment property, owner-occupied property and those financial assets, financial liabilities and insurance and investment contracts with discretionary participation features ('DPF') that have been measured at fair value.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS').

The financial statements are presented in sterling (£) rounded to the nearest million except where otherwise stated.

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

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiary undertakings including collective investment schemes where the Group exercises overall control. In accordance with the principles set out in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*, collective investment schemes which are managed by the Group and where more than 50% of the units in issue are directly held by Group entities at the end of the accounting period, are included in the consolidated financial statements, with the interests of external third parties recognised as a liability, see policy (j). Certain of the collective investment schemes have non-coterminous period ends and are consolidated on the basis of additional financial statements prepared to the period end. Intragroup balances and income and expenses arising from intragroup transactions are eliminated in preparing the consolidated financial statements.

Subsidiary undertakings are consolidated from the date that effective control is obtained by the Group and are excluded from consolidation from the date they cease to be subsidiary undertakings.

The Group uses the purchase method to account for the acquisition of subsidiary undertakings. The cost of an acquisition is measured at the fair value of the consideration. Any excess of the cost of acquisition over the fair value of the net assets acquired is recognised as goodwill. Any excess of the fair value of the net assets acquired over the cost of acquisition is recognised in the consolidated income statement. Directly attributable acquisition costs are included within administrative expenses, except for acquisitions undertaken prior to 2010 when they are included within the cost of the acquisition. Costs directly related to the issuing of debt or equity securities are included within the initial carrying amount of debt or equity securities where these are not carried at fair value.

Non-controlling interests are stated at the share of net assets attributed to the non-controlling interest holder, adjusted for the relevant share of subsequent changes in equity.

(b) Critical accounting estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Group's business that typically require such estimates are the measurement of insurance and investment contract liabilities, determination of the fair value of financial assets and liabilities, impairment tests for intangible assets, income tax assets and liabilities and pension scheme assets and liabilities.

Insurance and investment contract liabilities

Insurance and investment contract liability accounting is discussed in more detail in accounting policies (e) and (f) with further detail of the key assumptions made in determining insurance and investment contract liabilities included in note 42

Fair value of financial assets and liabilities
Financial assets and liabilities are measured at fair value and accounted for as set out in accounting policies (r) and (g) respectively. Where possible, financial assets and liabilities are valued on the basis of listed market prices by reference to quoted market bid prices for assets and offer prices for liabilities. These are categorised as Level 1 financial instruments and do not involve estimates. If prices are not readily determinable, fair value is determined using valuation techniques including pricing models, discounted cash flow techniques or broker quotes. Financial instruments valued where valuation techniques based on observable market data at the period end are categorised as Level 2 financial instruments. Financial instruments valued using valuation techniques based on non-observable inputs are categorised as Level 3 financial instruments. Level 2 and Level 3 financial instruments therefore involve the use of estimates. Further details of the estimates made are included in note 36.

Impairment of intangible assets
Intangible assets are subject to regular impairment reviews as detailed in accounting policy (n). Impairments are measured as the difference between the carrying value of a particular asset and its recoverable amount. Impairments are recognised in the consolidated income statement in the period in which they occur. Further details of estimates made are included in note 32.

Income tax assets and liabilities
Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The UK taxation regime applies separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets. Any judgements made, and uncertainties considered, in arriving at the carrying value of deferred tax in the financial statements are discussed in note 27.

The accounting policy for income taxes (both current and deferred) is discussed in more detail in accounting policy (l).

Pension scheme assets and liabilities
The valuation of pension scheme assets and liabilities is determined using actuarial valuations that include a number of assumptions. As defined benefit pension plans are long-term in nature, such assumptions are subject to significant uncertainty. Details of the key assumptions used are shown in note 31.

(c) Foreign currency transactions
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in sterling, which is the Group's presentation currency.

The results and financial position of all Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

– assets and liabilities are translated at the closing rate at the period end;

– income, expenses and cash flows denominated in foreign currencies are translated at average exchange rates; and

– all resulting exchange differences are recognised through the statement of consolidated comprehensive income.

Foreign currency transactions are translated into the functional currency of the transacting Group entity using exchange rates prevailing at the date of translation. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value through profit or loss are included in foreign exchange gains and losses. Translation differences on non-monetary items at fair value through profit or loss are reported as part of the fair value gain or loss.

(d) Classification of contracts
Contracts under which the Group accepts significant insurance risk are classified as insurance contracts.

Contracts under which the transfer of insurance risk to the Group from the policyholder is not significant are classified as investment contracts.

Some insurance and investment contracts contain a DPF. This feature entitles the policyholder to additional discretionary benefits as a supplement to guaranteed benefits. Investment contracts with a DPF are recognised, measured and presented as insurance contracts.

Notes to the consolidated financial statements
continued

1. Accounting policies (continued)

(e) Insurance contracts and investment contracts with DPF

Under current IFRS requirements the Group's insurance contracts and investment contracts with DPF are measured using accounting policies consistent with those previously adopted under UK GAAP. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Insurance liabilities

Insurance contract liabilities for non-participating business, other than unit-linked insurance contracts, are calculated on the basis of current data and assumptions, using either a net premium or gross premium method. Where a gross premium method is used, the liability includes allowance for prudent lapses. Negative policy values are allowed for on individual policies:

- where there are no guaranteed surrender values; or
- in the periods where guaranteed surrender values do not apply even though guaranteed surrender values are applicable after a specified period of time.

The principal assumptions are given in note 42.

For unit-linked insurance contract liabilities the provision is based on the fund value, together with an allowance for any excess of future expenses over charges, where appropriate.

For participating business, the liabilities under insurance contracts and investment contracts with DPF are calculated in accordance with the following methodology:

- liabilities to policyholders arising from the with-profit business are stated at the amount of the realistic value of the liabilities, adjusted to exclude the owners' share of projected future bonuses;
- acquisition costs are not deferred; and
- reinsurance recoveries are measured on a basis that is consistent with the valuation of the liability to policyholders to which the reinsurance applies.

The with-profit bonus reserve for an individual contract is determined by either a retrospective calculation of 'accumulated asset share' approach or by way of a prospective 'bonus reserve valuation' method. The cost of future policy related liabilities is determined using a market consistent approach, mainly based on a stochastic model calibrated to market conditions at the end of the reporting period. Non-market related assumptions (for example, persistency, mortality and expenses) are based on experience adjusted to take into account of future trends.

The realistic liability for any contract is equal to the sum of the with-profit bonus reserve and the cost of future policy-related liabilities.

Where policyholders have valuable guarantees, options or promises in respect of the with-profit business, these costs are generally valued using a stochastic model.

In calculating the realistic liabilities, account is taken of the future management actions consistent with those set out in the Principles and Practices of Financial Management ('PPFM').

The principal assumptions are given in note 42.

Present value of future profits on non-participating business in the with-profit funds

For UK with-profit life funds an amount may be recognised for the present value of future profits ('PVFP') on non-participating business written in a with-profit fund where the determination of the realistic value of liabilities in that with-profit fund takes account, directly or indirectly, of this value.

Where the value of future profits can be shown to be due to policyholders this amount is recognised as a reduction in the liability rather than as an intangible asset. This is then apportioned between the amounts that have been taken into account in the measurement of liabilities and other amounts which are shown as an adjustment to the unallocated surplus.

Where it is not possible to apportion the future profits on this non-participating business to policyholders, the PVFP on this business is recognised as an intangible asset and changes in its value are recorded as a separate item in the consolidated income statement.

The value of the PVFP is determined in a manner consistent with realistic measurement of liabilities. In particular, the methodology and assumptions involve adjustments to reflect risk and uncertainty, are based on current estimates of future experience and current market yields and allow for market consistent valuation of any guarantees or options within the contracts. The value is also adjusted to remove the value of capital backing the non-profit business if this is included in the realistic calculation of PVFP. The principal assumptions used to calculate the PVFP are the same as those used in calculating the insurance contract liabilities given in note 42.

Embedded derivatives

Embedded derivatives, including options to surrender insurance contracts, that meet the definition of insurance contracts or are closely related to the host insurance contract, are not separately measured. All other embedded derivatives are separated from the host contract and measured at fair value through profit or loss.

Liability adequacy

At each reporting date, liability adequacy tests are performed to assess whether the insurance contract and investment contract with DPF liabilities are adequate. Current best estimates of future cash flows are compared to the carrying value of the liabilities. Any deficiency is charged to the consolidated income statement.

The Group's accounting policies for insurance contracts meet the minimum specified requirements for liability adequacy testing under IFRS 4 *Insurance Contracts*, as they allow for current estimates of all contractual cash flows and of related cash flows such as claims handling costs. Cash flows resulting from embedded options and guarantees are also allowed for, with any deficiency being recognised in the consolidated income statement.

Unallocated surplus

The unallocated surplus comprises the excess of the assets over the policyholder liabilities of the with-profit business of the Group's life operations. For the Group's with-profit funds this represents amounts which have yet to be allocated to owners since the unallocated surplus attributable to policyholders has been included within liabilities under insurance contracts.

If the realistic value of liabilities to policyholders exceeds the value of the assets in the with-profit fund, the unallocated surplus is valued at £nil.

(f) Investment contracts without DPF

Receipts and payments on investment contracts without DPF are accounted for using deposit accounting, under which the amounts collected and paid out are recognised in the statement of consolidated financial position as an adjustment to the liability to the policyholder.

The valuation of liabilities on unit-linked contracts is based on the fair value of the related assets and liabilities. The liability is the sum of the unit-linked liabilities plus an additional amount to cover the present value of the excess of future policy costs over future charges.

Movements in the fair value of investment contracts without DPF are included in the 'change in investment contract liabilities' in the consolidated income statement.

(g) Financial liabilities

On initial recognition, financial liabilities are recognised when due and measured at the fair value of the consideration received less directly attributable transaction costs (with the exception of liabilities at fair value through profit or loss for which all transaction costs are expensed).

Subsequent to initial recognition, financial liabilities (except for liabilities under investment contracts and other liabilities designated at fair value through profit or loss) are measured at amortised cost using the effective interest method. Financial liabilities are designated upon initial recognition at fair value through profit or loss when doing so results in more meaningful information because either:

– it eliminates or significantly reduces accounting mismatches that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or

– a group of financial assets, financial liabilities or both is managed and its performance is evaluated and managed on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the investments is provided internally on that basis to the Group's key management personnel.

Warrants issued by the Company are recognised as a financial liability unless they can be exchanged for a fixed number of the Company's own shares, or meet the definition of equity-settled share-based payments, in which case they are recognised as equity.

Notes to the consolidated financial statements
continued

1. Accounting policies (continued)

(h) Borrowings

The majority of interest bearing borrowings are recognised initially at fair value less any attributable transaction costs. The difference between initial cost and the redemption value is amortised through the consolidated income statement over the period of the borrowing using the effective interest method.

Certain borrowings are designated upon initial recognition at fair value through profit or loss and measured at fair value where doing so provides more meaningful information due to the reasons stated above in the financial liabilities accounting policy. Transaction costs relating to borrowings designated upon initial recognition at fair value through profit or loss are expensed as incurred.

(i) Deposits from reinsurers

It is the Group's practice to obtain collateral to cover certain reinsurance transactions, usually in the form of cash or marketable securities. Where cash collateral is available to the Group for investment purposes, it is recognised as a 'financial asset' and the collateral repayable is recognised as 'deposits received from reinsurers' in the statement of consolidated financial position.

(j) Net asset value attributable to unitholders

The net asset value attributable to unitholders represents the non-controlling interest in collective investment schemes which are consolidated by the Group. This interest is classified at fair value through profit or loss and measured at fair value, which is equal to the bid value of the number of units of the collective investment scheme not owned by the Group.

(k) Obligations for repayment of collateral received

It is the Group's practice to obtain collateral in stock lending and derivative transactions, usually in the form of cash or marketable securities. Where cash collateral is available to the Group for investment purposes, it is recognised as a 'financial asset' and the collateral repayable is recognised as 'obligations for repayment of collateral received' in the statement of consolidated financial position. The 'obligations for repayment of collateral received' are measured at amortised cost, which in the case of cash is equivalent to the fair value of the consideration received.

(l) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised in the statement of consolidated comprehensive income or the statement of consolidated changes in equity, in which case it is recognised in these statements.

Current tax is the expected tax payable on the taxable income for the year, using tax rates and laws enacted or substantively enacted at the date of the statement of consolidated financial position together with adjustments to tax payable in respect of previous years.

Deferred tax is provided for on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not provided in respect of temporary differences arising from the initial recognition of goodwill and the initial recognition of assets or liabilities in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and laws enacted or substantively enacted at the period end.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on owners' returns. This allocation is calculated based on an assessment of the effective rate of tax that is applicable to owners for the year.

(m) Employee Benefits

Defined contribution pension plans
Obligations for contributions to defined contribution pension plans are recognised as an expense in the consolidated income statement as incurred.

Defined benefit pension schemes
The net surplus or deficit (the economic surplus or deficit) in respect of the defined benefit pension schemes is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value and the fair value of any scheme assets is deducted. The discount rate is the yield at the period end on AA credit rated bonds that have maturity dates approximating to the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. As required by IFRIC 14, IAS 19 – *The limit on a Defined Benefit Asset, minimum Funding Requirements and their Interaction* to the extent that the economic surplus will be available as a refund, the scheme assets are stated after a provision for tax that would be borne by the scheme administrators when the refund is made.

The economic surplus or deficit is subsequently adjusted to eliminate on consolidation the carrying value of insurance policies issued by Group entities to the defined benefit pension schemes (the reported surplus or deficit). A corresponding adjustment is made to the carrying values of insurance contracts liabilities and investment contracts liabilities.

The movement in the reported surplus/deficit is analysed between the service cost, past service cost, curtailments and settlements (recognised within administrative expenses in the consolidated income statement), the interest cost on the liabilities less the expected return on assets, including any reimbursement assets (recognised within net investment income in the consolidated income statement), actuarial gains and losses (recognised in other comprehensive income) and employer contributions. All actuarial gains and losses are recognised in full.

Part of the cost of changes in the longevity assumptions of the PGL Pension Scheme is recoverable from certain with-profit funds to the extent that cash contributions are made to the pension scheme. Recoveries are recognised when the related cash contributions are agreed with the Trustee of the pension scheme and are accounted for as a transfer to other comprehensive income from insurance contract liabilities.

(n) Intangible assets

Goodwill
Business combinations are accounted for by applying the purchase method. Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is measured on initial recognition at cost. Following initial recognition, goodwill is stated at cost less any accumulated impairment losses. It is tested for impairment annually or when there is evidence of possible impairment. Goodwill is not amortised. For impairment testing, goodwill is allocated to cash generating units (Phoenix Life and Ignis Asset Management). Goodwill is impaired when the recoverable amount is less than the carrying value.

Acquired in-force business
Insurance and investment contracts with and without DPF acquired in business combinations and portfolio transfers are measured at fair value at the time of acquisition. The difference between the fair value of the contractual rights acquired and obligations assumed and the liability measured in accordance with the Group's accounting polices for such contracts is recognised as acquired in-force business.

Acquired in-force business is amortised over the estimated life of the contracts on a basis which recognises the emergence of the economic benefits.

An impairment review is performed whenever there is an indication of impairment. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the consolidated income statement. Acquired in force business is also considered in the liability adequacy test for each reporting period.

Notes to the consolidated financial statements
continued

1. Accounting policies (continued)

(n) Intangible assets (continued)

Customer relationships

Intangible assets include vesting pension premiums and investment management contracts as detailed in note 32. These are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets are not capitalised and expenditure is reflected in the consolidated income statement in the year in which the expenditure is incurred.

Intangible assets with finite lives are amortised on a straight-line basis over their useful economic lives and assessed for impairment whenever there is an indication that the recoverable amount of the intangible asset is less than its carrying value.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised.

(o) Property, plant and equipment

Owner-occupied property is stated at revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment. Owner-occupied property is depreciated over its estimated useful life, which is taken as 50 years, except where the residual value is greater than its carrying value in which case no depreciation is charged to profit or loss. Land is not depreciated. Gains and losses on owner-occupied property are recognised in the statement of consolidated comprehensive income.

Plant and equipment is stated at cost less accumulated depreciation. Depreciation is charged to the consolidated income statement on a straight-line basis over the estimated useful lives.

(p) Investment property

Investment property is stated at fair value. Fair value is based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction. Gains and losses arising from the change in fair value are recognised in the consolidated income statement.

(q) Investments in associates and joint ventures

Investments in associates and joint ventures that are held for investment purposes are accounted for under IAS 39 *Financial Instruments: Recognition and Measurement* as permitted by IAS 28 *Interests in Associates* and IAS 31 *Interests in Joint Ventures*. These are measured at fair value through profit or loss. There are no investments in associates and joint ventures which are of a strategic nature.

(r) Financial assets

Purchases and sales of financial assets are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset.

Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market. These investments are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investment. All transaction costs directly attributable to the acquisition are also included in the cost of the investment. Subsequent to initial recognition, these investments are carried at amortised cost, using the effective interest method.

Derivative financial instruments are classified as held for trading. They are recognised initially at fair value and subsequently are re-measured to fair value. The gain or loss on re-measurement to fair value is recognised in the consolidated income statement.

Equities, fixed and variable rate income securities and collective investment schemes are designated at fair value through profit or loss and accordingly are stated in the statement of consolidated financial position at fair value. They are designated at fair value through profit or loss because this is reflective of the manner in which they are managed and the risks are evaluated.

Impairment of financial assets
The Group assesses at each period end whether a financial asset or group of financial assets held at amortised cost is impaired. The Group first assesses whether objective evidence of impairment exists. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognised, are not included in the collective assessment of impairment.

Fair value estimation
The fair value of financial instruments traded in active markets such as publicly traded securities and derivatives are based on quoted market prices at the period end. The quoted market price used for financial assets is the applicable bid price on the trade date. The fair value of investments that are not traded in an active market is determined using valuation techniques such as broker quotes, pricing models or discounted cash flow techniques. Where pricing models are used, inputs are based on market related data at the period end. Where discounted cash flow techniques are used, estimated future cash flows are based on contractual cash flows using current market conditions and market calibrated discount rates and interest rate assumptions for similar instruments.

For units in unit trusts and shares in open-ended investment companies, fair value is determined by reference to published bid-values. The fair value of receivables and floating rate and overnight deposits with credit institutions is their carrying value. The fair value of fixed interest-bearing deposits is estimated using discounted cash flow techniques.

Stock lending
Financial assets that are lent under the Group's stock lending programme do not qualify for derecognition from the statement of consolidated financial position as the Group retains substantially all the risks and rewards of the transferred assets.

Collateral
The Group receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, derivative contracts and reinsurance arrangements in order to reduce the credit risk of these transactions. The amount and type of collateral required where the Group receives collateral depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, where the Group has contractual rights to receive the cash flows generated, is recognised as an asset in the statement of consolidated financial position with a corresponding liability for its repayment. Non-cash collateral received is not recognised in the statement of consolidated financial position, unless the counterparty defaults on its obligations under the relevant agreement.

Cash and non-cash collateral pledged where the Group retains the contractual rights to receive the cash flows generated is not derecognised from the statement of consolidated financial position, unless the Group defaults on its obligations under the relevant agreement.

(s) Reinsurance
The Group cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance providers. Reinsurers' share of insurance contract liabilities is dependent on expected claims and benefits arising under the related reinsured policies.

Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting period. Impairment occurs when there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Group may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer. The impairment loss is recognised in the consolidated income statement. The reinsurers' share of investment contract liabilities is measured on a basis that is consistent with the valuation of the liability to policyholders to which the reinsurance applies.

Reinsurance premiums payable in respect of certain reinsured individual and group pensions annuity contracts are payable by quarterly instalments. Due to the period of time over which reinsurance premiums are payable under these arrangements, the reinsurance premiums and related payables are discounted to present values using a pre-tax risk-free rate of return. The unwinding of the discount is included as a charge within the consolidated income statement.

Gains or losses on purchasing reinsurance are recognised in the consolidated income statement at the date of purchase and are not amortised. They are the difference between the premiums ceded to reinsurers and the related change in the reinsurers' share of insurance contract liabilities.

Notes to the consolidated financial statements
continued

1. Accounting policies (continued)

(t) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and short-term deposits with an original maturity term of three months or less at the date of placement. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are deducted from cash and cash equivalents for the purpose of the statement of consolidated cash flows.

(u) Provisions and contingent liabilities

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where the Group has a present legal or constructive obligation, but it is not probable that there will be an outflow of resources to settle the obligation or the amount cannot be reliably estimated, this is disclosed as a contingent liability.

A provision is recognised for onerous contracts in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs reflect the net cost of exiting the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

(v) Earnings per share

Basic earnings per share is calculated using the earnings attributable to ordinary equity holders of the parent, divided by the weighted average number of ordinary shares in issue during the year.

For the diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares, including warrants and potentially issuable ordinary shares.

(w) Dividends

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Group's owners. Interim dividends are deducted from equity when they are paid. As permitted by Cayman Islands Companies Law, dividends have been charged within equity against the share premium account and other reserves account. Where shareholders exercise a scrip dividend option, the amount of the related dividend is credited to share premium in the statement of consolidated changes in equity and an amount equal to the nominal value of the shares issued is transferred from share premium to share capital.

Dividends for the year that are approved after the reporting period are dealt with as an event after the reporting period.

Declared dividends are those that are appropriately authorised and are no longer at the discretion of the entity.

(x) Income recognition

Gross premiums

In respect of insurance contracts and investment contracts with DPF, premiums are accounted for on a receivable basis and exclude any taxes or duties based on premiums. Funds at retirement under individual pension contracts converted to annuities with the Group are, for accounting purposes, included in both claims incurred and premiums within gross premiums written.

Reinsurance premiums

Outward reinsurance premiums are accounted for on a payable basis.

Fee and commission income

Fee and commission income relates to the following:

- fund management based fees, which are recognised as the services are provided;
- investment contract income – investment contract policyholders are charged for policy administration services, investment management services, surrenders and other contract fees. These fees are recognised as revenue over the period in which the related services are performed. If the fees are for services provided in future periods, then they are deferred and recognised over those periods. 'Front end' fees are charged on some non-participating investment contracts. Where the non-participating investment contract is measured at fair value, such fees which relate to the provision of investment management services are deferred and recognised as the services are provided; and
- other fees, which are recognised as the services are provided.

Net investment income
Net investment income comprises interest, dividends, rents receivable, net expected return on pension assets and liabilities, fair value gains and losses on financial assets and investment property at fair value and impairment losses on loans and receivables.

Interest income is recognised in the consolidated income statement as it accrues using the effective interest method.

Dividend income is recognised in the consolidated income statement on the date the right to receive payment is established, which in the case of listed securities is the ex-dividend date.

Rental income from investment property is recognised in the consolidated income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

Fair value gains and losses on financial assets designated at fair value through profit or loss are recognised in the consolidated income statement. Realised gains and losses are the difference between the net sale proceeds and the original cost. Unrealised gains and losses are the difference between the valuation at the period end and their valuation at the previous period end or purchase price, if acquired during the year.

Other operating income
Other operating income comprises the general business result and other non-investment income which is recognised on an accruals basis.

(y) Benefits, claims and expenses recognition

Gross benefits and claims
Claims on insurance contracts and investment contracts with DPF reflect the cost of all claims arising during the period, including policyholder bonuses allocated in anticipation of a bonus declaration. Claims payable on maturity are recognised when the claim becomes due for payment and claims payable on death are recognised on notification. Surrenders are accounted for at the earlier of the payment date or when the policy ceases to be included within insurance contract liabilities. Where claims are payable and the contract remains in-force, the claim instalment is accounted for when due for payment. Claims payable include the costs of settlement.

Reinsurance claims
Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

Share-based payments
Equity-settled share-based payments to employees and others providing services are measured at the fair value of the equity instruments at the grant date. The fair value excludes the effect of non-market-based vesting conditions. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in note 17.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest. At each period end, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the consolidated income statement such that the cumulative expense reflects the revised estimate with a corresponding adjustment to equity.

Finance costs
Interest payable is recognised in the consolidated income statement as it accrues and is calculated using the effective interest method.

Notes to the consolidated financial statements
continued

1. Accounting policies (continued)

(z) Share capital and shares held by the employee trust and Group entities

Ordinary share capital
The Group has issued ordinary shares which are classified as equity. Incremental external costs that are directly attributable to the issue of these shares are recognised in equity, net of tax.

Shares held by the employee trust and Group entities
Where an employee trust or other Group entity acquires shares in the Company or obtains rights to purchase its shares, the consideration paid (including any attributable transaction costs, net of tax) is shown as a deduction from owners' equity. Gains and losses on sales of shares held by the employee trust and Group entities are charged or credited to the own shares account in equity.

(aa) Non-current assets held for sale

Non-current assets or disposal groups are classified separately as held for sale in the balance sheet when their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is met only when the sale is highly probable, the asset or disposal group is available for immediate sale in its present condition, and management is committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Liabilities directly associated with the assets classified as held for sale and expected to be included as part of the sale transaction are correspondingly also classified separately. The net assets and liabilities of a disposal group classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

(bb) Leases

Where a significant element of the risks and rewards of title to the asset is retained by the lessor, such leases are treated as operating leases. Property leased out by the Group under operating leases are included in investment property, rental income from such leases is recognised as income in the statement of comprehensive income on a straight line basis over the period of the lease.

(cc) General business

The general insurance business has been closed to new business for a number of years and is in run-off. The results are included within other operating income in the consolidated income statement. Provisions are made for the estimated cost of claims, including claims incurred but not reported after taking into account handling costs, anticipated inflation and settlement trends. Any difference between the estimated provision and subsequent settlement is included in the consolidated income statement.

(dd) Segmental reporting

The Group's results are analysed across two reportable segments: Phoenix Life and Ignis Asset Management. The revenues generated in each reported segment are shown in the segmental information in note 4.

There are no differences between the measurement of the assets and liabilities reflected in the primary statements and that reported for the segments. A reconciliation between the reported segment revenues and expenses and the Group's revenues and expenses is shown in note 4.

Assets, liabilities, revenues or expenses that are not directly attributable to a particular segment are allocated between segments where there is a reasonable basis for doing so.

(ee) Events after the reporting period

The financial statements are adjusted to reflect significant events that have a material effect on the financial results and that have occurred between the period end and the date when the financial statements are authorised for issue, provided they give evidence of conditions that existed at the period end. Events that are indicative of conditions that arise after the period end that do not result in an adjustment to the financial statements are disclosed.

2. Financial information

The consolidated financial statements for the year ended 31 December 2012, set out on pages 93 to 176, were authorised on 21 March 2013 by the Board of Directors for issue.

In preparing the consolidated financial statements the Group has adopted for the first time the following standards, interpretations and amendments which have been issued by the International Accounting Standards Board ('IASB') and have been adopted for use by the EU. None of these have a material effect on the results of the Group.

- Deferred tax – Recovery of Underlying Assets (Amendments to IAS 12) (2012). This provides a practical approach to the measurement of deferred tax liabilities and assets when investment property is measured at fair value, according to whether the entity expects to recover an asset by using or selling it.
- Disclosure – Transfer of Financial Assets (Amendments to IFRS 7) (2012). This revises the required disclosures to help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position.

The IASB has issued the following standards, interpretations and amendments which, subject to adoption for use by the EU, apply from the dates shown. The Group has decided not to early adopt any of these standards, interpretations or amendments where this is permitted. The impact on the Group of adopting them is subject to evaluation:

- IFRS 9 *Financial Instruments* (2015). This is the first two parts of a replacement standard for IAS 39 *Financial Instruments: Recognition and Measurement* and deals with the classification and measurement of financial assets and financial liabilities, including some hybrid contracts.
- IFRS 10 *Consolidated Financial Statements* (2013) provides a single consolidation model that identifies control as the basis for consolidation for all types of entities.
- IFRS 11 *Joint Arrangements* (2013) establishes principles for financial reporting by parties to a joint arrangement.
- IFRS 12 *Disclosure of Interests in Other Entities* (2013) combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities.
- IFRS 13 *Fair Value Measurement* (2013) defines fair value and sets out in a single IFRS a framework for measuring fair value.
- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1) (2013). The amendment requires companies to group together items within other comprehensive income that may be reclassified to the profit or loss section of the income statement.
- IAS 19 *Employee Benefits* (Amendment) (2013). The IASB has issued numerous amendments to IAS 19. These range from fundamental changes like removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The impact of adopting this standard would be to reduce the net pension expense in the consolidated income statement with a corresponding increase in expense in other comprehensive income. There would be no impact on net assets.
- IAS 28 *Investments in Associates and Joint Ventures* (Revised) (2013). This standard supersedes IAS 28 *Investments in Associates* and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.
- Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7) (2013). The new disclosure requirements are intended to help users of financial statements better assess the effect or potential effect of offsetting arrangements on an entity's financial position.
- Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32) (2014). The amendments address inconsistencies in current practice when applying the offsetting criteria in IAS 32.
- Annual Improvements to IFRS 2009-2011 cycle (2013). This makes a number of minor improvements to existing standards and interpretations.
- Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12) (2013).
- Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27) (2014).

When IFRS 10, IFRS 11, IFRS 12, IAS 28 (Revised) and the consequential amendments to these were issued by the IASB the effective date of these standards was 1 January 2013. However, the EU endorsed these standards to be effective from 1 January 2014, with early adoption permitted. The Group currently intends to adopt these standards effective for the period commencing on 1 January 2014.

Notes to the consolidated financial statements
continued

2. Financial information (continued)

In addition, the following standards, interpretations and amendments have been issued but are not currently relevant to the Group:

– Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendments to IFRS 1) (2012).

– IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* (2013).

– IAS 27 *Separate Financial Statements* (Revised) (2013).

– Government Loans (Amendments to IFRS 1) (2013).

3. Assets and liabilities held for sale

The balances transferred to assets and liabilities classified as held for sale in the statement of consolidated financial position in 2012 relate to the anticipated Part VII transfer of a portfolio of wholly reinsured annuity liabilities to Guardian Assurance Limited ('Guardian') and the proposed sale of BA(GI) Limited ('BAGI') which comprise:

	Carrying amount 2012 £m
Assets classified as held for sale:	
Goodwill	**19**
Acquired in-force business	**138**
Financial assets	**61**
Reinsurer's share of insurance contract liabilities	**5,083**
Other assets	**9**
	5,310
Liabilities classified as held for sale:	
Liabilities under insurance contracts	**5,404**
Deferred tax liabilities	**23**
Payables related to direct insurance contracts	**42**
Other liabilities	**10**
	5,479

Annuity liabilities transfer

The Group entered into a reinsurance agreement, effective 1 July 2012, to reinsure certain portfolios of the Group's annuity liabilities to Guardian in exchange for the transfer of financial assets of £5.1 billion. It is highly probable that the reinsurance agreement will be replaced by a formal Part VII transfer of the annuity liabilities to Guardian in the second half of 2013 and accordingly the assets and liabilities to be transferred have been classified as held for sale.

Liabilities classified as held for sale include the annuity liabilities reinsured to Guardian. Assets classified as held for sale include the associated reinsurers' share of insurance contract liabilities and intangible assets.

Under the terms of this reinsurance agreement Guardian holds assets in a collateral account over which the Group has a fixed charge as disclosed in note 37.

As the annuity liabilities include prudential margins under IFRS a non-recurring gain of £177 million gross of tax was recognised on entering into the reinsurance agreement and emerges as the difference between the premium ceded to reinsurers and the reinsurers' share of insurance contract liabilities recognised.

The Group will make a net payment to Guardian at the time of the Part VII transfer for their assumption of the administration of the contracts.

General insurance

During 2012 the Group made considerable progress with its strategy to exit from its residual, non-core general insurance business. In January 2012, the business of PA(GI) Limited was transferred under a Part VII scheme to RSA, to whom the business had previously been reinsured. In April 2012, the general insurance business of Phoenix Life Assurance Limited (formerly Pearl Assurance Limited) was transferred under a Part VII scheme to BAGI, a fellow group company – which resulted in all of the Group's residual general insurance liabilities being held in the same entity. It is highly probable that the Group will complete a sale of its entire interest in BAGI during 2013 and accordingly its assets and liabilities have been classified as held for sale as at 31 December 2012.

4. Segmental analysis

The Group defines and presents operating segments based on the information which is provided to the Board.

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses relating to transactions with other components of the Group.

For management purposes, the Group is organised into business units based on their products and services and has two operating segments as follows:

- Phoenix Life – this segment manages a range of whole life, term assurance and pension products; and
- Ignis Asset Management – this segment provides investment management services to the life companies within the Group and to third parties, covering both retail and institutional investors.

Segment performance is evaluated based on profit or loss which, in certain respects, is presented differently from profit or loss in the consolidated financial statements. Group financing (including finance costs) and owners' taxes are managed on a Group basis and are not allocated to individual operating segments.

Inter-segment transactions are set on an arm's length basis in a manner similar to transactions with third parties. Segment results include those transfers between business segments which are then eliminated on consolidation.

Predominantly all revenues from external customers are sourced in the UK.

Predominantly all non-current assets are located in the UK.

No revenue transaction with a single customer external to the Group amounts to greater than 10% of the Group's revenue.

Notes to the consolidated financial statements
continued

4. Segmental analysis (continued)

4.1 Segmental result

2012

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Eliminations £m	Total £m
Net premiums written from:					
External customers	(3,564)	–	–	–	(3,564)
Fees from:					
External customers	123	34	–	–	157
Other segment	–	103	–	(103)	–
	123	137	–	(103)	157
Net investment income	4,585	1	(5)	–	4,581
Other operating income:					
External customers	13	–	–	–	13
Other segment	–	5	–	(5)	–
Net income	1,157	143	(5)	(108)	1,187
Net policyholder claims and benefits incurred:					
Recurring	763	–	–	–	763
Non-recurring	177	–	–	–	177
	940	–	–	–	940
Depreciation, impairment and amortisation:					
Depreciation of property, plant and equipment	–	(3)	–	–	(3)
Impairment losses on property, plant and equipment	(4)	–	–	–	(4)
Amortisation of acquired in-force business	(122)	–	–	–	(122)
Amortisation of customer relationships	(15)	(3)	–	–	(18)
	(141)	(6)	–	–	(147)
Other operating expenses:					
Recurring	(1,402)	(97)	(5)	108	(1,396)
Non-recurring	(37)	(2)	(7)	–	(46)
	(1,439)	(99)	(12)	108	(1,442)
Total operating expense	(640)	(105)	(12)	108	(649)
Profit/(loss) before finance costs and tax	517	38	(17)	–	538
Finance costs	(104)	–	(111)	–	(215)
Profit/(loss) before tax	413	38	(128)	–	323
Tax attributable to policyholders' returns	(33)	–	–	–	(33)
Segmental result before the tax attributable to owners	380	38	(128)	–	290

2011

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Eliminations £m	Total £m
Net premiums written from:					
External customers	1,388	–	–	–	1,388
Other segment	–	–	–	–	–
	1,388	–	–	–	1,388
Fees from:					
External customers	139	31	–	–	170
Other segment	–	113	–	(113)	–
	139	144	–	(113)	170
Net investment income:					
Recurring	4,911	1	8	–	4,920
Offset interest income on interest swaps against interest expenses[1]	–	–	(19)	–	(19)
	4,911	1	(11)	–	4,901
Other operating income:					
External customers	12	–	–	–	12
Other segment	–	1	–	(1)	–
Net income	6,450	146	(11)	(114)	6,471
Net policyholder claims and benefits incurred:					
Recurring	(5,879)	–	–	–	(5,879)
Non-recurring	35	–	–	–	35
	(5,844)	–	–	–	(5,844)
Depreciation, impairment and amortisation:					
Depreciation of property, plant and equipment	–	(3)	–	–	(3)
Impairment losses on property, plant and equipment	(8)	–	–	–	(8)
Amortisation of acquired in-force business	(134)	–	–	–	(134)
Amortisation of customer relationships	(13)	(5)	–	–	(18)
	(155)	(8)	–	–	(163)
Other operating expenses:					
Recurring	(181)	(97)	(51)	114	(215)
Non-recurring	(50)	(2)	31	–	(21)
	(231)	(99)	(20)	114	(236)
Total operating expense	(6,230)	(107)	(20)	114	(6,243)
Profit/(loss) before finance costs and tax	220	39	(31)	–	228
Finance costs	(122)	–	(129)	–	(251)
Offset interest income on interest swaps against interest expense[1]	–	–	19	–	19
	(122)	–	(110)	–	(232)
Profit/(loss) before tax	98	39	(141)	–	(4)
Tax attributable to policyholders' returns	(173)	–	–	–	(173)
Segmental result before the tax attributable to owners	(75)	39	(141)	–	(177)

1 The Group has entered into derivatives to protect its net exposure to interest rate fluctuations and this reallocation reflects the net economic interest exposure of the Group.

Notes to the consolidated financial statements
continued

4. Segmental analysis (continued)

4.2 Reconciliation of operating profit/(loss) before adjusting items to the segmental result

2012

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Total £m
Operating profit/(loss) before adjusting items	**399**	**43**	**(32)**	**410**
Investment return variances and economic assumption changes on long-term business	**1**	**–**	**–**	**1**
Variance on owners' funds	**(35)**	**–**	**22**	**(13)**
Amortisation of acquired in-force business	**(109)**	**–**	**–**	**(109)**
Amortisation of customer relationships	**(15)**	**(3)**	**–**	**(18)**
Non-recurring items	**139**	**(2)**	**(7)**	**130**
Financing costs attributable to owners	**–**	**–**	**(111)**	**(111)**
Segment result before the tax attributable to owners	**380**	**38**	**(128)**	**290**

Non-recurring items include:

- a gain of £177 million recognised upon entering into the reinsurance agreement with Guardian to transfer certain portfolios of annuity liabilities;
- regulatory change and systems transformation costs of £28 million; and
- restructuring costs of £19 million.

2011

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Total £m
Operating profit/(loss) before adjusting items	395	46	(54)	387
Investment return variances and economic assumption changes on long-term business	(338)	–	–	(338)
Variance on owners' funds	17	–	(8)	9
Amortisation of acquired in-force business	(121)	–	–	(121)
Amortisation of customer relationships	(13)	(5)	–	(18)
Non-recurring items	(15)	(2)	31	14
Financing costs attributable to owners	–	–	(110)	(110)
Segment result before the tax attributable to owners	(75)	39	(141)	(177)

Non-recurring items include:

- restructuring costs of £37 million;
- regulatory change and systems transformation costs of £21 million;
- a gain of £37 million arising from closing the Group's pension schemes to future accrual and implementing a pension increase exchange programme; and
- a £35 million recovery of historic costs under the management services agreements with the life division.

5. Investment return variances and economic assumption changes

The long-term nature of much of the Group's operations means that, for internal performance management, the effects of short-term economic volatility are treated as non-operating items. The Group focuses instead on an operating profit measure that incorporates an expected return on investments supporting its long-term business. This note explains the methodology behind this.

5.1 Life assurance business

Operating profit for life assurance business is based on expected investment returns on financial investments backing owners' and policyholder funds over the reporting period, with consistent allowance for the corresponding expected movements in liabilities. Operating profit includes the effect of variance in experience for non-economic items, for example mortality, persistency and expenses, and the effect of changes in non-economic assumptions. Changes due to economic items, for example market value movements and interest rate changes, which give rise to variances between actual and expected investment returns, and the impact of changes in economic assumptions on liabilities, are disclosed separately outside operating profit.

The movement in liabilities included in operating profit reflects both the change in liabilities due to the expected return on investments and the impact of experience variances and assumption changes for non-economic items.

The effect of differences between actual and expected economic experience on liabilities, and changes to economic assumptions used to value liabilities, are taken outside operating profit. For many types of long-term business, including unit-linked and with-profit funds, movements in asset values are offset by corresponding changes in liabilities, limiting the net impact on profit. For other long-term business the profit impact of economic volatility depends on the degree of matching of assets and liabilities, and exposure to financial options and guarantees.

The investment variances and economic assumption changes excluded from the long-term business operating profit reflect the impact of the increase in credit spreads on corporate bonds and movements in equities, properties and yields.

5.2 Owners' funds

For non-long-term business including owners' funds, the total investment income, including fair value gains, is analysed between a calculated longer-term return and short-term fluctuations.

The variances excluded from operating profit in relation to owners' funds are as follows:

	2012 £m	2011 £m
Variances on owners' funds of:		
Subsidiary undertakings	**(13)**	7
The Company	**–**	2
	(13)	9

The variances on owners' funds of the Company of £nil (2011: £2 million gain) comprise fair value gains arising from movements in the fair value of warrants in issue over the Company's shares.

5.3 Calculation of the long-term investment return

The expected return on investments for both owner and policyholder funds is based on opening economic assumptions applied to the funds under management at the beginning of the reporting period. Expected investment return assumptions are derived actively, based on market yields on risk-free fixed interest assets at the start of each financial year. The same margins are applied on a consistent basis across the Group to gross risk-free yields, to obtain investment return assumptions for equities and properties.

The principal assumptions underlying the calculation of the longer-term investment return are:

	2012 %	2011 %
Equities	**5.6**	7.1
Properties	**4.6**	6.1
Gilts (15 year gilt)	**2.6**	4.0
Other fixed interest	**3.6**	4.6

Notes to the consolidated financial statements
continued

6. Premiums ceded to reinsurers

On 27 June 2012, the Company entered into a reinsurance agreement with Guardian to reassure selected portfolios of its pension annuity in-payment liabilities with effect from 1 July 2012.

The Company paid a reinsurance premium of £5,104 million to Guardian. The agreement with Guardian includes provision for adjustment to the premium as part of an on-going data validation exercise. Under the terms of the agreement Guardian holds assets in a collateral account over which the Company has a fixed charge as disclosed in note 37.

7. Fees

	2012 £m	2011 £m
Fund management based fees	63	75
Investment contract income	94	95
	157	170

8. Net investment income

	2012 £m	2011 £m
Investment income		
Interest income on loans and receivables	40	49
Interest income on impaired financial assets	1	7
Interest income on financial assets designated at fair value through profit or loss on initial recognition	2,433	2,554
Dividend income	674	679
Rental income	88	86
Net expected return on pension assets	(4)	(11)
	3,232	3,364
Impairment losses on loans and receivables	–	(3)
Fair value gains/(losses)		
Financial assets at fair value through profit or loss		
Designated upon initial recognition	1,788	595
Held for trading – derivatives	(354)	960
Investment property	(85)	4
	1,349	1,556
Net investment income	4,581	4,920

9. Administrative expenses

	2012 £m	2011 £m
Employee costs	**144**	149
Outsourcer expenses	**134**	160
Professional fees	**76**	107
Office costs	**49**	45
Depreciation of property, plant and equipment	**3**	3
Investment management expenses and transaction costs	**89**	99
Direct costs of life companies	**27**	9
Direct costs of collective investment schemes	**28**	27
Pension service costs and curtailments	**5**	(21)
Impairment of property, plant and equipment	**4**	8
Other	**26**	20
	585	606

Certain prior year disclosures in note 9 have been amended to conform to current year presentation.

Employee costs comprise:

	2012 £m	2011 £m
Wages and salaries	**132**	137
Social security contributions	**12**	12
	144	149

	2012 Number	2011 Number
Average number of persons employed		
Phoenix Life	**809**	804
Ignis Asset Management	**456**	551
	1,265	1,355

10. Auditors' remuneration

The remuneration of the Company's auditors, including their associates, in respect of services supplied to members of the Group was £7.6 million (2011: £6.7 million). No services were provided by the Company's auditors to the Group's pension schemes in either 2012 or 2011.

	2012 £m	2011 £m
Audit of the consolidated financial statements	**0.4**	0.5
Audit of the Group's subsidiaries financial statements	**2.7**	2.9
Audit of MCEV supplementary information	**0.5**	0.6
Tax advisory services	**0.1**	0.4
Other assurance services	**1.8**	1.8
Corporate finance services	**1.6**	0.5
Other non-audit services	**0.5**	–
	7.6	6.7

Notes to the consolidated financial statements
continued

11. Finance costs

	2012 £m	2011 £m
Interest expense		
On financial liabilities at amortised cost	**189**	215
On financial liabilities at fair value through profit or loss	**26**	36
	215	251
Attributable to:		
– policyholders	**104**	122
– owners	**111**	129
	215	251

12. Tax (credit)/charge

12.1 Current year tax (credit)/charge

	2012 £m	2011 £m
Current tax:		
UK Corporation tax	**24**	68
Overseas tax	**15**	16
	39	84
Adjustment in respect of prior years	**6**	(57)
	45	27
Deferred tax:		
Impact of new life tax regime:		
Transitional adjustment on move to IFRS basis of taxation	**88**	–
Unwind of timing differences recognised under previous tax regime	**(62)**	(9)
Offset of 2012 losses against corresponding transitional gain	**(32)**	–
Other impacts of new life tax rules	**(6)**	–
	(12)	(9)
Recognition of deferred tax assets not previously valued	**(42)**	(13)
Reversal/origination of temporary differences:		
On amortisation of acquired in-force business	**(40)**	(44)
On amortisation of customer relationship intangible	**(4)**	(5)
On capital allowances in excess of depreciation	**(1)**	6
On accrued interest	**(33)**	7
On excess expenses and deferred acquisition costs	**9**	–
Pension scheme movements	**12**	30
On provisions for future expenditure	**2**	2
Other temporary differences	**1**	3
Utilisation of tax losses	**8**	131
Change in the rate of corporation tax	**(28)**	(41)
Prior year deferred tax	**(3)**	–
	(131)	67
Total tax (credit)/charge	**(86)**	94
Attributable to:		
– policyholders	**33**	173
– owners	**(119)**	(79)
	(86)	94

The Group, as a proxy for policyholders in the UK, is required to pay taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK life assurance policyholder earnings is included in income tax expense. The tax charge attributable to policyholder earnings was £33 million (2011: £173 million).

12.2 Tax credited to other comprehensive income

	2012 £m	2011 £m
Deferred tax on actuarial losses/gains of defined benefit schemes	**(110)**	(1)

12.3 Reconciliation of tax (credit)/charge

	2012 £m	2011 £m
Profit/(loss) before tax	**323**	(4)
Policyholder tax charge	**(33)**	(173)
Profit/(loss) before the tax attributable to owners	**290**	(177)
Tax at standard UK[1] rate of 24.5% (2011: 26.5%)	**71**	(47)
Untaxed income and gains	**(29)**	(7)
Disallowable expenses	**2**	3
Adjustment to shareholders tax charge in respect of prior years	**21**	(57)
Movement in non-profit surplus taxed at less than 24.5% (2011: 26.5%)	**–**	13
Movement on acquired in-force amortisation at less than 24.5% (2011: 26.5%)	**–**	3
Profits taxed at rates other than 24.5% (2011: 26.5%)	**(35)**	19
Recognition of previously unrecognised deferred tax assets	**(85)**	(11)
Prior year deferred tax	**(3)**	20
Deferred tax rate change	**(36)**	(41)
Current year losses not valued	**–**	3
Temporary differences not valued	**(7)**	27
Impact of new life tax regime	**(12)**	–
Other	**(6)**	(4)
Owners' tax credit	**(119)**	(79)
Policyholder tax charge	**33**	173
Total tax (credit)/charge for the year	**(86)**	94

1 The Group's two operating segments operate predominantly in the UK. The reconciliation of the tax (credit)/charge has, therefore, been completed by reference to the standard rate of UK tax rather than by reference to the Jersey income tax rate of 0% which is applicable to Phoenix Group Holdings.

13. Dividends on ordinary shares

	2012 £m	2011 £m
Dividends declared and paid in 2012	**73**	72

On 22 March 2012, the Board recommended a final dividend of 21p per share in respect of the year ended 31 December 2011. A scrip dividend option was available to shareholders at that time and the total dividend that was settled on 8 May 2012, following shareholders' approval at the AGM, amounted to £37 million of which £1 million was settled via the scrip dividend option.

On 22 August 2012, the Board declared an interim dividend of 21p per share for the half year ended 30 June 2012. The total dividend amounted to £36 million and was paid on 4 October 2012.

Notes to the consolidated financial statements
continued

14. Earnings per share

The profit attributable to owners for the purposes of calculating earnings per share has been calculated as set out below. This is after adjusting for profits attributable to non-controlling interests.

	2012 £m	2011 £m
Profit/(loss) for the year	**409**	(98)
Share of result attributable to non-controlling interests	**(17)**	(33)
Profit/(loss) attributable to owners	**392**	(131)

The basic earnings per share of 226.3p (2011: (76.2p)) has been based on the profit attributable to owners of the parent of £392 million (2011: loss £131 million) and a weighted average number of ordinary shares outstanding during the year of 173 million (2011: 171 million), calculated as follows:

	2012 Number million	2011 Number million
Issued ordinary shares at beginning of the year	**174**	171
Effect of ordinary shares issued/redeemed	**–**	1
Own shares held by employee trust and Group entities	**(1)**	(1)
Weighted average number of ordinary shares	**173**	171

The diluted earnings per share of 226.2p (2011: (76.2p)) has been based on the profit attributable to owners of the parent of £392 million (2011: loss of £131 million) and a diluted weighted average number of ordinary shares outstanding during the year of 173 million (2011: 171 million). The Group's Deferred BSP share-based scheme has increased the weighted average number of shares on a diluted based by 94,198 shares (2011: nil).

The following instruments could potentially dilute basic earnings per share in the future but have not been included in the diluted earnings per share figure because, due to their exercise price, they did not have a dilutive effect for the periods presented:

- 5 million warrants issued to certain entities providing finance to the Group ('the Lenders') on 2 September 2009;
- 12.36 million warrants issued to Royal London on 2 September 2009; and
- IPO warrants from 2 September 2009 on which date the exercise price of the outstanding warrants was increased from €7 to €11.

Details of the warrants are given in note 23.

There are 3,600,000 remaining contingent rights over ordinary shares which will result in the issue of ordinary shares on a one-for-one basis if on or before 22 June 2013 (i) an offer is made to acquire all or a majority of the Company's issued ordinary share capital or substantially all of the Company's assets (in each case such transaction having become unconditional in all respects); or (ii) any party or parties acting in concert becomes interested in more than 50% of the ordinary shares of the Company through the issue of shares by the Company. As the conditions for this conversion were not met in the reporting period, these additional shares have not been included in the diluted earnings per share figures.

On 21 February 2013 50 million ordinary shares were issued (see note 48). This equity raising contributed to the £450 million prepayment on 22 February 2013 which enabled the re-terming of the Impala facility (see note 21).

15. Share capital

	2012 £	2011 £
Authorised:		
410 million (2011: 410 million) ordinary shares of €0.0001 each	**31,750**	31,750
Issued and fully paid:		
174.6 million (2011: 174.5 million) ordinary shares of €0.0001 each	**14,174**	14,165

The holders of ordinary shares are entitled to one vote per share on matters to be voted on by owners and to receive such dividends, if any, as may be declared by the Board of Directors in its discretion out of legally available profits. Movements in issued share capital during the year:

2012

	Number	£
Shares in issue at 1 January	**174,472,815**	**14,165**
Ordinary shares issued for scrip dividend	**114,333**	**9**
Shares in issue at 31 December	**174,587,148**	**14,174**

During the year, the Company did not issue any shares to employees under the Group's share schemes.

2011

	Number	£
Shares in issue at 1 January	171,455,610	13,904
Ordinary shares issued for scrip dividend	3,005,093	260
Other ordinary shares issued in the year	12,112	1
Shares in issue at 31 December	174,472,815	14,165

During the year, the Company issued 12,112 shares at a premium of £68,190 in order to satisfy its obligation to employees under the Group's share schemes.

16. Shares held by the employee trust and Group entities

	2012 £m	2011 £m
At 1 January	**11**	13
Vested to employees in year	**–**	(2)
Shares sold in year	**(1)**	–
At 31 December	**10**	11

This reserve represents the value of the shares held by the Phoenix Group Holdings Employee Benefit Trust ('PGH EBT') to satisfy awards granted to employees under the Group's share-based payment schemes and shares issued to Phoenix Life Assurance Limited (formerly Pearl Assurance Limited) following the restructuring of the contingent rights over ordinary shares of the Company which occurred during 2010. During the year 18,146 (2011: 306,250) shares were awarded to employees, 229,370 (2011: nil) were sold to meet the Group's obligation under the deferred cash plan (note 17) and 47,349 (2011: 86,828) shares were received as scrip dividends. The number of shares held by the PGH EBT at 31 December 2012 was 1,045,342 (2011: 1,245,509).

17. Share-based payment

17.1 Share-based payment expense

The expense recognised for employee services receivable during the year is as follows:

	2012 £m	2011 £m
Expense arising from equity-settled share-based payment transactions	**5**	6
Expense arising from cash-settled share-based payment transactions	**–**	1
Total expense arising from share based payment transactions	**5**	7

Notes to the consolidated financial statements
continued

17. Share-based payment (continued)

17.2 Share-based payment schemes in issue

Long-term incentive plan ('LTIP')
In 2009, the Group implemented a long-term incentive plan to retain and motivate its senior management group. The awards under this plan are in the form of nil-cost options to acquire an allocated number of ordinary shares. Assuming no good leavers or other events which would trigger early vesting rights, these awards will be subject to performance conditions tied to the Company's financial performance in respect of growth in embedded value, cumulative cash generation over a three year period and, with respect to the 2012 LTIP only, total shareholder return ('TSR'). There are no cash settlement alternatives. The 2009 LTIP awards vested in 2010. Further awards were made in 2010 which will vest on 28 May 2013, in 2011 which will vest on 12 April 2014 and in 2012 which will vest on 2 April 2015.

The fair value of these awards is estimated at the share price at the grant date, taking into account the terms and conditions upon which the instruments were granted.

Save As You Earn ('SAYE')
The SAYE scheme allows participating employees to save up to £250 each month over a period of either 3 or 5 years.

Under the SAYE arrangement, participants remaining in the Group's employment at the end of the 3 or 5 year saving period are entitled to use their savings to purchase shares at an exercise price at a discount to the share price on the date of grant. Employees leaving the Group for certain reasons are able to use their savings to purchase shares if they leave less than six months before the end of their 3 or 5 year periods.

The fair value of the awards has been determined using a Black-Scholes valuation model. Key assumptions within this valuation model included expected share price volatility and expected dividend yield.

The following information was relevant in the determination of the fair value of the 2010 SAYE, 2011 SAYE and 2012 SAYE awards in the year:

	2012 SAYE	2011 SAYE	2010 SAYE
Share price (p)	**524.5**	669.5	650.0
Exercise price (£)	**4.78**	5.72	5.63
Expected life (years)	**3.25 and 5.25**	3.25 and 5.25	3.25 and 5.25
Risk-free rate (%) – based on UK government gilts commensurate with the expected term of the award	**0.6 (for 3.25 year scheme) and 1.1 (for 5.25 year scheme**	1.8 (for 3.25 year scheme) and 2.6 (for 5.25 year scheme	2.0 (for 3.25 year scheme) and 2.8 (for 5.25 year scheme)
Expected volatility (%) based on the Company's share price volatility to date	**30.0**	30.0	30.0
Dividend yield (%)	**8.0**	6.3	0

Following the equity raising on 21 February 2013 (see note 48) the exercise prices of the 2012 SAYE, 2011 SAYE and 2010 SAYE have been adjusted to £4.66, £5.58 and £5.49 respectively.

Bonus share plan ('BSP')
In 2009, certain employees were granted nil-cost options to acquire an allocated number of ordinary shares. There were no performance criteria associated with these awards and no cash settlement alternatives. The contractual life of the awards was two years and the fair value of these awards was estimated at the share price at the grant date, taking into account the terms and conditions upon which the options were granted. The majority of awards vested in 2011 with the remainder vesting in 2012.

Deferred cash plan
With effect from 2 September 2009, a number of executives were given deferred cash awards, the value of which was equal to a fixed number of Phoenix Group Holdings shares on 2 September 2012. As the award was through a cash-settled scheme, the fair value of the expense was updated at every period end to reflect movements in Phoenix Group Holdings' share price, and was determined on the assumption that all the granted awards would vest.

The awards vested on 2 September 2012 and £1 million was paid out to employees. The carrying amount of the liability relating to the cash-settled options at 31 December 2012 is therefore £nil (2011: £2 million).

Deferred bonus share plan ('Deferred BSP')

With effect from 31 December 2010, part of the annual incentive for certain executives, for any year, is deferred into Phoenix Group Holdings' shares. This grant of shares is conditional on the employee remaining in employment with the Group for a period of 3 years. The 2011 Deferred BSP shares are expected to vest on 6 April 2014 and the 2012 Deferred BSP shares are expected to vest on 2 April 2015.

The fair value of these awards is estimated at the share price at the grant date, taking into account the terms and conditions upon which the options were granted.

17.3 Movements in the year

The following tables illustrate the number of, and movements in, share options during the year:

	No of share options 2012				
	LTIP Schemes	SAYE Schemes	Deferred BSP Schemes	Deferred cash plan	2009 BSP
Outstanding at the beginning of the year	2,558,480	1,128,617	88,729	229,370	20,000
Granted during the year	1,608,102	473,463	112,668	–	–
Forfeited during the year	(303,143)	(179,504)	–	–	–
Cancelled during the year	–	(412,625)	–	–	–
Exercised during the year	–	–	(16,259)	(229,370)	(20,000)
Outstanding at the end of the year	3,863,439	1,009,951	185,138	–	–

	No of share options 2011				
	LTIP Schemes	SAYE Schemes	Deferred BSP Schemes	Deferred cash plan	2009 BSP
Outstanding at the beginning of the year	1,424,549	1,037,214	–	229,370	326,250
Granted during the year	1,405,116	310,366	88,729	–	
Forfeited during the year	(271,185)	(206,851)	–	–	–
Exercised during the year	–	(12,112)	–	–	(306,250)
Outstanding at the end of the year	2,558,480	1,128,617	88,729	229,370	20,000

The weighted average fair value of options granted during the year was £4.53 (2011: £5.65).

The weighted average share price at the date of exercise for the rewards exercised is £5.11 (2011: £5.84).

The weighted average remaining contractual life for the rewards outstanding as at 31 December 2012 is 1.6 years (2011: 2.0 years).

18. Non-controlling interests

2012

	Perpetual Reset Capital Securities £m	UK Commercial Property Trust Limited £m	Total £m
At 1 January	407	307	714
Profit/(loss) for the year	20	(3)	17
Dividends paid	–	(23)	(23)
Coupon paid, net of tax relief	(19)	–	(19)
Shares in subsidiaries subscribed for by non-controlling interests	–	35	35
At 31 December	408	316	724

Notes to the consolidated financial statements
continued

18. Non-controlling interests (continued)

2011

	Perpetual Reset Capital Securities £m	UK Commercial Property Trust Limited £m	Total £m
At 1 January	411	309	720
Profit for the year	15	18	33
Dividends paid	–	(21)	(21)
Coupon paid, net of tax relief	(19)	–	(19)
Shares in subsidiaries subscribed for by non controlling interests	–	1	1
At 31 December	407	307	714

18.1 Perpetual Reset Capital Securities

On 1 January 2010, Pearl Group Holdings (No. 1) Limited ('PGH1') had in issue £500 million of Perpetual Reset Capital Securities ('the Notes') which are admitted to the Official List of the UK Listing Authority and to trading on the LSE. Following amendments made to the Notes in 2010, the principal amount outstanding is now £425 million.

The Notes are unsecured obligations of PGH1 and are subordinate to the claims of senior creditors. Payments in respect of the Notes are conditional upon PGH1 being solvent at the time of payment and immediately following such payment.

The Notes have no fixed maturity date and coupon payments may be deferred at the option of PGH1; accordingly the Notes meet the definition of equity for financial reporting purposes. Under the rules of the FSA, the Notes also meet the conditions to be included in Tier 1 capital in the calculation of the group capital resources. As the Notes are not held by the Company, these are disclosed as a non-controlling interest in the consolidated financial statements.

The Notes may be redeemed at par at the option of PGH1 on the first reset date of 25 April 2016 or on any coupon payment date thereafter. Redemption is subject to the agreement of the FSA. In certain circumstances PGH1 has the right to substitute the Notes or to redeem the Notes before the first reset date.

Coupons are payable annually in arrears on 25 April, at the rate of 6.5864% per annum, until the first reset date. Thereafter coupons are payable semi-annually at 2.73% per annum over the then prevailing offered rate for six month sterling deposits.

If PGH1 opts to defer a coupon payment, then PGH1 has the option to either leave the coupon outstanding or satisfy the deferred coupon payment by the issue of securities ('ACSM instruments') by either PGH1 or a special purpose subsidiary of PGH1 established for the purpose of issuing ACSM instruments and which are guaranteed by PGH1. The obligations of PGH1 in respect of such securities will be subordinated to and rank or be expressed to rank junior to the Notes as to rights to payments of interest and participation in the assets of PGH1 in a winding-up and shall comply with the then current requirements of the FSA in relation to Tier 1 capital. ACSM instruments will in the first instance be offered to related parties (as defined in the Terms and Conditions of the Notes as amended by the Supplemental Trust Deed dated 30 July 2008) and to third parties if not purchased by related parties. In the event that neither such related parties nor third parties will purchase the required ACSM instruments then PGH2 is required to use its best endeavours to raise such funds as are deemed necessary to purchase the required amounts of ACSM instruments.

For so long as a deferred coupon payment has not been satisfied PGH1 may not declare, pay or distribute a dividend on any of its securities in issue ranking junior to the Notes including the ordinary shares of PGH1 or any parity securities or, except in particular circumstances, redeem, purchase or otherwise acquire any of its securities in issue ranking junior to the Notes, including its ordinary shares or any parity securities. These restrictions would also apply to the Company until the deferred coupon payment is satisfied.

On 25 April 2012, the 2012 coupon was settled in full by PGH1, other than to two companies within the Group which waived their right to receive that coupon.

18.2 UK Commercial Property Trust Limited

UK Commercial Property Trust Limited ('UKCPT') is a property investment subsidiary which is domiciled in Guernsey and is admitted to the Official List of the UK Listing Authority and to trading on the LSE.

Following a bookbuilding process, the Group disposed of an aggregate of 47,826,087 shares in UKCPT (amounting to 4% of the issued share capital of UKCPT) at a price of 69p per share on 21 March 2012. Following completion of the sale the Group now holds 62% (2011: 66%) of the issued share capital of UKCPT.

19. Liabilities under insurance contracts

	Gross liabilities 2012 £m	Reinsurers' share 2012 £m	Gross liabilities 2011 £m	Reinsurers' share 2011 £m
Life assurance business:				
Insurance contracts	**39,806**	**8,287**	40,517	3,153
Investment contracts with DPF	**11,328**	**–**	11,283	–
	51,134	**8,287**	51,800	3,153
Less amounts classified as held for sale (note 3)	**(5,404)**	**(5,083)**	–	–
	45,730	**3,204**	51,800	3,153
Amounts due for settlement after 12 months	**41,375**	**3,054**	46,759	2,792

	Gross liabilities 2012 £m	Reinsurers' share 2012 £m	Gross liabilities 2011 £m	Reinsurers' share 2011 £m
At 1 January	**51,800**	**3,153**	50,479	2,939
Premiums	**1,609**	**5,173**	1,473	85
Claims	**(5,166)**	**(364)**	(4,968)	(224)
Other changes in liabilities	**2,912**	**332**	4,833	361
Foreign exchange adjustments	**(21)**	**(7)**	(17)	(8)
	51,134	**8,287**	51,800	3,153
Less amounts classified as held for sale (note 3)	**(5,404)**	**(5,083)**	–	–
At 31 December	**45,730**	**3,204**	51,800	3,153

20. Unallocated surplus

	2012 £m	2011 £m
At 1 January	**848**	864
Transfer from/(to) income statement	**45**	(16)
At 31 December	**893**	848

21. Borrowings

	Carrying value		Fair value	
	2012 £m	2011 £m	2012 £m	2011 £m
Limited recourse bonds 2012 7.39% (note a)	**–**	11	**–**	11
Limited recourse bonds 2022 7.59% (note a)	**85**	90	**103**	102
Property Reversions loan (note b)	**194**	217	**194**	217
£80 million facility agreement (note c)	**80**	80	**80**	80
£150 million term facility (note d)	**150**	60	**150**	60
Total policyholder borrowings	**509**	458	**527**	470
£200 million 7.25% unsecured subordinated loan (note e)	**143**	135	**173**	154
Unsecured loan notes (note f)	**–**	7	**–**	7
£2,260 million syndicated loan facility (note g)	**1,852**	1,993	**1,797**	1,843
£100 million PIK notes and facility (note h)	**116**	111	**98**	85
£75 million secured loan note (note i)	**75**	73	**35**	33
£425 million loan facility (note i)	**351**	375	**322**	325
Total shareholder borrowings	**2,537**	2,694	**2,425**	2,447
Total borrowings	**3,046**	3,152	**2,952**	2,917
Amount due for settlement after 12 months	**2,821**	2,983		

The above analysis reflects the position as at 31 December 2012 and therefore does not reflect the £450 million prepayment made on 22 February 2013 in connection with of the re-terming of the Impala facility (see note 48).

Notes to the consolidated financial statements
continued

21. Borrowings (continued)

Debenture loans

a. In 1998, National Provident Institution raised £260 million of capital through the securitisation of embedded value on a block of existing unit-linked and unitised with-profit life and pension policies. Following the demutualisation of National Provident Institution, these were transferred to National Provident Life Limited ('NPLL'). The bonds were split between two classes, which rank pari passu. The £140 million 7.39% class A1 limited recourse bonds (2011: £11 million) matured in 2012. The final principal repayment of £11 million was made in September 2012 as per the terms of the agreement. The £120 million 7.59% class A2 limited recourse bonds with an outstanding principal of £116 million (2011: £120 million) have an average remaining life of 6 years maturing in 2022. NPLL has provided collateral of £50 million (2011: £65 million) to provide security to the holders of the NPLL recourse bonds in issue.

b. The Property Reversions loan from Santander UK plc ('Santander') was brought into the consolidated financial statements at fair value. It relates to the sale of Extra-Income Plan policies that Santander finances to the value of the associated property reversions. With effect from 1 January 2012, Phoenix Life Limited ('PLL') became party to a loan agreement with Santander UK plc ('Santander'). As part of the arrangement Santander receive an amount calculated by reference to the movement in the Halifax House Price Index and PLL is required to indemnify Santander against profits or losses arising from mortality or surrender experience which differs from the basis used to calculate the reversion amount. Repayment will be on a policy-by-policy basis and is expected to occur over the next 10 to 20 years. During the year, repayments totalling £29 million were made. Note 34 contains details of the assets that support this loan.

c. In 2008, UKCPT entered into an £80 million revolving loan facility agreement. This loan accrues interest at LIBOR plus a variable margin of 0.50% to 0.60% per annum. The lender holds a floating charge over certain assets of UKCPT and its subsidiaries. The repayment date for this facility is 19 June 2015. This facility was fully utilised during 2011 and 2012 in order to increase UKCPT's property portfolio.

d. On 19 May 2011, UKCPT entered into a £150 million investment term loan facility agreement. The £150 million investment term loan facility agreement accrues interest at LIBOR plus a variable margin of 1.60% to 2.00% per annum. The lender holds security over the assets of UK Commercial Property Estates Holdings Limited and UK Commercial Property Estates Limited, both of which are subsidiaries of UKCPT. The repayment date for this facility is 19 May 2018. As at 31 December 2012 the facility was fully drawn down (2011: £60 million).

e. Scottish Mutual Assurance Limited issued £200 million 7.25% undated, unsecured subordinated loan notes on 23 July 2001. The earliest repayment date of the notes is 25 March 2021 and thereafter on each fifth anniversary so long as the notes are outstanding. With effect from 1 January 2009, as a part of a Part VII transfer, these loan notes were transferred into the shareholder fund of PLL. In the event of the winding-up of PLL, the right of payment under the notes is subordinated to the rights of the higher-ranking creditors (principally policyholders). As a result of the acquisition of the Phoenix Life businesses in 2009 these subordinated loan notes were acquired at their fair value and as such, the outstanding principal of these subordinated loan notes differs from the carrying value in the statement of financial position. The fair value adjustments which were recognised on acquisition will unwind over the remaining life of these subordinated loan notes.

f. Unsecured loan notes of £72 million were issued by Impala Holdings Limited ('Impala') at par on 14 May 2008 at an interest rate of LIBOR minus 1% per annum which matured at the end of 2012. During the year the loan notes were settled in full and the remaining outstanding balance of £7 million (2011: £5 million payment made) was paid.

g. On 14 May 2008, PGH (LC1) Limited and PGH (LC2) Limited jointly obtained a £2,260 million loan facility from a syndicate of external banks (the 'Impala Facility'). This facility was split into Tranche loans A, B and C of £1,275 million, £492.5 million and £492.5 million respectively. The terms of this facility were:

 - Tranche A loan of £1,275 million is repayable over the period from 30 April 2011 to 30 November 2014 and attracts interest at LIBOR plus a cash margin of 1.00% and a PIK margin of 1.00% for the first four years and LIBOR plus a cash margin of 2.50% for the subsequent years;
 - Tranche B loan of £492.5 million is repayable on 30 November 2015 and attracts interest at LIBOR plus a cash margin of 1.25% and a PIK margin of 0.75% for the first four years and LIBOR plus a cash margin of 3.25% for the subsequent years; and
 - Tranche C loan of £492.5 million is repayable on 30 November 2016 and attracts interest at LIBOR plus a cash margin of 1.75% and a PIK margin of 0.25% for the first four years and LIBOR plus a cash margin of 3.75% for the subsequent years.

 The borrowings under this facility are secured by, amongst other things:

 - first fixed and floating charges over all the assets and undertaking of PGH (LC1) Limited and PGH (LC2) Limited (including their respective 12.5% shareholdings in Impala, all real estate, book debts, bank accounts, investments and other assets);
 - a limited recourse share charge granted by Pearl Group Holdings (No. 2) Limited ('PGH2') over its 75% shareholding in Impala.

 During 2012, a scheduled repayment of £125 million (2011: £125 million) and a voluntary repayment of £15 million (2011: £20 million) were made.

 On 22 February 2013, a £450 million prepayment was made against the facility and its terms were revised. Please see note 48 for further information.

h. On 14 May 2008, PGH (MC1) Limited issued PIK notes to the value of £154.5 million to Royal London and PGH (MC2) Limited obtained a £154.5 million PIK facility from Royal London. The PIK notes and facility were subsequently amended on 2 September 2009, leaving a total of £100 million outstanding. Interest accrues on the PIK notes and facility at LIBOR plus a margin of 2% unless an election is made by PGH (MC1) Limited or PGH (MC2) Limited to capitalise the interest, in which case the margin increases to 3.5%. During 2012, interest of £5 million (2011: £5 million) was capitalised on the PIK notes and facility. The final maturity date on the PIK notes and facility is 30 June 2019.

i. On 15 November 2006, PGH (LCA) Limited and PGH (LCB) Limited jointly became a party to a £905 million loan facility from a syndicate of external banks (the 'Pearl Facility'). This loan was subsequently amended on 2 September 2009, leaving £425 million outstanding on this facility and £75 million of secured C loan notes.

 The £425 million facility is repayable over the period from 30 June 2011 to 30 June 2016, attracting interest at LIBOR plus a margin of 1.25%. The £75 million secured C loan notes are repayable 15 years after amendment and attract interest at LIBOR plus a margin of 1.00%.

 The borrowings under the £425 million facility are secured by first fixed and floating charges over all of the assets and undertakings of PGH (LCA) Limited and PGH (LCB) Limited (including their respective 50% shareholdings in Phoenix Life Holdings Limited ('PLHL'), all real estate, book debts, bank accounts, investments and other assets).

 During the year a scheduled repayment of £24 million (2011: £24 million) was made on the £425 million loan facility and interest of £2 million (£2011: £1 million) was capitalised on the £75 million secured C loan notes.

Notes to the consolidated financial statements
continued

22. Deposits received from reinsurers

	2012 £m	2011 £m
Carrying value and fair value:		
At 31 December	**454**	472
Amount due for settlement after 12 months	**420**	439

23. Derivatives

The Group purchases derivative financial instruments in connection with the management of its insurance contract and investment contract liabilities based on the principles of reduction of risk and efficient portfolio management. The Group does not typically hold derivatives for the purpose of selling or repurchasing in the near term or with the objective of generating a profit from short-term fluctuations in price or margin.

The fair values of derivative financial instruments are as follows:

	Assets 2012 £m	Liabilities 2012 £m	Assets 2011 £m	Liabilities 2011 £m
Warrants over shares in Phoenix Group Holdings	**–**	**3**	–	3
Forward currency	**710**	**678**	771	794
Credit default options	**10**	**4**	33	–
Credit linked note	**32**	**–**	–	–
Contract for differences	**2**	**–**	–	–
Interest rate swaps	**2,307**	**2,314**	4,600	3,473
Swaptions	**383**	**–**	396	–
Inflation swaps	**19**	**6**	33	2
Equity options	**196**	**–**	216	–
Stock index futures	**4**	**20**	46	16
Fixed income futures	**2**	**1**	4	4
	3,665	**3,026**	6,099	4,292

The amount recoverable after one year is £2,829 million (2011: £4,320 million). The amount payable after one year is £2,222 million (2011: £3,368 million).

Warrants over shares

On 1 January 2012, the Company had in issue the following warrants:

	IPO warrants Number	Lenders' warrants Number	Royal London warrants Number
At 1 January 2011, 31 December 2011 and 31 December 2012	**8,169,868**	**5,000,000**	**12,360,000**

IPO warrants

The IPO warrants originally entitled the holder to purchase one ordinary share at a price of €7.00 per share, subject to adjustment, at any time commencing on the consummation of a business combination. On 2 September 2009 the exercise price was increased to €11. At 31 December 2012, the terms of the IPO warrants entitled the holder to purchase 1.027873 (2011: 1.0272) ordinary shares per IPO warrant, for an exercise price of €10.70 (2011: €10.71).

On 5 July 2010, the IPO warrants were admitted to trading on the LSE. The IPO warrants were subsequently delisted from Euronext on 17 November 2010.

The exercise period for the IPO warrants commenced on 2 September 2009, and will expire at the close of trading on the LSE on 3 September 2014 or earlier upon redemption or liquidation. The Company may call the warrants for redemption:

– in whole but not in part;

– at a price of €0.01 per warrant;

– upon not less than 30 days' prior written notice of redemption to each warrant holder; and

– if, and only if, the reported last sale price of the share equals or exceeds €13.75 per share for any 20 trading days within a period of 30 consecutive trading days ending on the third business day prior to the notice of redemption to warrant holders. On 2 September 2009 the threshold of €13.75 was increased to €16.50. At 31 December 2012 the threshold was reduced to €16.05 (2011: €16.06) following an issue of ordinary shares by the Company under a scrip dividend.

– If the foregoing conditions are satisfied and the Company issues notice of redemption of the warrants, each warrant holder shall be entitled to exercise their warrant prior to the scheduled redemption date. However, the price of the shares may fall below the redemption trigger price or the warrant exercise price after the redemption notice is issued.

If the Company calls the warrants for redemption as described above, it will have the option to require any holder that wishes to exercise its warrant to do so on a cashless basis.

The IPO warrants are listed and were previously valued using the warrant price quoted on the LSE for the Company. Due to the relatively low number of IPO warrants in issue, they are thinly traded and the quoted price is not considered to be the best indicator of their fair value. As a result the IPO warrants have been valued using an extended Black-Scholes valuation model. The key assumptions used to ascertain a value as at 31 December 2012 are as follows:

– share price as at 31 December 2012 of £5.45;

– volatility of 30%;

– the warrants are not adjusted for dividends; and

– the valuation incorporates the impact of amending some of the terms of the warrants on 8 May 2012.

At 31 December 2012 the IPO warrants were valued at £1 million (2011: £1 million).

Lenders' warrants

On 2 September 2009, the Company issued 5 million warrants over its shares to the Lenders. These warrants entitled the holder to purchase one 'B' ordinary share at a price of £15 per share, subject to adjustment. Following the achievement of the Company's Premium Listing on 5 July 2010, the Lenders' warrants relate to ordinary shares rather than 'B' ordinary shares. At 31 December 2012 the terms of Lenders' warrants entitled the holders to purchase 1.027873 (2011: 1.0272) ordinary shares per Lenders' warrant for an exercise price of £14.59 (2011: £14.60).

The exercise period terminates on the first to occur of:

– 15th anniversary of the date issued;

– date fixed for the redemption of the warrants; and

– liquidation of the Company.

All outstanding Lenders' warrants may be redeemed at the option of the Company at any time after they become exercisable and prior to their expiration at a price of €0.01 per warrant provided that the last closing bid price of the ordinary shares is equal to or exceeds £18.97 (2011: £18.98) on each of 20 consecutive trading days. The Company must give not less than 30 days notice of the redemption date. Each warrant may then be exercised by the warrant holder (in whole or any part) at its option.

The holders are entitled to exercise their warrants for cash, assignment of an amount of outstanding principal/accrued interest of any Global Debt (i.e. any debt owed to the registered holder by any Group company) or on a cashless basis where the Company redeems the warrants. Any warrant either not exercised or tendered back to the Company by the redemption date shall be cancelled on the books of the Company and have no further value except for the €0.01 redemption price.

These Lenders' warrants are not traded in an active market and have therefore been valued using an extended Black-Scholes valuation model to capture the embedded barrier feature. The key assumptions used to ascertain a value are the same as for the IPO warrants (see above). The value of the warrants at the year end was £200,000 (2011: £250,000).

Notes to the consolidated financial statements
continued

23. Derivatives (continued)

Royal London warrants

On 2 September 2009, the Company issued 12.36 million warrants (2 million transferable and 10.36 million non-transferable) over its shares to Royal London as part consideration for acquiring the benefit of £250 million of the PIK notes and facility outstanding (comprising principal and capitalised interest). These warrants entitled the holder to purchase one 'B' ordinary share at a price of €11 per share, subject to adjustment. Following the achievement of the Company's Premium Listing, the Royal London warrants relate to ordinary shares rather than 'B' ordinary shares. At 31 December 2012 the terms of the Royal London warrants entitled the holders to purchase 1.027873 (2011: 1.0272) ordinary shares per Royal London warrant for an exercise price of €10.70 (2011: €10.71).

The exercise period terminates on the first to occur of:

– 5th anniversary of the date issued;

– date fixed for the redemption of the warrants; and

– liquidation of the Company.

All outstanding warrants may be redeemed at the option of the Company at any time after they become exercisable and prior to their expiration at a price of €0.01 per warrant, provided that the last closing bid price of the ordinary shares is equal to or exceeds €16.50 on each of 20 consecutive trading days. At 31 December 2012 the threshold was reduced to €16.05 (2011: €16.06) following an issue of ordinary shares by the Company under a scrip dividend. The Company must give not less than 30 days' notice of the redemption date. Each warrant may then be exercised by the warrant holder (in whole or any part) at its option.

The holders are entitled to exercise their warrants for cash, assignment of an amount of outstanding principal plus accrued interest of any Global Debt (e.g. the PIK facility) or on a cashless basis where the Company redeems the warrants. Any warrant either not exercised or tendered back to the Company by the redemption date shall be cancelled on the books of the Company and have no further value except for the €0.01 redemption price.

The Royal London warrants are not traded in an active market and have therefore been valued using an extended Black-Scholes valuation model.

The key assumptions used to ascertain a value as at 31 December 2012 are as for the IPO warrants (see above). The value of the warrants at the year end was £2 million (2011: £2 million).

24. Obligations for repayment of collateral received

	2012 £m	2011 £m
Carrying value and fair value:		
At 31 December	**10,458**	13,005
Amount due for settlement after 12 months	**1,002**	1,552

25. Financial liabilities

	Carrying value		**Fair value**	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Financial liabilities at fair value through profit or loss:				
Designated upon initial recognition	**12,961**	11,404	**12,961**	11,404
Held for trading – derivatives	**3,026**	4,292	**3,026**	4,292
Financial liabilities measured at amortised cost	**13,764**	16,412	**13,716**	16,442
	29,751	32,108	**29,703**	32,138
Amount due for settlement after 12 months	**6,531**	8,343		

26. Provisions

2012

	Leasehold properties £m	Staff related £m	Known incidents £m	Other £m	Total £m
At 1 January	28	21	5	5	59
Additions in the year	–	7	2	11	20
Utilised during the year	(6)	(1)	(1)	(2)	(10)
Released during the year	–	–	(1)	(1)	(2)
At 31 December	22	27	5	13	67

The leasehold properties provision has been made for amounts in respect of the excess of lease rentals and other payments on properties that are currently vacant or are expected to become vacant, over the amounts to be recovered from subletting these properties. The discount rate used ranged between 2.6% and 5.5% (2011: 3.92% and 5%) and it is expected that the provision will be utilised over the next 12 years (2011: 13 years).

Staff related provisions include provisions for unfunded pensions of £6 million (2011: £5 million) and private medical insurance costs for former employees of £3 million (2011: £3 million). These provisions have been calculated on a realistic basis.

The known incidents provision was created for historical data quality, administration systems problems and process deficiencies on the policy administration, financial reconciliations and operational finance aspects of business outsourced.

Included in other provisions are litigation and onerous contract provisions.

27. Tax assets and liabilities

	2012 £m	2011 £m
Current tax receivables	6	8
Net deferred tax assets	–	–
Total tax assets	6	8
Current tax payables	71	105
Net deferred tax liabilities	409	673
Total tax liabilities	480	778

Deferred tax assets comprise:

	2012 £m	2011 £m
Trading losses	107	37
Expenses and deferred acquisition costs carried forward	5	14
Provisions and other temporary differences	9	11
Pension scheme deficit	97	–
Accelerated capital allowances	17	18
Unpaid interest	62	34
Gross deferred tax assets	297	114
Less: offset against deferred tax liabilities	(297)	(114)
Net deferred tax assets	–	–

Notes to the consolidated financial statements
continued

27. Tax assets and liabilities (continued)

Deferred tax liabilities comprise:

	2012 £m	2011 £m
Acquired in-force business	501	593
Customer relationships	88	100
Surplus within the non-profit funds	–	62
IFRS transitional adjustments	88	–
Provisions and other temporary differences	6	8
Adjustment for insurance policies held with related parties in respect of the PGL Pension Scheme	23	24
Gross deferred tax liabilities	706	787
Less: offset against deferred tax assets	(297)	(114)
Net deferred tax liabilities	409	673

Movements in net deferred tax liabilities comprise:

	2012 £m	2011 £m
At 1 January	(673)	(607)
Amounts credited/(charged) to the income statement	131	(67)
Amounts credited to the statement of other comprehensive income	110	1
Amounts classified as held for sale (note 3)	23	–
At 31 December	(409)	(673)

The Finance Act 2012 set the rate of corporation tax at 23% from 1 April 2013. Consequently a rate of 23% has been used for the purposes of providing for deferred tax in these consolidated financial statements. Further reductions to 21% in April 2014 and 20% from April 2015 have been announced and will be introduced by future legislation. The benefit to the Group's net assets arising from the further 3% reduction in the tax rate is estimated at £25 million in total and will be recognised as the legislation is substantively enacted.

The Finance Act 2012 introduced new rules for the taxation of insurance companies, with effect from 1 January 2013. The deferred tax on the non-profit surplus has reversed and is replaced with IFRS transitional adjustments. The increase to the Group's net assets arising from the introduction of the new rules is estimated as £12 million in total. The impact is included in the tax reconciliation in note 12.3. The deferred tax liability will be amortised over a 10 year period on a straight line basis commencing in 2013 and ending in 2022 as the IFRS tax transitional adjustment is brought into account in the current year tax computations.

Deferred income tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable.

	2012 £m	2011 £m
Deferred tax assets have not been recognised in respect of:		
Tax losses carried forward	52	102
Excess expenses and deferred acquisition costs carried forward	–	22
Provisions and other temporary differences	7	14
Deferred tax assets not recognised on capital losses[1]	229	262

1 These can only be recognised against future capital gains and have no expiry date.

28. Payables related to direct insurance contracts

	2012 £m	2011 £m
Payables related to direct insurance contracts	**435**	707
Less amounts classified as held for sale	**(42)**	–
	393	707
Amount due for settlement after 12 months	**–**	39

Payables relating to direct insurance contracts include claims outstanding on general insurance and life assurance. The general insurance element amounts to £42 million (2011: £240 million) which is included within liabilities held for sale.

29. Accruals and deferred income

	2012 £m	2011 £m
Accruals and deferred income	**171**	175
Less amounts classified as held for sale (note 3)	**(5)**	–
	166	175
Amount due for settlement after 12 months	**3**	6

30. Other payables

	2012 £m	2011 £m
Investment broker balances	**363**	487
Other payables	**151**	140
	514	627
Less amounts classified as held for sale (note 3)	**(5)**	–
	509	627
Amount due for settlement after 12 months	**–**	–

31. Pension schemes

The Group operates two main staff pension schemes, the Pearl Group Staff Pension Scheme and the PGL Pension Scheme.

The carrying value of the defined benefit pension schemes is set out below.

	2012 £m	2011 £m
Pearl Group Staff Pension Scheme		
Economic (deficit)/surplus including £nil (2011: £56 million) available as a refund on a winding-up of the scheme	**(114)**	56
Irrecoverable amount of deficit reduction contributions	**(83)**	–
Provision for tax on that part of the economic surplus available as a refund on a winding-up of the scheme	**–**	(19)
Reported (deficit)/surplus	**(197)**	37
PGL Pension Scheme		
Economic surplus (including £285 million (2011: £471 million) available as a refund on a winding-up of the scheme)	**344**	520
Adjustment for insurance policies eliminated on consolidation	**(95)**	(94)
Net economic surplus	**249**	426
Provision for tax on that part of the economic surplus available as a refund on a winding-up of the scheme	**(112)**	(149)
Reported surplus	**137**	277

Notes to the consolidated financial statements
continued

31. Pension schemes (continued)

The total net actuarial (losses)/gains recognised in the statement of consolidated comprehensive income is set out below.

	2012 £m	2011 £m
Pearl Group Staff Pension Scheme	**(252)**	81
PGL Pension Scheme	**(170)**	170
Total actuarial (losses)/gains	**(422)**	251

Information on each of these schemes is set out below.

31.1 Pearl Group Staff Pension Scheme

The Pearl Group Staff Pension Scheme ('the Pearl Scheme') comprises a final salary section, a money purchase section and a hybrid section (a mix of final salary and money purchase). The final salary and hybrid sections of the Pearl Scheme are closed to new members.

Defined contribution scheme

Contributions in the year amounted to £1 million (2011: £1 million).

Defined benefit scheme

The defined benefit scheme is funded by payment of contributions to a separately administered trust fund. A Group company, PGH2, is the principal employer of the Pearl Scheme. The principal employer meets the administration expenses of the Pearl Scheme.

The valuation has been based on an assessment of the liabilities of the Pearl Scheme as at 31 December 2012, undertaken by independent qualified actuaries. The present values of the defined benefit obligation and the related current service costs have been measured using the projected unit credit method.

The scheme has been closed to future accrual by active members since 1 July 2011. Thus, the active members became deferred members of the scheme and their future service will not qualify for benefits under the scheme.

In November 2011, following formal consultation, the Group carried out a pension increase exchange ('PIE') exercise where existing in-scope pensioners were offered the option to exchange future non-statutory pension increases for benefits accrued before 6 April 1997 for a higher, non-increasing pension, thereby reducing longevity and inflation risk for the Group. The offer period for this exercise formally closed in February 2012.The financial effect of all acceptances received in the period and any reversals of acceptances received in the prior period, has been recognised in the consolidated financial statements and the reduction in scheme liabilities of £3 million (2011: £16 million) is shown as a negative past service cost in the consolidated income statement.

The principal financial assumptions of the Pearl Scheme are set out below.

	2012 %	2011 %
Rate of increase for pensions in payment (5% per annum or RPI if lower)	**2.90**	3.10
Rate of increase for deferred pensions (CPI)	**2.25**	2.10
Discount rate	**4.50**	4.90
Inflation – RPI	**3.00**	3.10
Inflation – CPI	**2.25**	2.10
Expected rate of return on scheme assets	**4.50**	3.70

The discount rate and inflation rate assumptions used for the calculation of the liabilities have been determined by considering the shape of the appropriate yield curves and the duration of the Pearl Scheme's liabilities. This method determines an equivalent single rate for each of the discount and inflation rates, which is derived from the profile of projected benefit payments.

The expected rate of return on scheme assets is derived after considering historical returns and assuming that asset classes with higher volatility generate higher returns (consistent with widely accepted capital market principles). The overall expected return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation.

It has been assumed that post-retirement mortality is in line with a scheme-specific table which was derived from the actual mortality experience in recent years, performed as part of the actuarial valuation as at 30 June 2012, based on the SAPS standard tables for males and for females based on year of use. This includes the 2011 CMI Core Projections mortality improvements, with a long-term trend assumption of 1.5% per annum. Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 30.1 years and 33.5 years for male and female members respectively.

A triennial funding valuation of the Pearl Scheme as at 30 June 2009 was completed in June 2010. This showed a deficit on the funding basis as at 30 June 2009 of £755 million. The triennial funding valuation of the Pearl Scheme as at 30 June 2012 is currently being performed and the initial estimate prepared by the actuary for the Pearl Scheme is that the deficit as at 30 June 2012 was £480 million, on the agreed technical provisions basis.

On 27 November 2012 the principal employer and the Trustee of the Pearl Scheme entered into a revised pensions funding agreement (the 'Pensions Agreement'), which forms the basis of the 30 June 2012 triennial valuation. The principal terms of the Pensions Agreement are:

– cash payments into the scheme of £70 million payable on 30 September in both 2013 and 2014, followed by payments of £40 million each year from 2015 and 2021. The Pensions Agreement includes a sharing mechanism that in certain circumstances allows for an acceleration of the contributions to be paid to the Pearl Scheme;
– increased and further contributions may become payable if the scheme is not anticipated to meet the two agreed funding targets:
  (i) to reach full funding on the technical provisions basis by 30 June 2022; and
  (ii) to reach full funding on a gilts flat basis by 30 June 2031;
– the Trustee continues to benefit from a first charge over shares in Phoenix Life Assurance Limited, London Life, National Provident Life Limited, Pearl Group Services Limited and PGS2 Limited. The value of the security claim granted under the share charges is, since 30 June 2012, capped at the lower of £600 million and 60% of the Pearl Scheme deficit (calculated on a basis linked to UK government securities) revalued every three years thereafter. Immediately following the repayment of the £425 million loan facility and £75 million of secured C loan notes (see note 21) the value of the security claim increases to 100% of the Pearl Scheme deficit (on a basis linked to UK government securities) revalued every three years, subject to a £600 million cap; and
– covenants test relating to the embedded value of certain companies within the Group.

Under IFRIC 14, pension funding contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available to the Group after they are paid into the scheme, a liability is recognised when the obligation arises. An additional liability of £83 million has been recognised, reflecting a charge on any refund of the resultant IAS 19 surplus of £237 million (£351 million of discounted future contributions less a current deficit of £114 million) in accordance with the minimum funding requirement. A deferred tax asset of £81 million has also been recognised to reflect tax relief at a rate of 23% that is expected to be available on the contributions, once paid into the scheme.

The amounts recognised in the income statement are as follows:

	2012 £m	2011 £m
Current service cost	**(1)**	(1)
Interest cost	**(85)**	(95)
Expected return on scheme assets	**75**	81
Past service cost	**3**	16
Curtailment gain	**–**	3
	(8)	4

Notes to the consolidated financial statements
continued

31. Pension schemes (continued)

31.1 Pearl Group Staff Pension Scheme (continued)

The net actuarial (losses)/gains recognised in other comprehensive income comprise the following:

	2012 £m	2011 £m
Actual return less expected return on scheme assets	**(7)**	110
Experience losses arising on scheme liabilities	**(24)**	(22)
(Loss)/gain due to changes in assumptions underlying scheme liabilities	**(157)**	12
	(188)	100
Irrecoverable amount of deficit reduction contributions	**(83)**	–
Change in provision for tax on the economic surplus available as a refund	**19**	(19)
	(252)	81

The cumulative net actuarial (losses)/gains recognised in other comprehensive income amount to £(104) million (2011: £148 million).

The (deficit)/surplus recognised in the statement of financial position is as follows:

	2012 £m	2011 £m
Fair value of scheme assets	**1,870**	1,865
Present value of defined benefit obligation	**(1,984)**	(1,809)
Provision for tax on the economic surplus available as a refund	**–**	(19)
Irrecoverable amount of deficit reduction contributions	**(83)**	–
	(197)	37

The actual return on the scheme assets comprises the following:

	2012 £m	2011 £m
Expected return on scheme assets	**75**	81
Actual return less expected return on scheme assets	**(7)**	110
	68	191

The change in the present value of the defined benefit obligation is as follows:

	2012 £m	2011 £m
At 1 January	**1,809**	1,802
Current service cost	**1**	1
Interest cost	**85**	95
Past service cost	**(3)**	(16)
Curtailment gain	**–**	(3)
Actuarial losses	**181**	9
Benefits paid	**(89)**	(79)
At 31 December	**1,984**	1,809

The defined benefit obligation arises from plans that are wholly or partly funded.

The change in the fair value of the scheme assets is as follows:

	2012 £m	2011 £m
At 1 January	**1,865**	1,725
Expected return on scheme assets	**75**	81
Actual return less expected return on scheme assets	**(7)**	110
Contributions by the employer	**26**	28
Benefits paid	**(89)**	(79)
At 31 December	**1,870**	1,865

The distribution of the scheme assets at the end of the year was as follows:

	2012 £m	2011 £m
Equities	**98**	165
Bonds	**642**	1,385
Properties	**159**	166
Private equities	**35**	–
Hedge fund	**801**	–
Cash and other	**135**	149
	1,870	1,865

Contributions totalling £70 million are expected to be paid into the scheme in 2013.

Table of historical information:

	2012 £m	2011 £m	2010 £m	2009 £m
Fair value of scheme assets	**1,870**	1,865	1,725	1,684
Defined benefit obligation	**(1,984)**	(1,809)	(1,802)	(1,805)
Irrecoverable amount of deficit reduction contributions	**(83)**	–	–	–
Provision for tax on the economic surplus available as a refund	**–**	(19)	–	–
(Deficit)/surplus	**(197)**	37	(77)	(121)
Experience (losses)/gains on scheme assets	**(7)**	110	19	36
Experience (losses)/gains on scheme liabilities	**(24)**	(22)	70	58

Five years historical information is not available, as prior to 2009 Phoenix Group Holdings did not prepare consolidated financial statements.

31.2 PGL Pension Scheme

The PGL Pension Scheme comprises a final salary section and a defined contribution section.

Defined contribution scheme
Contributions in the year amounted to £1 million (2011: £2 million).

Defined benefit scheme
The defined benefit section of the PGL Pension Scheme is a final salary arrangement which is closed to new entrants.

The valuation has been based on an assessment of the liabilities of the PGL Pension Scheme as at 31 December 2012, undertaken by independent qualified actuaries.

The scheme has been closed to future accrual by active members since 1 July 2011. A curtailment gain of £7 million, was recognised in the consolidated income statement during 2011.

In November 2011, following formal consultation, the Group carried out a PIE exercise, the same as that outlined for the Pearl Scheme. The financial effects of the exercise were treated in the same way as for the Pearl Scheme. The financial effects of all acceptances in the period, and any reversals of acceptances received in the period to 31 December 2012, have been recognised in the consolidated financial statements and the reduction in scheme liabilities of £2 million (2011: £11 million) is shown as a negative past service cost in the consolidated income statement.

In November 2011, the Group commenced an Enhanced Transfer Value ('ETV') exercise which offered in-scope deferred members of the PGL Pension Scheme the option to take an Equivalent Cash Transfer Value to exit the Scheme, thereby extinguishing any future liability and risk for the Group with respect to these members. The financial effect of all completed transfers has been recognised in the consolidated financial statements in 2012. As at 31 December 2012, ETVs of £36 million have been paid out, reducing scheme assets, and there was a resulting reduction in the scheme liabilities of £29 million. The net settlement cost of £7 million has been recognised in the consolidated income statement.

Notes to the consolidated financial statements
continued

31. Pension schemes (continued)

31.2 PGL Pension Scheme (continued)

A triennial funding valuation of the PGL Pension Scheme as at 30 June 2009 was completed in September 2010. This showed a deficit on the funding basis as at 30 June 2009 of £255 million. Following discussions with the Trustee of the PGL Pension Scheme it was agreed that new cash contributions to the scheme amounting to £160 million would be paid over the period from September 2010 to August 2017. Total future contributions amount to £77 million at 31 December 2012. The triennial funding valuation of the PGL Pension Scheme as at 30 June 2012 is currently being performed and the initial estimate prepared by the actuary for the PGL Pension Scheme is that the deficit was £64 million as at 30 June 2012, using the technical provisions basis underlying the valuation (updated for market conditions as at 30 June 2012).

In accordance with an agreement dated November 2005, certain of the Group's with-profit funds have indemnified the Shareholders in respect of contribution calls equal to their share of the costs of changes in longevity assumptions. The potential for any recovery from the Group's with-profit funds will be considered as part of the process to finalise the triennial funding valuation as at 30 June 2012.

The principal financial assumptions of the PGL Pension Scheme are set out below.

	2012 %	2011 %
Rate of increase for pensions in payment	**2.85**	3.00
Rate of increase for deferred pensions ('CPI')	**2.25**	2.10
Discount rate	**4.50**	4.90
Inflation – RPI	**3.00**	3.10
Inflation – CPI	**2.25**	2.10
Expected rate of return on scheme assets	**3.90**	3.90

The discount rate and inflation assumptions used for the calculation of the liabilities have been determined by considering the shape of the appropriate yield curves and the duration of the PGL Scheme liabilities. This method determines an equivalent single rate for each of the discount and inflation rates, which is derived from the profile of projected benefit payments.

The expected rate of return on scheme assets is derived after considering historical returns and assuming that asset classes with higher volatility generate higher returns (consistent with widely accepted capital market principles). The overall expected return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation.

It has been assumed that post-retirement mortality is in line with standard tables PNA00 with a scaling factor of 105% being applied, allowing for future improvements in line with the long cohort improvement factors, subject to a minimum improvement from 2007 onwards of 1.25% p.a. and 0.75% p.a. for males and females respectively. Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 31.7 years and 34.1 years for male and female members respectively.

The economic value of the PGL Pension Scheme assets as at 31 December 2012 amounted to £1,704 million (2011: £1,589 million) and the economic value of the surplus amounted to £344 million (2011: £520 million). For financial reporting purposes the carrying value of the insurance policies effected by the PGL Pension Scheme with the Group have been eliminated on consolidation, resulting in reported assets of the PGL Pension Scheme as at 31 December 2012 of £1,609 million (2011: £1,660 million) and a reported surplus of £137 million (2011: £277 million).

The amounts recognised in the income statement are as follows:

	2012 £m	2011 £m
Current service cost	**(1)**	(3)
Interest cost	**(56)**	(63)
Expected return on scheme assets	**62**	66
Past service cost	**1**	11
Settlement cost – ETV	**(7)**	–
Gain on curtailment	**–**	7
	(1)	18

The net actuarial (losses)/gains recognised in other comprehensive income comprise the following:

	2012 £m	2011 £m
Actual return less expected return on scheme assets	**(51)**	327
Experience loss arising on scheme liabilities	**(64)**	(15)
Loss due to changes in assumptions underlying scheme liabilities	**(92)**	(25)
	(207)	287
Change in provision for tax on the economic surplus available as a refund	**37**	(117)
	(170)	170

The cumulative net actuarial gains recognised in other comprehensive income amounted to £83 million (2011: £253 million).

The surplus recognised in the statement of financial position is as follows:

	2012 £m	2011 £m
Fair value of scheme assets	**1,609**	1,660
Present value of defined benefit obligation	**(1,360)**	(1,234)
Provision for tax on the economic surplus available as a refund	**(112)**	(149)
	137	277

The actual return on the scheme assets comprises the following:

	2012 £m	2011 £m
Expected return on scheme assets	**62**	66
Actual return less expected return on scheme assets	**(51)**	327
	11	393

The change in the present value of the defined benefit obligation is as follows:

	2012 £m	2011 £m
At 1 January	**1,234**	1,193
Current service cost	**1**	3
Interest cost	**56**	63
Past service cost	**(1)**	(11)
Curtailment gain	**–**	(7)
Actuarial losses	**156**	40
Settlement – ETV	**(29)**	–
Benefits paid	**(57)**	(47)
At 31 December	**1,360**	1,234

The defined benefit obligation arises from plans that are wholly or partly funded.

Notes to the consolidated financial statements
continued

31. Pension schemes (continued)

31.2 PGL Pension Scheme (continued)

The change in the fair value of the scheme assets is as follows:

	2012 £m	2011 £m
At 1 January	**1,660**	1,284
Expected return on scheme assets	**62**	66
Actual return less expected return on scheme assets	**(51)**	327
Contributions by the employer	**31**	30
Settlement – ETV	**(36)**	–
Benefits paid	**(57)**	(47)
At 31 December	**1,609**	1,660

The distribution of the scheme assets at the end of the year was as follows:

	2012 £m	2011 £m
Bonds	**927**	1,443
Properties	**158**	117
Cash and other	**455**	100
Hedge funds	**69**	–
	1,609	1,660

Contributions totalling £23 million are expected to be paid into the scheme in 2013.

Table of historical information:

	2012 £m	2011 £m	2010 £m	2009 £m
Fair value of scheme assets	**1,609**	1,660	1,284	1,126
Defined benefit obligation	**(1,360)**	(1,234)	(1,193)	(1,130)
Provision for tax on the economic surplus available as a refund	**(112)**	(149)	(32)	–
Surplus/(deficit)	**137**	277	59	(4)
Experience (losses)/gains on scheme assets	**(51)**	327	81	23
Experience (losses)/gains on scheme liabilities	**(64)**	(15)	(23)	18

Five years historical information is not available, as prior to 2009 Phoenix Group Holdings did not prepare consolidated financial statements.

32. Intangible assets

2012

	Goodwill £m	Acquired in-force business £m	Customer relationships £m	Present value of future profits £m	Total £m
Cost or valuation	**115**	**2,213**	**445**	**23**	**2,796**
At 1 January					
Amounts classified as held for sale (note 3)	**(19)**	**(165)**	**–**	**–**	**(184)**
At 31 December	**96**	**2,048**	**445**	**23**	**2,612**
Amortisation					
At 1 January	**–**	**331**	**43**	**–**	**374**
Charge for the year	**–**	**122**	**18**	**–**	**140**
Amounts classified as held for sale (note 3)	**–**	**(27)**	**–**	**–**	**(27)**
At 31 December	**–**	**426**	**61**	**–**	**487**
Carrying amount at 31 December	**96**	**1,622**	**384**	**23**	**2,125**
Amount recoverable after 12 months	**96**	**1,511**	**366**	**23**	**1,996**

2011

	Goodwill £m	Acquired in-force business £m	Customer relationships £m	Present value of future profits £m	Total £m
Cost or valuation					
At 1 January	115	2,213	445	42	2,815
Revaluation	–	–	–	(19)	(19)
At 31 December	115	2,213	445	23	2,796
Amortisation					
At 1 January	–	197	25	–	222
Charge for the year	–	134	18	–	152
At 31 December	–	331	43	–	374
Carrying amount at 31 December	115	1,882	402	23	2,422
Amount recoverable after 12 months	115	1,755	384	23	2,277

Notes to the consolidated financial statements
continued

32. Intangible assets (continued)

Goodwill

The carrying value of goodwill has been tested for impairment at the period end. No impairment has resulted as the value in use of this intangible continues to exceed its carrying value. Value in use has been determined as the present value of certain future cash flows associated with the Ignis Asset Management business and the management services business of the Phoenix Life segment. The cash flows used in this calculation are consistent with those adopted by management in the Group's operating plan and for the period 2017 and beyond, reflect the anticipated run-off of the Phoenix Life insurance business.

Future cash flows have been valued using a discount rate of 10.1% (2011: 10.0%) for the Ignis Asset Management business and a discount rate of 7.8% (2011: 6.7%) for the management services business of the Phoenix Life segment.

Impairment tests have been performed using assumptions which management consider reasonable. Given the magnitude of the excess of the value in use over carrying value, management does not believe that a reasonably foreseeable change in key assumptions would cause the carrying value to exceed value in use.

The carrying amount of goodwill allocated to the Phoenix Life segment is £39 million (2011: £58 million) and to the Ignis Asset Management segment is £57 million (2011: £57 million).

Acquired in-force business

Acquired in-force business represents the difference between the fair value of the contractual rights acquired and obligations assumed under insurance and investment contracts with and without DPF and the liability measured in accordance with the Group's accounting policies for such contracts. This intangible is being amortised in accordance with the run-off of the book of business within the Phoenix Life segment.

The acquired in-force business is allocated to the Phoenix Life segment.

Customer relationships

The first part of the customer relationships intangible relates to vesting pension premiums which captures the new business arising from policies in-force at the acquisition date, specifically top-ups made to existing policies and annuities vested from matured pension policies. The total value of this customer relationship intangible at acquisition was £297 million and has been allocated to the Phoenix Life segment. This intangible is being amortised over a 20 year period.

The second part of the customer relationships intangible relates to the investment management contracts ('IMCs') held within Ignis Asset Management. These are further split into IMCs held with open ended funds and institutional mandates. The open ended IMCs had a value at acquisition of £130 million and an indefinite useful economic life ('UEL'). The reason for the indefinite UEL is that funds are open ended and indefinite in nature. An impairment review has been completed for these intangibles at the period end with an indefinite life and no impairment has arisen. Under this impairment review, value in use has been determined as the present value of future cash flows associated with the open-ended IMCs. The cash flows used in this calculation are consistent with those adopted by management in the Group's operating plan, with a declining growth rate assumed for the extended forecast period beyond the period of this plan. Future cash flows have been valued using a discount rate of 10.1% (2011: 10.0%). The institutional mandate IMCs had a value at acquisition of £18 million and a UEL of between 5 and 7 years.

These IMC customer relationships have been allocated to the Ignis Asset Management segment.

The amortisation charge for customer relationships is presented separately in the consolidated income statement.

PVFP on non-participating business in the with-profit fund

The value of the PVFP is determined on a realistic basis and is allocated in full to the Phoenix Life segment. The principal assumptions used to calculate the PVFP are the same as those used in calculating the insurance contract liabilities given in note 42.5.1. Revaluation of PVFP is charged or credited to the consolidated income statement as appropriate.

33. Property, plant and equipment

	2012 £m	2011 £m
Cost or valuation		
At 1 January	**44**	39
Additions	**3**	7
Disposals	**(1)**	(2)
At 31 December	**46**	44
Depreciation and impairment		
At 1 January	**(16)**	(5)
Charge for the year	**(3)**	(3)
Disposals	**1**	–
Impairment	**(4)**	(8)
At 31 December	**(22)**	(16)
Carrying amount		
At 31 December	**24**	28

The useful lives of plant and equipment have been taken as follows: motor vehicles 3–4 years, computer equipment 3–4 years, furniture and office equipment 5–10 years.

The valuation of land and buildings is carried out at least every three years as at 31 December by external surveyors in accordance with the Royal Institution of Chartered Surveyors' requirements under an open market valuation basis. The Group's main operating site in Wythall is owned by one of the Group's management services companies following its purchase from one of the Group's with-profit funds during 2012.

34. Investment property

	2012 £m	2011 £m
At 1 January	**1,816**	1,732
Additions	**65**	102
Improvements	**9**	9
Disposals	**(78)**	(31)
(Losses)/gains on adjustments to fair value	**(85)**	4
At 31 December	**1,727**	1,816

Investment property is stated at fair value and is independently valued in accordance with the Royal Institute of Chartered Surveyors' guidelines on the basis of the open market value of such properties.

Investment properties include £199 million (2011: £221 million) property reversions arising from sales of the NPI Extra Income Plan. With effect from 1 January 2012, as part of a Part VII transfer, the NPI Limited property reversions were transferred to PLL. The reversionary interest is valued as the PLL and NPLL proportion of the current market value, projected for the lifetime of the policyholder at the assumed future increase in house prices, then discounted back by the valuation rate of interest. The acquisition of these investment properties was financed by the Property Reversions loan as detailed in note 21.

Direct operating expenses (offset against rental income in the income statement) in respect of investment properties that generated rental income during the year amounted to £8 million (2011: £4 million). The direct operating expenses arising from investment property that did not generate rental income during the year amounted to £2 million (2011: £2 million).

Notes to the consolidated financial statements
continued

35. Financial assets

	2012 £m	2011 £m
Loans and receivables at amortised cost	**1,914**	3,529
Financial assets at fair value through profit or loss		
Held for trading – derivatives	**3,665**	6,099
Designated upon initial recognition		
Equities	**11,005**	11,078
Fixed and variable rate income securities	**40,945**	42,010
Collective investment schemes	**6,052**	6,251
	63,581	68,967
Less amounts classified as held for sale (note 3)	**(61)**	–
	63,520	68,967
Amount due for settlement after 12 months	**32,123**	40,303

The fair value of loans and receivables at amortised cost amounted to £1,912 million (2011: £3,494 million).

36. Financial instrument fair value hierarchy

36.1 Determination of fair value and fair value hierarchy of financial instruments

Level 1 financial instruments

The fair value of financial instruments traded in active markets (such as publicly traded securities and derivatives) is based on quoted market prices at the period end. The quoted market price used for financial assets is the current bid price on the trade date. If the bid price is unavailable a 'last traded' approach is adopted. For units in unit trusts and shares in open ended investment companies, fair value is by reference to published bid values.

Level 2 financial instruments

The fair values of investments that are not traded in an active market are determined using valuation techniques with observable market inputs. The fair value of shares and other variable yield securities and derivative financial instruments, are estimated using pricing models, discounted cash flow techniques or broker quotes. Where pricing models are used, inputs are based on market related data at the period end. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market related rate for a similar instrument.

Level 3 financial instruments

The Group's financial assets determined by valuation techniques using non observable inputs are based on a combination of independent third party evidence and internally developed models. Third party evidence in the form of net asset valuation statements, are used in the valuation of the majority of indirect property, private equity and hedge funds. Broker quotes are received for certain bonds where the market is considered to be inactive. Internally developed models have been used in the valuation of a small number of investment vehicles which due to their nature and complexity have no external market. Inputs into the internally developed models are based on market observable data where available.

36.2 Fair value hierarchy of financial instruments measured at fair value

2012

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivatives	**37**	**3,616**	**12**	**3,665**
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	**10,017**	**178**	**810**	**11,005**
Fixed and variable rate income securities	**28,997**	**11,448**	**500**	**40,945**
Collective investment schemes	**5,048**	**846**	**158**	**6,052**
	44,062	**12,472**	**1,468**	**58,002**
Less amounts classified as held for sale (note 3)	**(61)**	**–**	**–**	**(61)**
Total financial assets at fair value	**44,038**	**16,088**	**1,480**	**61,606**

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities at fair value				
Derivatives	**–**	**3,023**	**3**	**3,026**
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	**–**	**8,096**	**–**	**8,096**
Borrowings	**–**	**194**	**–**	**194**
Net asset value attributable to unitholders	**4,601**	**–**	**70**	**4,671**
	4,601	**8,290**	**70**	**12,961**
Total financial liabilities at fair value	**4,601**	**11,313**	**73**	**15,987**

2011

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivatives	–	6,038	61	6,099
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	10,222	42	814	11,078
Fixed and variable rate income securities	31,592	9,556	862	42,010
Collective investment schemes	4,976	1,043	232	6,251
	46,790	10,641	1,908	59,339
Total financial assets at fair value	46,790	16,679	1,969	65,438

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities at fair value				
Derivatives	–	4,292	–	4,292
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	–	7,978	–	7,978
Borrowings	–	217	–	217
Net asset value attributable to unitholders	3,040	–	169	3,209
	3,040	8,195	169	11,404
Total financial liabilities at fair value	3,040	12,487	169	15,696

36.3 Level 3 financial instrument sensitivities

Included in Level 3 investments is a property investment structure with a value of £102 million (2011: £102 million). It has been valued by taking the fair value of the property within the structure, which has been independently valued, less the fair value of the debt within the structure. The valuation is sensitive to movements in yields on the underlying property portfolio. An increase in yields of 25bps would reduce the value of the investment by £22 million (2011: £23 million) and a reduction in yields of 25bps would increase the value by £25 million (2011: £25 million).

Level 3 investments in indirect property, private equity and hedge funds are valued using net asset statements provided by independent third parties and therefore no sensitivity analysis has been prepared.

Debt securities categorised as Level 3 investments are valued using broker quotes. Although such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

Notes to the consolidated financial statements
continued

36. Financial instrument fair value hierarchy (continued)

36.4 Significant transfers of financial instruments between Level 1 and Level 2

2012

	From Level 1 to Level 2 £m	From Level 2 to Level 1 £m
Financial assets at fair value		
Financial assets designated at fair value through profit or loss upon initial recognition		
Fixed and variable rate income securities	**276**	**686**

2011

	From Level 1 to Level 2 £m	From Level 2 to Level 1 £m
Financial assets at fair value		
Financial assets designated at fair value through profit or loss upon initial recognition		
Fixed and variable rate income securities	1,181	186

There were no transfers of financial liabilities at fair value between Level 1 and Level 2 and between Level 2 and Level 1.

All the Group's Level 1 and Level 2 assets have been valued using standard market pricing sources, which have not changed during 2012.

The Group generally saw an improvement in the liquidity of the fixed and variable rate securities market throughout 2012, which resulted in a number of securities moving from Level 2 into Level 1.

36.5 Movement in Level 3 financial instruments measured at fair value

2012

	At 1 January 2012 £m	Total (losses)/ gains in income statement £m	Purchases and sales £m	Transfers to Level 1 and Level 2 £m	At 31 December 2012 £m	Unrealised losses on assets held at end of year £m
Financial assets						
Derivative assets	**61**	**(28)**	**(21)**	**–**	**12**	**(26)**
Financial assets designated at fair value through profit or loss upon initial recognition						
Equities	**814**	**9**	**(9)**	**(4)**	**810**	**(6)**
Fixed and variable rate income securities	**862**	**(67)**	**(171)**	**(124)**	**500**	**(72)**
Collective investment schemes	**232**	**(11)**	**(55)**	**(8)**	**158**	**(4)**
	1,908	**(69)**	**(235)**	**(136)**	**1,468**	**(82)**
Total financial assets	**1,969**	**(97)**	**(256)**	**(136)**	**1,480**	**(108)**

	At 1 January 2012 £m	Total (losses)/ gains in income statement £m	Purchases and sales £m	Transfers from Level 1 and Level 2 £m	At 31 December 2012 £m	Unrealised (losses)/gains on liabilities held at end of year £m
Financial liabilities						
Derivative liabilities	**–**	**3**	**–**	**–**	**3**	**(4)**
Financial liabilities designated at fair value through profit or loss upon initial recognition						
Net asset value attributable to unitholders	**169**	**2**	**(101)**	**–**	**70**	**2**
Total financial liabilities	**169**	**5**	**(101)**	**–**	**73**	**(2)**

Level 3 financial instruments are transferred to Level 1 or Level 2 as and when the conditions of each Level are met. During 2012 the Group saw an increase in observable inputs, due to improving market liquidity, leading to a decrease in Level 3 financial instruments.

2011

	At 1 January 2011 £m	Total (losses)/ gains in income statement £m	Purchases and sales £m	Transfers from Level 1 and Level 2 £m	At 31 December 2011 £m	Unrealised losses on assets held at end of year £m
Financial assets						
Derivative assets	89	(17)	(11)	–	61	(40)
Financial assets designated at fair value through profit or loss upon initial recognition						
Equities	793	29	(10)	2	814	(2)
Fixed and variable rate income securities	747	9	(3)	109	862	(1)
Collective investment schemes	316	(2)	(82)	–	232	(1)
	1,856	36	(95)	111	1,908	(4)
Total financial assets	1,945	19	(106)	111	1,969	(44)

	At 1 January 2011 £m	Total (losses)/ gains in income statement £m	Purchases and sales £m	Transfers from Level 1 and Level 2 £m	At 31 December 2011 £m	Unrealised gains on liabilities held at end of year £m
Financial liabilities						
Derivative liabilities	11	(11)	–	–	–	–
Financial liabilities designated at fair value through profit or loss upon initial recognition						
Net asset value attributable to unitholders	168	1	–	–	169	44
Total financial liabilities	179	(10)	–	–	169	44

Gains and losses on Level 3 financial instruments are included in net investment income in the consolidated income statement. There were no gains or losses recognised in other comprehensive income.

37. Stock lending and collateral

The Group lends listed financial assets held in its investment portfolio to other institutions. The Group conducts its stock lending programme only with well-established, reputable institutions in accordance with established market conventions.

The financial assets do not qualify for derecognition as the Group retains all the risks and rewards of the transferred assets except for the voting rights. The carrying value of listed financial assets lent at 31 December 2012 that have not been derecognised amounted to fixed and variable rate income securities of £9,179 million (2011: £10,924 million).

It is the Group's practice to obtain collateral in stock lending transactions, usually in the form of cash or marketable securities.

Where the Group receives collateral in the form of marketable securities which it is not permitted to sell or re-pledge except in the case of default, such collateral is not recognised in the statement of consolidated financial position. The fair value of financial assets accepted as such collateral amounts to £83 million (2011: £255 million).

Where the Group receives collateral in the form of cash it is recognised in the statement of consolidated financial position along with a corresponding liability to repay the amount of the collateral received. The amount recognised as a financial asset and a financial liability at 31 December 2012 is £9,269 million (2011: £10,823million) and £9,249 million (2011: £10,916 million) respectively.

The maximum exposure to credit risk in respect of stock lending transactions is £9,179 million (2011: £10,924 million) of which credit risk of £9,179 million (2011: £10,913 million) is mitigated through the use of collateral arrangements.

Collateral and pledges

Assets accepted

It is the Group's practice to obtain collateral to mitigate the counterparty risk related to over-the-counter ('OTC') derivatives and reinsurance transactions, usually in the form of cash or marketable securities.

Notes to the consolidated financial statements
continued

37. Stock lending and collateral (continued)

Collateral and pledges (continued)

Where the Group receives collateral in the form of marketable securities which it is not permitted to sell or re-pledge except in the case of default, it is not recognised in the statement of consolidated financial position. The fair value of financial assets accepted as collateral for OTC derivatives and reinsurance transactions but not recognised in the statement of consolidated financial position amounts to £245 million and £7,350 million respectively (2011: £371 million and £2,089 million). The increase in collateral for reinsurance transactions is largely driven by the reinsurance agreement entered into with Guardian during the period over selected portfolios of the Group's annuity liabilities.

Where the Group receives collateral on OTC derivatives and reinsurance transactions in the form of cash it is recognised in the statement of consolidated financial position along with a corresponding liability to repay the amount of collateral received, disclosed as 'Obligations for the repayment of collateral received' and 'Deposits received from reinsurers' respectively. The amounts recognised as financial assets and liabilities from cash collateral received at 31 December 2012 are set out below.

	OTC derivatives		Reinsurance transactions	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Financial assets	**1,340**	2,089	**445**	472
Financial liability	**1,337**	2,089	**445**	472

The maximum exposure to credit risk in respect of OTC derivative assets is £3,619 million (2011: £6,045 million) of which credit risk of £3,492 million (2011: £5,871 million) is mitigated by use of collateral arrangements (which are settled net after taking account of any OTC derivative liabilities owed to the counterparty).

Credit risk on exchange traded derivative assets of £46 million (2011: £54 million) is mitigated through regular margining and the protection offered by the exchange.

Assets pledged

The Group pledges collateral in respect of its OTC derivative liabilities.

Where the Group pledges collateral in the form of cash or marketable securities and retains all the risks and rewards of the transferred assets, they continue to be recognised in the statement of consolidated financial position. The value of assets pledged at 31 December 2012 in respect of OTC derivative liabilities of £3,002 million (2011: £4,268 million) amounted to £1,048 million (2011: £236 million).

Collateral has also been pledged and charges granted in respect of certain of the Group's borrowings as set out in note 21 In addition, the Trustee of the Pearl Group Staff Pension Scheme has been granted certain charges as set out in note 31.

38. Other receivables

	2012 £m	2011 £m
Investment broker balances	**331**	95
Other debtors	**108**	105
	439	200
Amount recoverable after 12 months	**–**	–

39. Cash and cash equivalents

	2012 £m	2011 £m
Bank and cash balances	**1,764**	1,713
Short-term deposits (including demand and time deposits)	**7,264**	10,010
	9,028	11,723

All deposits are subject to fixed interest rates. The carrying amounts approximate to fair value at the period end. Cash and cash equivalents in long-term business operations and collective investment schemes of £8,552 million (2011: £11,387 million) are primarily held for the benefit of policyholders and so are not generally available for use by the owners.

40. Cash flows from operating activities

	2012 £m	2011 £m
Profit/(loss) for the year before tax	**323**	(4)
Non-cash movements in profit for the year before tax		
Fair value losses/(gains) on:		
Investment property	**85**	(4)
Financial assets	**(1,445)**	(1,572)
Change in fair value of borrowings	**11**	20
Depreciation of property, plant and equipment	**3**	3
Impairment of owner occupied property	**4**	8
Amortisation of intangible assets	**140**	152
Change in PVFP	**–**	19
Change in unallocated surplus	**45**	(16)
Share-based payment charge	**5**	4
Interest expense on borrowings	**215**	251
Net expected return on pension assets	**3**	11
Other losses/(gains) on pension schemes	**2**	(37)
Decrease in investment assets	**7,082**	1,400
Decrease/(increase) in reinsurance assets	**156**	(201)
(Decrease)/increase in insurance contract and investment contract liabilities	**(6,262)**	450
(Decrease)/increase in deposits received from reinsurers	**(18)**	53
(Decrease)/increase in obligation for repayment of collateral received	**(2,547)**	2,845
Net (increase)/decrease in working capital	**(93)**	310
Cash (utilised)/generated by operations	**(2,291)**	3,692

41. Capital statement

Capital Management Framework

The Group's Capital Management Framework is designed to achieve the following objectives:

- provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary excess capital;
- ensure sufficient liquidity to meet obligations to policyholders and other creditors; and
- optimise the overall gearing to ensure an efficient capital base.

The framework comprises a suite of capital management policies that govern the allocation of capital throughout the Group to achieve the framework objectives under a range of stress conditions. The policy suite is defined with reference to policyholder security, creditor obligations, owner dividend policy and regulatory capital requirements.

The capital policy of each life company is set and monitored by each life company Board. These policies ensure there is sufficient capital within each life company to meet regulatory capital requirements under a range of stress conditions. The capital policy of each life company varies according to the risk profile and financial strength of the company.

Regulatory capital adequacy at a group level is calculated at the ultimate insurance parent undertaking which is PLHL. PLHL aims to maintain group regulatory surplus at least equal to the capital buffers agreed with the FSA.

Notes to the consolidated financial statements
continued

41. Capital statement (continued)

Capital Management Framework (continued)

The capital policy of each Group holding company is designed to ensure that there is sufficient liquidity to meet creditor obligations through the combination of cash buffers and cash flows from the Group's operating companies.

Group capital

Capital resources

The primary sources of capital used by the Group comprise equity shareholder funds as measured on an MCEV basis, the Perpetual Reset Capital Securities and shareholder borrowings. This is analysed as follows:

	Notes	2012 £m	2011 £m
Total IFRS equity attributable to owners of the parent[1]		**1,658**	1,652
Adjustments between IFRS equity attributable to owners of the parent and MCEV net worth[2]		**(1,913)**	(2,163)
MCEV value of in-force business[2]		**2,377**	2,629
Group MCEV		**2,122**	2,118
Gross shareholder debt:			
50% of the Perpetual Reset Capital Securities given their hybrid nature	18	**204**	204
Shareholder borrowings	21	**2,537**	2,694
Difference between IFRS and MCEV carrying values of shareholder borrowings		**112**	71
Gross MCEV		**4,975**	5,087

1 As shown in the consolidated statement of financial position.

2 As detailed in the reconciliation of Group IFRS equity to MCEV net worth in the MCEV financial statements.

Leverage

In managing capital the Group seeks to optimise the level of debt on its balance sheet. The Group's closed book business model allows it to operate with higher leverage than life companies that are still writing new business, as it does not need to fund upfront capital requirements and new business acquisition expenses.

Further details on the Group's gearing calculation (unaudited) is printed in the Business review on page 39.

Regulatory capital requirements of the Group

Insurance Groups' Directive ('IGD')

FSA regulated insurance groups (including their holding companies) are also required to assess capital adequacy on a Group wide basis to enable the FSA to assess both the level of insurance and financial risk within the Group and the capital resources available to cover that risk. The assessment is known as the IGD.

The Group's IGD assessment is made at the ultimate insurance parent undertaking within the EEA, which is PLHL.

The capital position statement shown above presents the total capital that the Group manages on a Pillar 1 basis in respect of its life insurance companies. It is different from the total capital available in the IGD calculation on the basis that the IGD is assessed at the PLHL level and is subject to different rules pertaining to its calculation. For example, due to the Group's current corporate structure, certain of the Group's subsidiaries are only included in the IGD calculation at 75% of their regulatory value, including capital requirements. The capital position statement includes these subsidiaries in full. This difference and other adjustments amount to a reduction of £916 million (2011: £1,168 million) in Phoenix Life available capital resources of £6,532 million (estimated) (2011 (actual): £6,777 million) compared with PLHL Group Capital Resources of £5,616 million (estimated) (2011 (actual): £5,608 million). Further detail of the PLHL IGD position (unaudited) is provided in the business review on page 37.

PLHL ICA

The Group undertakes a further group solvency calculation, the 'PLHL ICA', at the same level at which the IGD calculation is performed. This involves an assessment, on an economic basis, of the capital resources and requirements arising from the obligations and risks which exist outside of the life companies.

For this measure the capital resources include the surplus over capital policy in the life companies, a prudent assessment of the present value of future profits of Ignis Asset Management and the net assets of the Holding Companies, less the pension scheme obligations on an economic basis. The capital requirements relate to the risks arising outside of the life companies including those in relation to the Group's staff pension schemes, offset by Group diversification benefits. Further detail of the PLHL ICA position is provided in the business review (unaudited) on page 38.

Regulatory capital requirements of the life companies

Each UK life company and the Group must retain sufficient capital at all times to meet the regulatory capital requirements mandated by the FSA. In addition to EU-directive-based 'Pillar 1' and group capital requirements, the FSA has also stipulated a 'Pillar 2' of risk-based capital requirements that have been implemented in the UK. A life company's actual capital requirement is based on whichever of the Pillar 1 or Pillar 2 requirement turns out to be more onerous for the company. Each life company generally holds an amount of capital that is greater than the minimum required amount to allow for adverse events in the future that may use capital and might otherwise cause the company to fail the minimum level of regulatory capital test.

Pillar 1

With the exception of with-profit businesses, the regulatory capital requirement under Pillar 1 is the total amount held in respect of investment, expense and insurance risks (the 'long-term insurance capital requirement' ('LTICR')) and any additional amounts required to cover the more onerous of two specified stress tests (the 'resilience capital requirement' ('RCR')). The regulatory capital requirement is then deducted from the available capital resources to give the excess capital on a regulatory basis.

An alternative test to the RCR is required under Pillar 1 in respect of with-profit funds which may result in an additional capital requirement referred to as the 'with-profit insurance capital component' ('WPICC').

Pillar 2

The Pillar 2 capital requirements are based on a self-assessment methodology, called the 'Individual Capital Assessment' ('ICA'). This methodology determines the capital requirement to ensure that the life company's realistic liabilities can be met in one year's time with a 99.5% confidence level, or in other words to be able to withstand a one in 200 year event. The FSA reviews each life company's ICA and may impose additional capital requirements if necessary in the form of 'Individual Capital Guidance' ('ICG').

Regulatory capital position statement for the life companies

The purpose of the capital position statement is to set out the Pillar 1 capital resources of the Group's life companies calculated in accordance with the regulatory rules applicable to individual life companies. It provides an analysis of the disposition and constraints over the availability of capital to meet risks and regulatory requirements. The capital position statement also provides a reconciliation of the life companies owners' funds to regulatory capital and an analysis of the regulatory capital between the Group's with-profits funds, non-participating business and life business owners' funds.

The Group has a number of internal loan arrangements in place, which allow the Group to provide capital support to other areas of the business. In addition to these internal loan arrangements, the Group has in place a number of internal reinsurance contracts which are structured to manage the capital position between certain life funds.

The available capital resources in each part of the business are generally subject to restrictions as to their availability to meet requirements that may arise elsewhere in the Group. The principal restrictions are:

With-profit funds – any available surplus held in each fund can only be used to meet the requirements of the fund itself or be distributed to policyholders and owners. In 90:10 with-profit funds, policyholders are entitled to at least 90% of the distributed profits while owners receive the balance. In 100:0 with-profit funds, policyholders are entitled to 100% of the distributed profits. Any distribution to the owners would be subject to a tax charge which, for some funds, would be deducted from the amount received by owners.

Non-participating funds – any available surplus held in these funds is attributable to owners. Capital within the non-participating funds may be made available to meet capital requirements elsewhere in the Group subject to meeting regulatory and legal requirements, and after consideration of the internal capital requirements of the relevant fund and company. Any transfer of surplus may give rise to a tax charge subject to availability of tax relief elsewhere in the Group.

Notes to the consolidated financial statements
continued

41. Capital statement (continued)

Regulatory capital position statement (continued)

The capital statement and movement analysis that follows presents information about the capital resources for the Group's UK life businesses.

2012

	With-profit (see below) £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m	Other activities and consolidation adjustments[4] £m	Group total £m
Owners' funds held outside long-term fund	–	–	1,822	1,822	(605)	1,217
Owners' funds held in long-term fund	–	441	–	441	–	441
Total owners' funds	–	441	1,822	2,263	(605)	1,658
Adjustments onto a regulatory basis:						
Unallocated surplus	883	10	–	893		
Adjustments to assets[1]	(31)	(214)	(604)	(849)		
Adjustments to liabilities[2]	3,687	(149)	42	3,580		
Other qualifying capital:						
Subordinated debt[3]	–	–	645	645		
Contingent loans	350	(55)	(295)	–		
Total available capital resources	4,889	33	1,610	6,532		

With-Profit

2012

	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Total £m
Owners' funds held outside long-term fund	–	–	–	–	–	–	–
Owners' funds held in long-term fund	–	–	–	–	–	–	–
Total owners' funds	–	–	–	–	–	–	–
Adjustments onto a regulatory basis:							
Unallocated surplus	304	138	221	35	86	99	883
Adjustments to assets[1]	(1)	(1)	(2)	–	(1)	(26)	(31)
Adjustments to liabilities[2]	984	569	985	206	615	328	3,687
Other qualifying capital:							
Subordinated debt	–	–	–	–	–	–	–
Contingent loans	–	–	–	–	–	350	350
Total available capital resources	1,287	706	1,204	241	700	751	4,889

Notes

1 Regulatory adjustments to assets reflect adjustments to derecognise inadmissible assets such as intangibles and deferred tax assets as well as those adjustments that are necessary where asset and counterparty exposures exceed the prescribed regulatory limits.

2 Regulatory adjustments to liabilities primarily reflect differences between the realistic valuation basis for the with-profit business used in calculating owners' funds on an IFRS basis, and the regulatory valuation basis used to calculate the FSA peak 1 capital resources.

3 Of the £645 million (2011: £645 million) subordinated debt attributed to the Phoenix Life segment of the Group £445 million (2011: £445 million) is internal to the Group, comprising £250 million (2011: £250 million) provided to Phoenix Life Assurance Limited and £195 million (2011: £195 million) provided to Phoenix & London Assurance Limited which was transferred to PLL on 1 January 2011 following a Part VII transfer. The remaining £200 million (2011: £200 million) is external subordinated debt, see note 21 for details.

4 'Other activities and consolidation adjustments' represent the consolidated owners' funds arising outside of the Phoenix Life business. This includes the owners' funds of Ignis Asset Management and the holding companies of the Group plus the value of the acquired in-force business net of the consolidation adjustments to eliminate the cost of the Group's investment in the Phoenix Life business in the form of equity capital and subordinated loans.

2011

	With-profit (see below) £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m	Other activities and consolidation adjustments[4] £m	Group total £m
Owners' funds held outside long-term fund	–	–	1,688	1,688	(763)	925
Owners' funds held in long-term fund	–	727	–	727	–	727
Total owners' funds	–	727	1,688	2,415	(763)	1,652
Adjustments onto a regulatory basis:						
Unallocated surplus	843	5	–	848		
Adjustments to assets[1]	(34)	(251)	(535)	(820)		
Adjustments to liabilities[2]	3,667	(141)	33	3,559		
Other qualifying capital:						
Subordinated debt[3]	–	–	645	645		
Contingent loans	412	(73)	(209)	130		
Total available capital resources	4,888	267	1,622	6,777		

With-profit

2011

	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Total £m
Owners' funds held outside long-term fund	–	–	–	–	–	–	–
Owners' funds held in long-term fund	–	–	–	–	–	–	–
Total owners' funds	–	–	–	–	–	–	–
Adjustments onto a regulatory basis:							
Unallocated surplus	280	148	218	52	57	88	843
Adjustments to assets[1]	(1)	(1)	(4)	–	(1)	(27)	(34)
Adjustments to liabilities[2]	841	710	782	275	655	404	3,667
Other qualifying capital:							
Contingent loans	–	–	–	–	–	412	412
Total available capital resources	1,120	857	996	327	711	877	4,888

Notes to the consolidated financial statements
continued

41. Capital statement (continued)

An analysis of the movement in available capital resources for the period 1 January 2012 to 31 December 2012 is shown below:

	With-profit								
	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m
Total available capital resources at 1 January 2012	1,120	857	996	327	711	877	267	1,622	6,777
Regular surplus	118	–	(18)	35	8	60	142	–	345
Investment return	294	65	346	108	152	261	15	28	1,269
Cost of bonus	(135)	(198)	(94)	(56)	(93)	(84)	–	57	(603)
Changes in methodology and assumptions:									
Longevity	2	18	1	6	3	56	2	–	88
Expenses	5	12	(7)	(1)	57	31	2	–	99
Persistency	–	–	–	–	–	(7)	(5)	–	(12)
Morbidity	–	–	–	–	–	–	(2)	–	(2)
Other	17	(77)	(1)	–	21	(12)	70	–	18
Management actions:									
Distributions made by Phoenix Life	–	–	–	–	–	–	–	(494)	(494)
New business and other factors:									
Intragroup capital movement	–	–	–	–	–	(107)	(383)	479	(11)
Valuation rate of interest	(136)	30	(19)	(178)	(159)	(324)	–	–	(786)
Adjustment for internal loans in excess of counterparty limits	–	–	–	–	–	–	(52)	(82)	(134)
Other	2	(1)	–	–	–	–	(23)	–	(22)
Total available capital resources at 31 December 2012	1,287	706	1,204	241	700	751	33	1,610	6,532

An analysis of the movement in available capital resources for the period 1 January 2011 to 31 December 2011 is shown below:

	With-profit								
	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m
Total available capital resources at 1 January 2011	1,048	963	1,032	295	713	1,023	709	1,441	7,224
Regular surplus	44	54	(12)	56	7	51	137	–	337
Investment return	554	302	178	217	130	705	5	69	2,160
Cost of bonus	(119)	(184)	(83)	(55)	(74)	(81)	–	51	(545)
Changes in methodology and assumptions:									
Longevity	2	33	(2)	3	3	11	(32)	–	18
Expenses	22	5	3	1	(46)	24	1	–	10
Persistency	–	–	–	–	–	(13)	(1)	–	(14)
Other	–	15	–	12	(1)	69	12	–	107
Management actions:									
Distributions made by Phoenix Life	–	–	–	–	–	–	–	(585)	(585)
New business and other factors:									
Intragroup capital movement	–	–	(31)	–	–	(222)	(581)	834	–
Valuation rate of interest	(441)	(331)	(89)	(201)	(88)	(690)	–	–	(1,840)
Adjustment for internal loans in excess of counterparty limits	–	–	–	–	–	–	(2)	(182)	(184)
Other	10	–	–	(1)	67	–	19	(6)	89
Total available capital resources at 31 December 2011	1,120	857	996	327	711	877	267	1,622	6,777

Changes in methodology and assumptions

Changes to capital resources arising from changes in methodology and assumptions occur in the normal course of the assumption setting process and reflect changes in available data inputs.

Management actions

The management actions that have had the most significant impact on available capital resources of the Phoenix Life segment of the Group during the period to 31 December 2012 generally comprise payment of dividends to Group entities.

Notes to the consolidated financial statements
continued

42. Risk management

The Group's overall approach to risk management is described in the Risk management commentary on pages 41 to 46 of the Annual Report and Accounts.

42.1 Risk and capital management objectives

The risk management objectives and policies of the Group are based on the requirement to protect the Group's regulatory capital position, thereby safeguarding policyholders' guaranteed benefits whilst also ensuring the Group can meet its various cash flow requirements. Subject to this, the Group seeks to use available capital to achieve increased returns, balancing risk and reward, to generate additional value for policyholders and shareholders.

In pursuing these objectives, the Group deploys financial assets and incurs financial liabilities. Financial assets principally comprise investments in equity securities, fixed and variable rate income securities, collective investment schemes, property, derivatives, reinsurance, trade and other receivables, and banking deposits. Financial liabilities comprise investment contracts, borrowings for financing purposes, derivative liabilities and other payables.

42.2 Asset liability management ('ALM') framework

The use of financial instruments naturally exposes the Group to the risks associated with them, mainly, market risk, credit risk and financial soundness risk. Financial soundness risk is a broad risk category encompassing financial control and reporting risk, capital management risk, liquidity and funding risk, and tax risk. Liquidity and funding risk is the most relevant of the financial soundness risks for financial instruments.

Responsibility for agreeing the financial risk profile rests with the Board of each life company, as advised by investment managers, internal committees and the actuarial function. In setting the risk profile, the Board of each life company will receive advice from the appointed investment managers and the relevant actuarial function holder as to the potential implications of that risk profile with regard to the probability of both realistic insolvency and of failing to meet the regulatory minimum capital requirement. The actuarial function holder will also advise the extent to which the investment risk taken is consistent with the Group's commitment to treat customers fairly.

Derivatives are used in a number of the Group's funds, within policy guidelines agreed by the Board of each life company and overseen by Investment Committees of the Boards of each life company supported by management oversight committees. Derivatives are primarily used for efficient portfolio management or for risk hedging purposes, including the activities of the Group's Treasury function.

More detail on the Group's exposure to financial risk is provided in note 42.3 below.

The Group is also exposed to insurance risk arising from its Phoenix Life segment. Life insurance risk in the Group arises through its exposure to mortality, longevity and to other variances between assumed and actual experience. These variances can be in factors such as persistency levels and management and administrative expenses. More details on the Group's exposure to insurance risk are provided in note 42.5 below.

The Group's overall exposure to market and credit risk is monitored by appropriate committees, which agree policies for managing each type of risk on an ongoing basis, in line with the investment strategy developed to achieve investment returns in excess of amounts due in respect of insurance contracts. The effectiveness of the Group's ALM relies on the matching of assets and liabilities arising from insurance and investment contracts, taking into account the types of benefits payable to policyholders under each type of contract. Separate portfolios of assets are maintained for with-profit business, (which includes all of the Group's participating business), non-linked non-participating business and unit-linked business.

42.3 Financial risk analysis

Transactions in financial instruments result in the Group assuming financial risks. These include credit risk, market risk and financial soundness risk. Each of these are described below, together with a summary of how the Group manages them.

42.3.1 Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. These obligations can relate to both on and off balance sheet assets and liabilities.

There are two principal sources of credit risk for the Group:

– Credit risk which results from direct investment activities, including investments in fixed and variable rate income securities, derivatives, collective investment schemes and the placing of cash deposits; and

– Credit risk which results indirectly from activities undertaken in the normal course of business. Such activities include premium payments, outsourcing contracts, reinsurance, exposure from material suppliers and the lending of securities.

The amount disclosed in the statement of consolidated financial position in respect of all financial assets, together with rights secured under off balance sheet collateral arrangements, and excluding those that back unit-linked liabilities, represents the Group's maximum exposure to credit risk.

The impact of non-government fixed and variable rate income securities and, inter alia, the change in market credit spreads during the year is fully reflected in the values shown in these financial statements. Credit spreads are the excess of corporate bond yields over gilts yields to reflect the higher level of risk. Similarly, the value of derivatives that the Group holds takes into account fully the changes in swap rates.

There is an exposure to spread changes affecting the prices of corporate bonds and derivatives. This exposure applies to with-profit funds, non-profit funds (where risks and rewards fall wholly to shareholders), shareholders' funds and to unit–linked funds to the extent of management fees generated by the Group.

The Group holds £2,866 billion of corporate bonds which are used to back annuity in payment liabilities in non-profit funds (this excludes the liabilities reinsured to Opal Reassurance Limited. These annuity liabilities include an aggregate credit default provision of £228 million to fund against the risk of default.

A 100 basis point widening of credit spreads, with all other variables held constant and no change in assumed expected defaults, would result in a decrease in the profit after tax in respect of a full financial year, and in equity, of £51 million (2011: £82 million).

A 100 basis point narrowing of credit spreads, with all other variables held constant and no change in assumed expected defaults, would result in an increase in the profit after tax in respect of a full financial year, and in equity, of £72 million (2011: £95 million).

Credit risk is managed by the monitoring of aggregate Group exposures to individual counterparties and by appropriate credit risk diversification. The Group manages the level of credit risk it accepts through credit risk tolerances. In certain cases, protection against exposure to particular credit risk types may be achieved through the use of derivatives. The credit risk borne by the shareholder on with-profit policies is dependent on the extent to which the underlying insurance fund is relying on shareholder support.

Quality of credit assets

An indication of the Group's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The following table provides information regarding the aggregate credit exposure split by credit rating (ratings obtained from reputable rating agencies are used in deriving the table below):

2012

	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Non-rated £m	Unit-linked £m	Total £m
Loans and receivables	–	–	1,687	–	–	179	42	6	1,914
Derivatives	–	–	3,499	–	–	–	73	93	3,665
Fixed and variable rate income securities	24,956	6,502	4,461	3,495	376	527	443	132	40,892
Reinsurers' share of insurance contract liabilities	–	761	2,440	3	–	–	–	–	3,204
Cash and cash equivalents	5,409	1,990	1,408	66	6	3	–	146	9,028
	30,365	9,253	13,495	3,564	382	709	558	377	58,703

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.3 Financial risk analysis (continued)

2011

	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Non-rated £m	Unit-linked £m	Total £m
Loans and receivables	–	–	3,008	–	11	454	51	5	3,529
Derivatives	–	73	5,665	–	–	–	183	178	6,099
Fixed and variable rate income securities	28,722	2,478	5,015	4,107	492	425	603	168	42,010
Reinsurers' share of insurance contract liabilities	–	759	2,374	20	–	–	–	–	3,153
Cash and cash equivalents	8,509	1,574	1,474	19	8	6	1	132	11,723
	37,231	4,884	17,536	4,146	511	885	838	483	66,514

Non-equity based derivatives are included in the credit risk table above.

Credit ratings have not been disclosed in the above tables for holdings in collective investment schemes. The credit quality of the underlying debt securities within these vehicles is managed by the safeguards built into the investment mandates for these vehicles.

It is also the Group's policy to maintain accurate and consistent internal risk ratings across its asset portfolio. This enables management to focus on the applicable risks and to compare credit exposures across all lines of business, geographical regions and products. The rating system is supported by a variety of financial analytics combined with market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories of assets and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

A further indicator of the quality of the Group's financial assets is the extent to which they are neither past due nor impaired. The following table gives information regarding the ageing of financial assets that are past due but not impaired and the carrying value of financial assets that have been impaired.

2012

	Neither past due nor impaired £m	Less than 30 days £m	30–90 days £m	Greater than 90 days £m	Impaired £m	Unit-linked £m	Carrying value £m
Loans and receivables	**1,895**	**–**	**–**	**–**	**13**	**6**	**1,914**
Derivatives	**3,572**	**–**	**–**	**–**	**–**	**93**	**3,665**
Fixed and variable rate income securities	**40,760**	**–**	**–**	**–**	**–**	**132**	**40,892**
Reinsurers' share of insurance contract liabilities	**3,204**	**–**	**–**	**–**	**–**	**–**	**3,204**
Reinsurance receivables	**64**	**–**	**–**	**–**	**–**	**–**	**64**
Prepayments and accrued income	**500**	**–**	**–**	**–**	**–**	**–**	**500**
Other receivables	**439**	**–**	**–**	**–**	**–**	**–**	**439**
Cash and cash equivalents	**8,882**	**–**	**–**	**–**	**–**	**146**	**9,028**

2011

	Neither past due nor impaired £m	Less than 30 days £m	30–90 days £m	Greater than 90 days £m	Impaired £m	Unit-linked £m	Carrying value £m
Loans and receivables	3,468	–	–	–	56	5	3,529
Derivatives	5,921	–	–	–	–	178	6,099
Fixed and variable rate income securities	41,842	–	–	–	–	168	42,010
Reinsurers' share of insurance contract liabilities	3,153	–	–	–	–	–	3,153
Reinsurance receivables	257	–	–	–	–	–	257
Prepayments and accrued income	599	–	–	–	–	–	599
Other receivables	200	–	–	–	–	–	200
Cash and cash equivalents	11,591	–	–	–	–	132	11,723

Please refer to page 177 for additional life company asset disclosures which include the life companies' exposure to peripheral Eurozone debt securities. Peripheral Eurozone is defined as Portugal, Spain, Italy, Ireland and Greece.

Assets backing unit-linked business have not been analysed in these tables as the credit risk on such financial assets is borne by the policyholders. However, these assets have been included as a separate column in these tables to reconcile the information to the statement of consolidated financial position. Shareholder credit exposure on unit-linked assets is limited to the level of asset manager fee which is dependent on the underlying assets.

Concentration of credit risk

Concentration of credit risk might exist where the Group has significant exposure to an individual counterparty or a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions. The Group has most of its counterparty risk within its life business and this is monitored by the counterparty limits contained within the investment guidelines and investment management agreements, overlaid by regulatory requirements and the monitoring of aggregate counterparty exposures across the Group.

The Group is also exposed to concentration risk with outsource partners. This is due to the nature of the outsourced services market. The Group operates a policy to manage outsourcer service counterparty exposures and the impact from default is reviewed regularly by Executive Committees and measured though the ICA stress and scenario testing.

Collateral

The credit risk of the Group is mitigated, in certain circumstances, by entering into collateral agreements. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and the valuation parameters. Collateral is mainly obtained for stock lending, certain reinsurance arrangements and to provide security against the maturity proceeds of derivative financial instruments. Management monitors the market value of the collateral received, requests additional collateral when needed, and performs an impairment valuation when impairment indicators exist and the asset is not fully secured (and is not carried at fair value).

42.3.2 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market influences. Market risk comprises interest rate risk, currency risk and other price risk (comprising equity risk, property risk, inflation risk and alternative asset class risk).

The Group is mainly exposed to market risk as a result of:

- the mismatch between liability profiles and the related asset investment portfolios;
- the investment of surplus assets including shareholder reserves yet to be distributed, surplus assets within the with-profit funds and assets held to meet regulatory capital and solvency requirements; and
- the income flow of management charges from the invested assets of the business.

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.3 Financial risk analysis (continued)

The Group manages the levels of market risk that it accepts through an approach to investment management that determines:

- the constituents of market risk for the Group;
- the basis used to fair value financial assets and liabilities;
- the asset allocation and portfolio limit structure;
- diversification from and within benchmarks by type of instrument and geographical area;
- the net exposure limits by each counterparty or group of counterparties, geographical and industry segments;
- control over hedging activities;
- reporting of market risk exposures and activities; and
- monitoring of compliance with market risk policy and review of market risk policy for pertinence to the changing environment.

All operations comply with regulatory requirements relating to the taking of market risk.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate relative to the respective liability due to the impact of changes in market interest rates on the value of interest-bearing assets and on the value of future guarantees provided under certain contracts of insurance.

Interest rate risk is managed by matching assets and liabilities where practicable and by entering into derivative arrangements for hedging purposes where appropriate. This is particularly the case for the non-participating funds. For participating business, some element of investment mismatching is permitted where it is consistent with the principles of treating customers fairly. The with-profit funds of the Group provide capital to allow such mismatching to be effected. In practice, the life companies of the Group maintain an appropriate mix of fixed and variable rate instruments according to the underlying insurance or investment contracts and will review this at regular intervals to ensure that overall exposure is kept within the risk profile agreed for each particular fund. This also requires the maturity profile of these assets to be managed in line with the liabilities to policyholders.

The sensitivity analysis for interest rate risk indicates how changes in the fair value or future cash flows of a financial instrument arising from changes in market interest rates at the reporting date result in a change in profit after tax and in equity. It takes into account the effect of such changes in market interest rates on all assets and liabilities that contribute to the Group's reported profit after tax and in equity (but excludes the impact on the Group's pension schemes).

With-profit business and non-participating business within the with-profit funds are exposed to interest rate risk as guaranteed liabilities are valued relative to market interest rates and investments include fixed interest securities and derivatives. For with-profit business the profit or loss arising from mismatches between such assets and liabilities is largely offset by increased or reduced discretionary policyholder benefits dependent on the existence of policyholder guarantees. The contribution of these funds to the Group result is determined primarily by either the shareholders' share of the declared annual bonus or by the shareholders' interest in any change in value in the capital advanced to the Group's with-profit funds.

In the non-participating funds, policy liabilities' sensitivity to interest rates are matched primarily with fixed and variable rate income securities, with the result that sensitivity to changes in interest rates is very low. For unit-linked funds this risk is borne by the policyholders and the risk to the Group is limited to the extent of the management fees generated by the Group.

An increase of 1% in interest rates, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year, and in equity, of £41 million (2011: an increase of £2 million). A decrease of 1% in interest rates, with all other variables held constant, would result in a decrease in profit after tax in respect of a full financial year, and in equity, of £79 million (2011: a decrease of £6 million).

Equity, property and inflation risk

The Group has exposure to financial assets and liabilities whose values will fluctuate as a result of changes in market prices other than from interest rate and currency fluctuations. This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Group limits its exposure to anyone counterparty in its investment portfolios and to any one foreign market.

The portfolio of marketable equity securities and property investments which is carried in the statement of consolidated financial position at fair value, has exposure to price risk. The Group's objective in holding these assets is to earn higher long-term returns by investing in a diverse portfolio of equities and properties. Portfolio characteristics are analysed regularly and price risks are actively managed in line with investment mandates. The Group's holdings are diversified across industries and concentrations in any one company or industry are limited.

Equity and property price risk is primarily borne in respect of assets held in with-profit or unit-linked funds. For unit-linked funds this risk is borne by policyholders and asset movements directly impact unit prices and hence policy values. For with-profit funds policyholders' future bonuses will be impacted by the investment returns achieved and hence the price risk, whilst the Group also has exposure to the value of guarantees provided to with-profit policyholders. In addition some equity investments are held in respect of shareholders' funds. The Group as a whole is exposed to price risk fluctuations impacting the income flow of management charges from the invested assets of all funds.

Equity and property price risk is managed through the agreement and monitoring of financial risk profiles that are appropriate for each of the Group's life funds in respect of maintaining adequate regulatory capital and treating customers fairly. This is largely achieved through asset class diversification and within the Group's ALM framework through the holding of derivatives or physical positions in relevant assets where appropriate.

The sensitivity analysis for equity and property price risk illustrates how a change in the fair value of equities and properties affects the Group result. It takes into account the effect of such changes in equity and property prices on all assets and liabilities that contribute to the Group's reported profit after tax and in equity (but excludes the impact on the Group's pension schemes).

A 10% decrease in equity prices, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and, in equity, of £12 million (2011: an increase of £16 million).

A 10% increase in equity prices, with all other variables held constant, would result in an decrease in the profit after tax in respect of a full financial year, and in equity, of £12 million (2011: a decrease of £16 million).

A 10% decrease in property prices, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year, and in equity, of £19 million (2011: £43 million).

A 10% increase in property prices, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year, and in equity, of £20 million (2011: £45 million).

The Group is exposed to inflation risk through certain contracts, such as annuities, which may provide for future benefits to be paid taking account of changes in the level of experienced and implied inflation, and also through the Group's cost base. The Group seeks to manage inflation risk within the ALM framework through the holding of derivatives, such as inflation swaps, or physical positions in relevant assets, such as index linked gilts, where appropriate.

Currency risk

The Group's principal transactions are carried out in sterling and therefore its exchange risk is limited principally to historic business that was written in the Republic of Ireland, where the assets are generally held in the same currency denomination as their liabilities, therefore, any foreign currency mismatch is largely mitigated. Consequently, the foreign currency risk relating to this business mainly arises when the assets and liabilities are translated into sterling.

The Group's financial assets are primarily denominated in the same currencies as its insurance and investment liabilities. Thus the main foreign exchange risk arises from recognised assets and liabilities denominated in currencies other than those in which insurance and investment liabilities are expected to be settled and, indirectly, from the earnings of UK companies arising abroad.

Certain Phoenix Life with-profit funds have an exposure to overseas assets which is not driven by liability considerations. The purpose of this exposure is to reduce overall risk whilst maximising returns by diversification. This exposure is limited and managed through investment mandates which are subject to the oversight of the Investment Committees of the Boards of each life company. Fluctuations in exchange rates from certain holdings in overseas assets are hedged against currency risks.

Sensitivity of profit after tax and equity to fluctuations in currency exchange rates is not considered significant at 31 December 2012, since unhedged exposure to foreign currency was relatively low (2011: not considered significant).

42.3.3 Financial soundness risk

Financial soundness risk is a broad risk category encompassing financial control and reporting risk, capital management risk, liquidity and funding risk, and tax risk.

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.3 Financial risk analysis (continued)

Financial control and reporting risk is defined as the failure of the Group to appropriately record, report or disclose financial information. The Group has exposure to financial control and reporting risk through the production of its Interim and Annual Report and Accounts. The Group's subsidiaries have exposure to financial control and reporting risk through their annual entity statutory and regulatory reporting.

Capital management risk is defined as the failure of the Group, or one of its separately regulated subsidiaries, to maintain sufficient capital to provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary capital. The PLHL Group has exposure to capital management risk through the requirements of the IGD and ICA, as implemented by the FSA, to calculate regulatory capital adequacy at a Group level. The Group's UK life subsidiaries have exposure to capital management risk through the regulatory capital requirements mandated by the FSA. The Group's approach to managing capital management risk is described in detail in note 41.

Liquidity and funding risk is defined as the failure of the Group to maintain adequate levels of financial resources to enable it to meet its obligations as they fall due. The Group has exposure to liquidity risk as a result of servicing its external debt and equity investors, and from the operating requirements of its subsidiaries. The Group's subsidiaries have exposure to liquidity risk as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements.

Tax risk is defined as the risk of financial or reputational loss arising from a lack of liquidity, funding or capital due to an unforeseen tax cost, or by the inappropriate reporting and disclosure of information in relation to taxation. The Group has exposure to tax risk through the production of its Interim and Annual Report and Accounts and the provisions for taxation therein. Tax risk is managed by maintaining an appropriately-staffed tax team who have the qualifications and experience to make judgements on tax issues, augmented by advice from external specialists where required. The Group has a formal tax risk policy, which sets out its risk appetite in relation to specific aspects of tax risk, and which details the controls the Group has in place to manage those risks. These controls are subject to a regular review process. The Group's subsidiaries have exposure to tax risk through the annual statutory and regulatory reporting and through the processing of policyholder tax requirements.

The Board of Phoenix Group Holdings has defined a number of governance objectives and principles and the liquidity risk frameworks of each subsidiary are designed to ensure that:

- liquidity risk is managed in a manner consistent with the subsidiary company Boards' strategic objectives, risk appetite and Principles and Practices of Financial Management ('PPFM');
- cash flows are appropriately managed and the reputation of the Group is safeguarded; and
- appropriate information on liquidity risk is available to those making decisions.

The Group's policy is to maintain sufficient liquid assets of suitable credit quality at all times including, where appropriate, by having access to borrowings so as to be able to meet all foreseeable current liabilities as they fall due in a cost-effective manner. Forecasts are prepared regularly to predict required liquidity levels over both the short and medium term allowing management to respond appropriately to changes in circumstances.

The vast majority of the Group's derivative contracts are traded OTC (over-the-counter) and have a two day collateral settlement period. The Group's derivative contracts are monitored daily, via an end of day valuation process, to assess the need for additional funds to cover margin or collateral calls.

Some of the Group's commercial property investments are held through collective investment schemes which are either managed or overseen by Ignis Asset Management. The collective investment schemes have the power to restrict and/or suspend withdrawals, which would, in turn, affect liquidity. To date, the collective investment schemes have continued to process both investments and realisations in a normal manner and have not imposed any restrictions or delays.

Some of the Group's cash and cash equivalents are held through collective investment schemes. The collective investment schemes have the power, in an extreme stress, to restrict and/or suspend withdrawals, which would, in turn, affect liquidity. To date, the collective investment schemes have continued to process both investments and realisations in a normal manner and have not imposed any restrictions or delays.

The following table provides a maturity analysis showing the remaining contractual maturities of the Group's undiscounted financial liabilities and associated interest. Liabilities under insurance contract contractual maturities are included based on the estimated timing of the amounts recognised in the statement of consolidated financial position in accordance with the requirements of IFRS 4:

2012

	1 year or less or on demand £m	**1–5 years £m**	**Greater than 5 years £m**	**No fixed term £m**	**Total £m**
Liabilities under insurance contracts	**4,354**	**12,159**	**26,645**	**2,572**	**45,730**
Investment contracts	**8,096**	**–**	**–**	**–**	**8,096**
Borrowings	**225**	**2,323**	**613**	**194**	**3,355**
Deposits received from reinsurers	**34**	**127**	**430**	**–**	**591**
Derivatives	**804**	**166**	**4,172**	**–**	**5,142**
Net asset value attributable to unitholders	**4,671**	**–**	**–**	**–**	**4,671**
Obligations for repayment of collateral received	**9,456**	**157**	**845**	**–**	**10,458**
Reinsurance payables	**47**	**–**	**–**	**–**	**47**
Payables related to direct insurance contracts	**393**	**–**	**–**	**–**	**393**
Accruals and deferred income	**163**	**2**	**–**	**1**	**166**
Other payables	**509**	**–**	**–**	**–**	**509**

2011

	1 year or less or on demand £m	1–5 years £m	Greater than 5 years £m	No fixed term £m	Total £m
Liabilities under insurance contracts	5,041	14,279	29,932	2,548	51,800
Investment contracts	7,978	–	–	–	7,978
Borrowings	169	2,345	520	216	3,250
Deposits received from reinsurers	33	124	458	–	615
Derivatives	924	385	5,859	–	7,168
Net asset value attributable to unitholders	3,209	–	–	–	3,209
Obligations for repayment of collateral received	11,453	255	1,297	–	13,005
Reinsurance payables	33	–	–	–	33
Payables related to direct insurance contracts	668	39	–	–	707
Accruals and deferred income	169	4	–	2	175
Other payables	623	4	–	–	627

Investment contract policyholders have the option to terminate or transfer their contracts at any time and to receive the surrender or transfer value of their policies. Although these liabilities are payable on demand, and are therefore included in the contractual maturity analysis as due within one year, the Group does not expect all these amounts to be paid out within one year of the reporting date.

A significant proportion of the Group's financial assets are held in gilts, cash, supranationals and highly rated securities which the Group considers sufficient to meet the liabilities as they fall due. The vast majority of these investments are readily realisable immediately since most of them are quoted in an active market.

42.4 Unit-linked contracts

For unit-linked contracts the Group matches all the liabilities with assets in the portfolio on which the unit prices are based. There is therefore no interest, price, currency or credit risk for the Group on these contracts.

In extreme circumstances, the Group could be exposed to liquidity risk in its unit-linked funds. This could occur where a high volume of surrenders coincides with a tightening of liquidity in a unit-linked fund to the point where assets of that fund have to be sold to meet those withdrawals. Where the fund affected consists of property, it can take several months to complete a sale and this would impede the proper operation of the fund. In these situations, the Group considers its risk to be low since there are steps that can be taken first within the funds themselves both to ensure the fair treatment of all investors in those funds and to protect the Group's own risk exposure.

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.5 Insurance risk

Insurance risk refers to the risk that the frequency or severity of insured events may be worse than expected and includes expense risk. The Phoenix Life segment contracts include the following sources of insurance risk:

Mortality	higher than expected number of death claims on assurance products and occurrence of one or more large claims;
Longevity	faster than expected improvements in life expectancy on immediate and deferred annuity products;
Morbidity	higher than expected number of serious illness claims or more sickness claims which last longer on income protection policies;
Expenses	policies cost more to administer than expected;
Lapses	the numbers of policies terminating early is different to that expected in a way which increases expected claims costs or expenses or reduces future profits;
Options	unanticipated changes in policyholder option exercise rates giving rise to increased claims costs; and
General insurance	higher than expected number of non-life claims on general insurance policies and occurrence of one or more large claims.

Objectives and policies for mitigating insurance risk

The Group uses several methods to assess and monitor insurance risk exposures both for individual types of risks insured and overall risks. These methods include internal risk measurement models, experience analyses, external data comparisons, sensitivity analyses, scenario analyses and stress testing.

The profitability of the run-off of the closed long-term insurance businesses within the Group depends, to a significant extent, on the values of claims paid in the future relative to the assets accumulated to the date of claim. Typically, over the lifetime of a contract, premiums and investment returns exceed claim costs in the early years and it is necessary to set aside these amounts to meet future obligations. The amount of such future obligations is assessed on actuarial principles by reference to assumptions about the development of financial and insurance risks.

It is therefore necessary for the Directors of each life company to make decisions, based on actuarial advice, which ensure an appropriate accumulation of assets relative to liabilities. These decisions include investment policy, bonus policy and, where discretion exists, the level of payments on early termination.

The Group has a number of small books of general insurance which are currently classified as amounts held for sale. These have been closed to new business for a number of years and are in run-off. Further information can be found in note 3.

Due to the historic diversity of issued general insurance policies and taking into account the legal and regulatory environment for hazardous risks, it is possible that additional claims could emerge from long tail unexpired risks albeit it is not possible to predict the quantum, location or timing of such occurrences.

The estimation of the provisions for the ultimate cost of claims for asbestos and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of insurance business and as a consequence of this uncertainty the eventual costs of settlement of outstanding claims and unexpired risks can vary substantially from the estimates.

This general insurance business is managed by an experienced team of specialists who are responsible for all aspects of claims management, reserving and oversight of any activities undertaken by third parties. All such activity is carried out in accordance with the relevant regulations and industry standards.

Sensitivities

Insurance liabilities are sensitive to changes in risk variables, such as prevailing market interest rates, currency rates and equity prices, since these variations alter the value of the financial assets held to meet obligations arising from insurance contracts and changes in investment conditions also have an impact on the value of insurance liabilities themselves. Additionally, insurance liabilities are sensitive to the assumptions which have been applied in their calculation, such as mortality and lapse rates. Sometimes allowance must also be made for the effect on future assumptions of management or policyholder actions in certain economic scenarios. This could lead to changes in assumed asset mix or future bonus rates. The most significant non economic sensitivities arise from mortality, longevity and lapse risk.

A decrease of 5% in assurance mortality, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year, and an increase in equity of £25 million (2011: £24 million).

An increase of 5% in assurance mortality, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year, and a decrease in equity of £25 million (2011: £24 million).

A decrease of 5% in annuitant longevity, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year, and an increase in equity of £132 million (2011: £191 million).

An increase of 5% in annuitant longevity, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year, and a decrease in equity of £130 million (2011: £186 million).

A decrease of 25% in lapse rates, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year, and a decrease in equity of £51 million (2011: £56 million).

An increase of 25% in lapse rates, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year, and an increase in equity of £47 million (2011: £51 million).

42.5.1 Assumptions

Valuation of participating insurance and investment contracts

For participating business, which is with-profit business (insurance and investment contracts), the insurance contract liability is calculated on a realistic basis, adjusted to exclude the shareholders' share of future bonuses and the associated tax liability. This is a market consistent valuation, which involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns.

Valuation of non-participating insurance contracts

The non-participating insurance contract liabilities are determined using either a net premium or gross premium valuation method.

Process used to determine assumptions

For participating business in realistic basis companies the assumptions about future demographic trends are intended to be 'best estimates'. They are determined after considering the companies' recent experience and/or relevant industry data. Economic assumptions are market consistent.

For other business, demographic assumptions are derived by adding a prudent margin to best estimate assumptions. Economic assumptions are prudent estimates of the returns expected to be achieved on the assets backing the liabilities.

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.5 Insurance risk (continued)

During the year a number of changes were made to assumptions to reflect changes in expected experience or to harmonise the approach across the enlarged Group. The impact of material changes during the year was as follows:

	Increase/ (decrease) in insurance liabilities 2012 £m	Increase/ (decrease) in insurance liabilities 2011 £m
Change in longevity assumptions	**(5)**	(72)
Change in persistency assumptions	**32**	18
Change in expenses assumptions	**(1)**	(25)

Valuation interest rate

For realistic basis companies the liabilities are determined stochastically using an appropriate number of risk neutral scenarios produced by an economic scenario generator calibrated to market conditions and gilt yields as at the valuation date.

For funds not subject to realistic reporting, the method used to determine valuation interest rates generally follows the regulations set out in the Prudential Sourcebook for Insurers.

Assets are firstly hypothecated to classes of business being valued. The valuation interest rates for each block of business are based on the expected returns of the hypothecated assets. The yield is then adjusted to make allowance for credit risk, liquidity risk, reinvestment risk and investment management expenses.

Valuation interest rates (after tax for life policies) are typically in the following ranges:

	2012 %	2011 %
Life policies	**2.16 – 2.70**	1.82 – 3.41
Pension policies	**2.34 – 3.14**	1.72 – 3.80

Expense inflation

Expenses are assumed to increase at the rate of increase in the Retail Price Index ('RPI') plus fixed margins in accordance with the various management service agreements ('MSAs') the Group has in place with outsource partners. For with-profit business the rate of RPI inflation is determined within each stochastic scenario. For other business it is based on the Bank of England inflation spot curve. For MSAs with contractual increases set by reference to national average earnings inflation, this is approximated as RPI inflation plus 1%. In instances in which inflation risk is not mitigated, a further margin for adverse deviations may then be added to the rate of expense inflation.

Mortality and longevity rates

Mortality rates are based on published tables, adjusted appropriately to take account of changes in the underlying population mortality since the table was published, company experience and forecast changes in future mortality. Where appropriate, a margin is added to assurance mortality rates to allow for adverse future deviations. Annuitant mortality rates are adjusted to make allowance for future improvements in pensioner longevity.

Lapse and surrender rates (persistency)

The assumed rates for surrender and voluntary premium discontinuance depend on the length of time a policy has been in force and the relevant company. Surrender or voluntary premium discontinuances are only assumed for realistic basis companies. Withdrawal rates used in the valuation of with-profit policies are based on observed experience and adjusted when it is considered that future policyholder behaviour will be influenced by different considerations than in the past. In particular, it is assumed that withdrawal rates for unitised with-profit contracts will be higher on policy anniversaries on which Market Value Adjustments do not apply.

Discretionary participating bonus rate

For realistic basis companies, the regular bonus rates assumed in each scenario are determined in accordance with each company's PPFM. Final bonuses are assumed at a level such that maturity payments will equal asset shares subject to smoothing rules set out in the PPFM.

Policyholder options and guarantees

Some of the Group's products give potentially valuable guarantees, or give options to change policy benefits which can be exercised at the policyholders' discretion. These products are described below.

Most with-profit contracts give a guaranteed minimum payment on a specified date or range of dates or on death if before that date or dates. For pensions contracts, the specified date is the policyholder's chosen retirement date or a range of dates around that date. For endowment contracts, it is the maturity date of the contract. For with-profit bonds it is often a specified anniversary of commencement, in some cases with further dates thereafter. Annual bonuses when added to with-profit contracts usually increase the guaranteed amount.

There are guaranteed surrender values on a small number of older contracts.

Some pensions contracts include guaranteed annuity options (see deferred annuities in section 42.5.2 for details). The total amount provided in the with-profit and non-profit funds in respect of the future costs of guaranteed annuity options are £2,054 million (2011: £2,248 million) and £31 million (2011: £59 million) respectively.

In common with other life companies in the UK which have written pension transfer and opt-out business, the Group has set up provisions for the review and possible redress relating to personal pension policies. These provisions, which have been calculated from data derived from detailed file reviews of specific cases and using a certainty equivalent approach, which give a result very similar to a market consistent valuation, are included in liabilities arising under insurance contracts. The total amount provided in the with-profit funds and non-profit funds in respect of the review and possible redress relating to pension policies, including associated costs, are £338 million (2011: £409 million) and £16 million (2011: £22 million) respectively.

With-profit deferred annuities participate in profits only up to the date of retirement. At retirement, a guaranteed cash option allows the policyholder to commute the annuity benefit into cash on guaranteed terms.

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.5 Insurance risk (continued)

42.5.2 Managing product risk

The following sections give an assessment of the risks associated with the Group's main life assurance products, as shown below, and the ways in which the Group manages those risks.

2012

	Gross		Reinsurance	
	Insurance contracts £m	Investment contracts with DPF £m	Insurance contracts £m	Investment contracts with DPF £m
With-profit funds:				
Pensions:				
Deferred annuities – with guarantees	9,562	180	799	–
Deferred annuities – without guarantees	1,893	–	–	–
Immediate annuities	3,385	–	725	–
Unitised with-profit	1,198	9,179	4	–
Total pensions	16,038	9,359	1,528	–
Life:				
Immediate annuities	76	–	6	–
Unitised with-profit	721	773	2	–
Life with-profit	5,298	–	13	–
Total life	6,095	773	21	–
Other	2,073	7	144	–
Non-profit funds:				
Deferred annuities – with guarantees	50	–	–	–
Deferred annuities – without guarantees	615	6	–	–
Immediate annuities	6,834	–	1,170	–
Protection	652	–	279	–
Unit-linked	1,667	1,183	10	–
Other	378	–	52	–
	34,402	11,328	3,204	–

2011

	Gross		Reinsurance	
	Insurance contracts £m	Investment contracts with DPF £m	Insurance contracts £m	Investment contracts with DPF £m
With-profit funds:				
Pensions:				
Deferred annuities – with guarantees	9,823	79	795	–
Deferred annuities – without guarantees	1,930	105	–	–
Immediate annuities	3,651	–	688	–
Unitised with-profit	1,202	9,033	3	–
Total pensions	16,606	9,217	1,486	–
Life:				
Immediate annuities	101	–	6	–
Unitised with-profit	859	832	2	–
Life with-profit	6,083	–	11	–
Total life	7,043	832	19	–
Other	1,992	7	135	–
Non-profit funds:				
Deferred annuities – with guarantees	75	–	–	–
Deferred annuities – without guarantees	643	6	–	–
Immediate annuities	11,351	–	1,195	–
Protection	663	–	279	–
Unit-linked	1,801	1,220	12	–
Other	343	1	27	–
	40,517	11,283	3,153	–

With-profit fund (unitised and traditional)

The Group operates a number of with-profit funds in the UK in which the with-profit policyholders benefit from a discretionary annual bonus (guaranteed once added in most cases) and a discretionary final bonus. Non-participating business is also written in some of the with-profit funds and some of the funds may include immediate annuities and deferred annuities with Guaranteed Annuity Rates ('GAR').

The investment strategy of each fund differs, but is broadly to invest in a mixture of fixed interest investments and equities and/or property and other asset classes in such proportions as is appropriate to the investment risk exposure of the fund and its capital resources.

The Group has significant discretion regarding investment policy, bonus policy and early termination values. The process for exercising discretion in the management of the with-profit funds is set out in the PPFM for each with-profit fund and is overseen by With-Profit Committees. Advice is also taken from the with-profit actuary of each with-profit fund. Compliance with the PPFM is reviewed annually and reported to the FSA and policyholders.

The bonuses are designed to distribute to policyholders a fair share of the return on the assets in the with-profit funds together with other elements of the experience of the fund. The shareholders of the Group are entitled to receive one-ninth of the cost of bonuses declared for some funds and £nil for others.

Unitised and traditional with-profit policies are exposed to equivalent risks, the main difference being that unitised with-profit policies purchase notional units in a with-profit fund whereas traditional with-profit policies do not. Benefit payments for unitised policies are then dependent on unit prices at the time of a claim, although charges may be applied. A unitised with-profit fund price is typically guaranteed not to fall and increases in line with any discretionary bonus payments over the course of 1 year.

Notes to the consolidated financial statements
continued

42. Risk management (continued)

42.5 Insurance risk (continued)

42.5.2 Managing product risk (continued)

Deferred annuities

Deferred annuity policies are written to provide either a cash benefit at retirement, which the policyholder can use to buy an annuity on the terms then applicable, or an annuity payable from retirement. The policies contain an element of guarantee expressed in the form that the contract is written in i.e. to provide cash or an annuity. Deferred annuity policies written to provide a cash benefit may also contain an option to convert the cash benefit to an annuity benefit on guaranteed terms; these are known as GAR policies. Deferred annuity policies written to provide an annuity benefit may also contain an option to convert the annuity benefit into cash benefits on guaranteed terms; these are known as Guaranteed Cash Option ('GCO') policies.

During the last decade, interest rates and inflation have fallen and life expectancy has increased more rapidly than originally anticipated. The guaranteed terms on GAR policies are more favourable than the annuity rates currently available in the market available for cash benefits. The guaranteed terms on GCO policies are currently not valuable. Deferred annuity policies which are written to provide annuity benefits are managed in a similar manner to immediate annuities and are exposed to the same risks.

The option provisions on GAR policies are particularly sensitive to downward movements in interest rates, increasing life expectancy and the proportion of customers exercising their option. Adverse movements in these factors could lead to a requirement to increase reserves which could adversely impact profit and potentially require additional capital. In order to address the interest rate risk (but not the risk of increasing life expectancy or changing customer behaviour with regard to exercise of the option), insurance subsidiaries within the Group have purchased derivatives that provide protection against an increase in liabilities and have thus reduced the sensitivity of profit to movements in interest rates.

The Group seeks to manage this risk in accordance with both the terms of the issued policies and the interests of customers, and has obtained external advice supporting the manner in which it operates the long-term funds in this respect.

Immediate annuities

This type of annuity is purchased with a single premium at the outset, and is paid to the policyholder for the remainder of their lifetime. Payments may also continue for the benefit of a surviving spouse or partner after the annuitant's death. Annuities may be level, or escalate at a fixed rate, or may escalate in line with a price index and may be payable for a minimum period irrespective of whether the policyholder remains alive.

The main risks associated with this product are longevity and investment risks. Longevity risk arises where the annuities are paid for the lifetime of the policyholder, and is managed through the initial pricing of the annuity and through reinsurance (appropriately collateralised) or transfer of existing liabilities. Annuities may also be a partial 'natural hedge' against losses incurred in protection business in the event of increased mortality (and vice versa) although the extent to which this occurs will depend on the similarity of the demographic profile of each book of business.

The pricing assumption for mortality risk is based on both historic internal information and externally generated information on mortality experience, including allowances for future mortality improvements. Pricing will also include a contingency margin for adverse deviations in assumptions.

Market and credit risk is influenced by the extent to which the cash flows under the contracts have been matched by suitable assets which is managed under the ALM framework. Asset/liability modelling is used to monitor this position on a regular basis.

Protection

These contracts are typically secured by the payment of a regular premium payable for a period of years providing benefits payable on certain events occurring within the period. The benefits may be a single lump sum or a series of payments and may be payable on death, serious illness or sickness.

The main risk associated with this product is the claims experience and this risk is managed through the initial pricing of the policy (based on actuarial principles), the use of reinsurance and a clear process for administering claims.

Market and credit risk is influenced by the extent to which the cash flows under the contracts have been matched by suitable assets which is managed under the ALM framework. Asset/liability modelling is used to monitor this position on a regular basis.

43. Operating leases

Operating lease rentals charged within administrative expenses amounted to £14 million (2011: £16 million).

The Group has commitments under non-cancellable operating leases as set out below:

	2012 £m	2011 £m
Not later than 1 year	10	15
Later than 1 year and not later than 5 years	41	56
Later than 5 years	28	35

The principal operating lease commitments concern office space located at Bothwell Street, Glasgow; St Vincent Street, Glasgow; Juxon House, London and Cheapside, London.

44. Commitments

	2012 £m	2011 £m
To subscribe to private equity funds and other unlisted assets	286	356
To purchase, construct or develop investment property	46	61
For repairs, maintenance or enhancements of investment property	2	1
To acquire property, plant and equipment	5	–

45. Related party transactions

The Group has related party transactions with its pension schemes and its key management personnel.

Transactions with pension schemes

During the year the Group entered into the following transactions with its pension schemes:

	Transactions 2012 £m	Balances outstanding 2012 £m	Transactions 2011 £m	Balances outstanding 2011 £m
Pearl Group Staff Pension Scheme				
Investment management fees	0.6	0.1	0.6	0.2
Payment of administrative expenses	(4.0)	–	(4.0)	–
	(3.4)	0.1	(3.4)	0.2
PGL Pension Scheme				
Investment management fees	2.4	0.4	2.4	0.8

The Pearl Scheme has invested in collective investment schemes that are controlled by the Group. At 31 December 2012 the Pearl Scheme held 458,795 units (2011: 1,118,197 units) in the Ignis Systematic Strategies Fund and 121,909,177 units (2011: 53,243,341 units) in the Ignis Liquidity Fund. The value of these investments at 31 December 2012 was £70 million (2011: £169 million) and £122 million (2011: £53 million) respectively.

Information on other transactions with the pension schemes is included in note 31.

Transactions with key management personnel

The total compensation of key management personnel, being those having authority and responsibility for planning, directing and controlling the activities of the Group, including the Executive and Non-Executive Directors, are as follows:

	2012 £m	2011 £m
Salary and other short-term benefits	3.7	4.8
Equity compensation plans	2.2	2.2
Termination payments	–	0.7

Details of the shareholdings and emoluments of individual Directors are provided in the Remuneration report.

Notes to the consolidated financial statements
continued

46. Contingent liabilities

In the normal course of business the Group is exposed to certain legal issues, which involve litigation and arbitration. At the period end, the Group has a number of contingent liabilities in this regard, none of which are considered by the directors to be material.

47. Group entities

As at 31 December 2012, the principal subsidiary undertakings of the Group are as follows:

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Insurance companies		
BA (GI) Limited (general insurance company)	UK	Ordinary shares of £0.05
National Provident Life Limited (life assurance company)	UK	Ordinary shares of £1
Phoenix Life Assurance Limited (formerly Pearl Assurance Limited) (life assurance company)	UK	'A' ordinary shares of £0.05 'B' ordinary shares of £1
Phoenix Life Limited (life assurance company)	UK	Ordinary shares of £1
Scottish Mutual International Limited (life assurance company)	ROI	Ordinary shares of €1.25
Non-insurance companies		
Ignis Asset Management Limited (holding company)	UK	Ordinary shares of £1
Ignis Fund Managers Limited (unit trust management company)	UK	Ordinary shares of £1
Ignis Investment Services Limited (investment management company)	UK	Ordinary shares of £0.10`
Impala Holdings Limited (holding company)	UK	'A' ordinary shares of £1, 'B' ordinary shares of £1 'C' ordinary shares of £1 and 'D' ordinary shares of £1
Mutual Securitisation plc (finance company)	ROI	Quasi subsidiary
NP Life Holdings Limited (holding company)	UK	'A' ordinary shares of £1 and 'B' ordinary shares of £1
Opal Reassurance Limited (reassurance company)	Bermuda	'A' ordinary shares of £1 'B' ordinary shares of £1 and Preference shares of £1
PGH (LCA) Limited (finance company)	UK	Ordinary shares of £1
PGH (LCB) Limited (finance company)	UK	Ordinary shares of £1
PGH (LC1) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (LC2) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (MC1) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
PGH (MC2) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (TC1) Limited (holding company)	UK	'A' ordinary shares of £1 and Preference shares of £1
PGH (TC2) Limited (holding company)	UK	'A' ordinary shares of £1 and Preference shares of £1
Pearl Group Holdings (No. 1) Limited (finance company)	UK	Ordinary shares of £0.05
Pearl Group Holdings (No. 2) Limited (holding company)	UK	Ordinary shares of £1
Pearl Life Holdings Limited (holding company)	UK	Ordinary shares of £1
Pearl Group Services Limited (management services company)	UK	Ordinary shares of £1
Pearl Group Management Services Limited (management services company)	UK	Ordinary shares of £1
Phoenix Life Holdings Limited (holding company)	UK	Ordinary shares of £1
UK Commercial Property Trust Limited (property fund)	Guernsey	62% of ordinary shares of £0.25

The information disclosed above is only in respect of those undertakings which materially affect the figures shown in the Group's consolidated financial statements. There are a number of other subsidiaries and associated undertakings whose business does not materially affect the Group's profits or the amount of its assets and particulars of these have been omitted in view of their excessive length.

Notes to the consolidated financial statements
continued

48. Events after the reporting period

In January 2013 the Group announced the re-terming of the Impala facility and an equity raising of £250 million. The equity raising comprised equity placings with certain Och-Ziff funds and an open offer to raise aggregate gross proceeds of £250 million through the issuance on 21 February 2013 of 50 million ordinary shares. The proceeds of the equity raising net of deduction of commissions, fees and expenses were £232 million.

This equity raising enabled the re-terming of the Impala facility and contributed to the £450 million prepayment on 22 February 2013. Following the re-terming the bullet repayments which were due in 2014, 2015 and 2016 have been replaced by a single tranche repayable by June 2019 (assuming the option to extend to this date is validly exercised). The mandatory repayments on the Impala facility have been reduced from £125 million per annum to £60 million per annum. The terms of this new facility are:

– repayment instalments of £30 million are due semi-annually on 30 June and 31 December each year;

– the facility maturity date is 31 December 2017, with the option for the Group to extend this date to 30 June 2019; and

– the facility bears interest at LIBOR plus a margin of 4.75% per annum which would increase by:

(i) 2.25% per annum after 31 December 2017 if the option to extend the final maturity date to 30 June 2019 is exercised; and

(ii) 0.5% per annum if additional target repayments of £60 million per annum have not occured within the required period. The additional interest charge applies from the end of the period when the repayment was due until the repayment had been made.

The rate will be reduced by 0.25% per annum with effect from 1 January 2015 if by that date the borrowers have made voluntary repayments of not less than £200 million in addition to all mandatory and target repayments.

On 21 March 2013 the Board recommended a final dividend of 26.7p per share (2011: 21p per share) for the year ended 31 December 2012. Payment of the final dividend is subject to compliance with the processes set out in the Group's main credit facilities and shareholder approval at the AGM. The cost of this dividend has not been recognised as a liability in the financial statements for 2012 and will be charged to the statement of changes in equity in 2013.

H Davies
C Bannister
J McConville
A Lyons
I Ashken
R P Azria
D Barnes
C Clarke
I Cormack
T Cross Brown
M Dale
I Hudson
H Osmond
D Woods

St Helier, Jersey
21 March 2013

Asset disclosures

In this section

Additional life company asset disclosures

The analysis of the asset portfolio provided below comprises the assets held by the Group's life companies including stock lending collateral. It excludes other Group assets such as cash held in the holding and service companies and Ignis; the assets held by the non-controlling interest in collective investment schemes and UK Commercial Property Trust Limited ('UKCPT'); and are net of derivative liabilities.

The following table provides an overview of the exposure by asset category of the Group's life companies' shareholder and policyholder funds:

31 December 2012

Carrying value	Shareholder and non-profit funds[1] £m	Participating[1] supported £m	Participating[2] non-supported £m	Unit-linked[2] £m	Total[3] £m
Cash and cash equivalents[4]	2,448	925	8,298	972	12,643
Debt securities – gilts[4]	1,478	2,369	10,255	800	14,902
Debt securities – bonds[4]	5,356	2,244	10,357	872	18,829
Equity securities	378	14	5,889	7,517	13,798
Property investments	132	103	1,074	308	1,617
Other investments[5]	742	161	2,279	25	3,207
As at 31 December 2012	**10,534**	**5,816**	**38,152**	**10,494**	**64,996**
Collective investment schemes					5,339
UKCPT					587
Cash held in other Group entities					352
General insurance business					8
Corporate derivative liabilities					(36)
Adjustments on consolidation					3
Total Group consolidated assets					71,249
Comprised of:					
Investment property					1,727
Financial assets					63,520
Cash and cash equivalents					9,028
Derivative liabilities					(3,026)
					71,249

31 December 2011

Carrying value	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
Cash and cash equivalents	3,280	965	7,493	1,035	12,773
Debt securities – gilts	3,202	1,883	12,093	886	18,064
Debt securities – bonds	7,570	2,279	10,099	870	20,818
Equity securities	390	17	6,631	7,436	14,474
Property investments	153	184	759	306	1,402
Other investments	1,687	(79)	4,173	35	5,816
As at 31 December 2011	16,282	5,249	41,248	10,568	73,347
Collective investment schemes					4,087
UKCPT					518
Cash held in other Group entities					314
General insurance business					17
Corporate derivative liabilities					(52)
Adjustments on consolidation					(17)
Total Group consolidated assets					78,214
Comprised of:					
Investment property					1,816
Financial assets					68,967
Cash and cash equivalents					11,723
Derivative liabilities					(4,292)
					78,214

1 Includes assets where shareholders of the life companies bear the investment risk.

2 Includes assets where policyholders bear most of the investment risk. In the second half of 2012 one with-profit fund has moved from 'Participating non-supported' to ''Participating supported'.

3 This information is presented on a look through basis to underlying funds where available.

4 As a result of the reinsurance agreement entered into with Guardian Assurance Limited ('Guardian') effective 1 July 2012, £5.1 billion of shareholder financial assets were transferred to Guardian. These assets were made up of £610 million of cash and cash equivalents, £1,934 million of gilts and £2,580 million of bonds. Subsequent to this transfer £292 million of gilts were purchased to rebalance the remaining portfolio of financial assets.

5 Includes repurchase loans of £1,683 million (2011: £3,003 million), policy loans of £16 million (2011: £15 million), other loans of £22 million (2011: £41 million), net derivatives of £647 million (2011: £1,797 million) and other investments of £839 million (2011: £960 million).

The following table analyses by type the debt securities of the life companies:

31 December 2012

Analysis by type of debt securities	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
Gilts	**1,478**	**2,369**	**10,255**	**800**	**14,902**
Other government and supranational[1]	**867**	**703**	**1,995**	**150**	**3,715**
Corporate – financial institutions	**1,974**	**581**	**3,721**	**184**	**6,460**
Corporate – other	**2,283**	**536**	**3,723**	**517**	**7,059**
Asset backed securities ('ABS')	**232**	**424**	**918**	**21**	**1,595**
As at 31 December 2012	**6,834**	**4,613**	**20,612**	**1,672**	**33,731**

31 December 2011

Analysis by type of debt securities	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
Gilts	3,202	1,883	12,093	886	18,064
Other government and supranational[1]	1,460	670	2,151	169	4,450
Corporate – financial institutions	2,230	666	3,603	206	6,705
Corporate – other	3,547	481	3,112	480	7,620
Asset backed securities ('ABS')	333	462	1,233	15	2,043
As at 31 December 2011	10,772	4,162	22,192	1,756	38,882

1 Includes debt issued by governments; public and statutory bodies; government backed institutions and supranationals.

The life companies' debt portfolio was £33.7 billion at 31 December 2012. Shareholders had direct exposure to £11.4 billion of these assets (including supported participating funds), of which 94% of rated securities were investment grade. The shareholders' credit risk exposure to the non-supported participating funds is primarily limited to the shareholders' share of future bonuses. Shareholders' credit risk exposure to the unit-linked funds is limited to the level of asset management fee, which is dependent on the underlying assets.

Sovereign and supranational debt represented 47% of the debt portfolio in respect of shareholder exposure, or £5.4 billion, at 31 December 2012. The vast majority of the life companies' exposure to sovereign and supranational debt holdings is to UK gilts.

Additional life company asset disclosures
continued

The following table sets out a breakdown of the life companies' sovereign and supranational debt security holdings by country:

31 December 2012

Analysis of sovereign and supranational debt security holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	**1,482**	**2,369**	**10,356**	**800**	**15,007**
European Investment Bank	**396**	**380**	**669**	**57**	**1,502**
USA	**3**	**17**	**18**	**23**	**61**
Germany	**425**	**286**	**967**	**26**	**1,704**
France	**4**	**–**	**21**	**2**	**27**
Netherlands	**17**	**–**	**57**	**3**	**77**
Portugal	**–**	**–**	**–**	**–**	**–**
Italy	**–**	**–**	**–**	**5**	**5**
Ireland	**–**	**–**	**–**	**–**	**–**
Greece	**–**	**–**	**–**	**–**	**–**
Spain	**–**	**4**	**–**	**2**	**6**
Other – non-Eurozone	**11**	**7**	**128**	**27**	**173**
Other – Eurozone	**7**	**9**	**34**	**5**	**55**
As at 31 December 2012	**2,345**	**3,072**	**12,250**	**950**	**18,617**

31 December 2011

Analysis of sovereign and supranational debt security holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	3,211	1,884	12,112	887	18,094
European Investment Bank	525	365	862	57	1,809
USA	35	16	34	30	115
Germany	673	245	936	29	1,883
France	119	–	72	5	196
Netherlands	27	–	24	3	54
Portugal	–	–	–	–	–
Italy	1	–	93	6	100
Ireland	–	–	2	–	2
Greece	–	–	–	–	–
Spain	–	8	36	2	46
Other – non-Eurozone	10	25	34	30	99
Other – Eurozone	61	10	39	6	116
As at 31 December 2011	4,662	2,553	14,244	1,055	22,514

At 31 December 2012, the life companies had £4 million shareholder exposure to sovereign debt of the Peripheral Eurozone, defined as Portugal, Italy, Ireland, Greece and Spain. This exposure has been reduced from £9 million at 31 December 2011. This reduction of £5 million reflects a decision to reduce the levels of Peripheral Eurozone sovereign debt in certain funds.

All of the life companies' debt securities are held at fair value through profit or loss under IAS 39, and therefore already reflect any reduction in value between the date of purchase and the balance sheet date.

The life companies have in place a comprehensive database that consolidates credit exposures across counterparties, geographies and business lines. This database is used for credit monitoring, stress testing and scenario planning. The life companies continue to manage their balance sheets prudently and have taken extra measures to ensure their market exposures remain within risk appetite.

The following table sets out a breakdown of the life companies' financial institution corporate debt security holdings by country:

31 December 2012

Analysis of financial institution corporate debt security holdings by country	**Shareholder and non-profit funds £m**	**Participating supported £m**	**Participating non-supported £m**	**Unit-linked £m**	**Total £m**
UK	**1,172**	**437**	**2,141**	**139**	**3,889**
USA	**319**	**81**	**547**	**18**	**965**
Germany	**73**	**4**	**132**	**–**	**209**
France	**63**	**1**	**84**	**2**	**150**
Netherlands	**225**	**41**	**516**	**22**	**804**
Portugal	**–**	**–**	**–**	**–**	**–**
Italy	**2**	**–**	**15**	**–**	**17**
Ireland	**–**	**–**	**1**	**–**	**1**
Greece	**–**	**–**	**–**	**–**	**–**
Spain	**3**	**1**	**14**	**–**	**18**
Other – non-Eurozone	**68**	**13**	**201**	**3**	**285**
Other – Eurozone	**49**	**3**	**70**	**–**	**122**
As at 31 December 2012	**1,974**	**581**	**3,721**	**184**	**6,460**

31 December 2011

Analysis of financial institution corporate debt security holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	1,171	504	1,962	126	3,763
USA	326	73	447	18	864
Germany	46	1	58	–	105
France	143	20	287	12	462
Netherlands	313	46	559	40	958
Portugal	–	–	–	–	–
Italy	5	3	16	–	24
Ireland	68	1	9	–	78
Greece	–	–	–	–	–
Spain	10	1	23	1	35
Other – non-Eurozone	90	14	147	5	256
Other – Eurozone	58	3	95	4	160
As at 31 December 2011	2,230	666	3,603	206	6,705

The life companies had £6 million shareholder exposure to financial institution corporate debt of the Peripheral Eurozone at 31 December 2012. This exposure has been reduced from £88 million at 31 December 2011, a reduction of £82 million. The reduction again reflects the decision to reduce the levels of Peripheral Eurozone financial institution corporate debt. The £2,555 million (2011: £2,896 million) total shareholder exposure comprised £1,771 million (2011: £2,148 million) senior debt, £321 million (2011: £261 million) Tier 1 debt and £463 million (2011: £487 million) Tier 2 debt.

Indirect exposure

The £2,555 million shareholder exposure to financial institution corporate debt comprised £1,445 million (2011: £1,554 million) bank debt and £1,110 million (2011: £1,342 million) non-bank debt.

For each of the life companies' significant financial institution counterparties, industry and other data has been used to assess the exposure of the individual counterparties to Peripheral Eurozone markets. As part of the Group's risk appetite framework and analysis of shareholder exposure to a potential worsening of the Eurozone situation, this assessment has been used to identify counterparties considered to be most at risk from Peripheral Eurozone sovereign defaults. The financial impact on these counterparties, and the contagion impact on the rest of the shareholder corporate bond portfolio, is assessed under various Eurozone scenarios and assumptions. This analysis is regularly reviewed to reflect the latest Eurozone outlook, economic data and changes to asset portfolios. The results are used to inform the Group's views on whether any management actions are required.

Additional life company asset disclosures
continued

The following table sets out a breakdown of the life companies' corporate – other debt security holdings by country:

31 December 2012

Analysis of corporate – other debt security holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	**1,258**	**260**	**2,019**	**420**	**3,957**
USA	**257**	**78**	**401**	**17**	**753**
Germany	**89**	**35**	**135**	**5**	**264**
France	**149**	**82**	**276**	**14**	**521**
Netherlands	**192**	**52**	**386**	**20**	**650**
Portugal	**–**	**–**	**6**	**–**	**6**
Italy	**54**	**1**	**81**	**4**	**140**
Ireland	**6**	**–**	**27**	**–**	**33**
Greece	**4**	**–**	**4**	**–**	**8**
Spain	**29**	**–**	**57**	**3**	**89**
Other – non-Eurozone	**113**	**21**	**187**	**16**	**337**
Other – Eurozone	**132**	**7**	**144**	**18**	**301**
As at 31 December 2012	**2,283**	**536**	**3,723**	**517**	**7,059**

31 December 2011

Analysis of corporate – other debt security holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	1,391	244	1,556	381	3,572
USA	787	70	357	15	1,229
Germany	56	2	65	6	129
France	408	82	342	18	850
Netherlands	403	56	374	24	857
Portugal	–	–	–	–	–
Italy	67	3	71	6	147
Ireland	10	–	9	–	19
Greece	8	–	2	–	10
Spain	105	3	80	6	194
Other – non-Eurozone	95	19	129	10	253
Other – Eurozone	217	2	127	14	360
As at 31 December 2011	3,547	481	3,112	480	7,620

The following table sets out a breakdown of the life companies' ABS holdings by country:

31 December 2012

Analysis of ABS holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	**176**	**330**	**635**	**21**	**1,162**
USA	**36**	**–**	**19**	**–**	**55**
Germany	**1**	**13**	**61**	**–**	**75**
France	**–**	**2**	**7**	**–**	**9**
Netherlands	**1**	**29**	**64**	**–**	**94**
Portugal	**–**	**–**	**1**	**–**	**1**
Italy	**–**	**5**	**15**	**–**	**20**
Ireland	**12**	**16**	**60**	**–**	**88**
Greece	**–**	**–**	**–**	**–**	**–**
Spain	**–**	**7**	**16**	**–**	**23**
Other – non-Eurozone	**5**	**5**	**6**	**–**	**16**
Other – Eurozone	**1**	**17**	**34**	**–**	**52**
As at 31 December 2012	**232**	**424**	**918**	**21**	**1,595**

31 December 2011

Analysis of ABS holdings by country	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
UK	273	321	802	15	1,411
USA	29	–	35	–	64
Germany	5	44	139	–	188
France	–	10	25	–	35
Netherlands	3	36	98	–	137
Portugal	–	–	2	–	2
Italy	–	10	31	–	41
Ireland	18	19	48	–	85
Greece	–	–	–	–	–
Spain	5	18	33	–	56
Other – non-Eurozone	–	4	20	–	24
Other – Eurozone	–	–	–	–	–
As at 31 December 2011	333	462	1,233	15	2,043

The following table sets out the credit rating analysis of the debt portfolio:

31 December 2012

Credit rating analysis of debt portfolio	**Shareholder and non-profit funds £m**	**Participating supported £m**	**Participating non-supported £m**	**Unit-linked £m**	**Total £m**
AAA	**2,746**	**3,677**	**13,709**	**720**	**20,852**
AA	**501**	**268**	**1,378**	**61**	**2,208**
A	**1,318**	**508**	**2,251**	**137**	**4,214**
BBB	**1,394**	**128**	**2,391**	**210**	**4,123**
BB	**288**	**14**	**219**	**14**	**535**
B and below	**359**	**–**	**66**	**–**	**425**
Non-rated	**228**	**18**	**598**	**530**	**1,374**
As at 31 December 2012	**6,834**	**4,613**	**20,612**	**1,672**	**33,731**

97% of rated securities were investment grade at 31 December 2012 (2011: 97%). The percentage of rated securities that were investment grade in relation to the shareholder and policyholders' funds were 94% and 99% respectively (2011: 95% and 99% respectively).

31 December 2011

Credit rating analysis of debt portfolio	Shareholder and non-profit funds £m	Participating supported £m	Participating non-supported £m	Unit-linked £m	Total £m
AAA	5,067	2,977	15,190	768	24,002
AA	701	264	1,005	89	2,059
A	1,997	638	2,612	148	5,395
BBB	1,615	211	2,236	197	4,259
BB	127	29	230	17	403
B and below	544	1	77	1	623
Non-rated	721	42	842	536	2,141
As at 31 December 2011	10,772	4,162	22,192	1,756	38,882

MCEV supplementary information

In this section

Statement of Directors' responsibilities in respect of the Market Consistent Embedded Value ('MCEV') basis

When compliance with the CFO Forum MCEV principles published in June 2008 and amended in October 2009 is stated those principles require the Directors to prepare supplementary information in accordance with the MCEV principles and to disclose and provide reasons for any non-compliance with the principles.

The MCEV methodology adopted by the Group is in accordance with these MCEV principles with the exception of:

– risk-free rates have been defined as the annually compounded UK Government bond nominal spot curve plus 10 basis points rather than as the swap rate curve;

– the value of the asset management and the management service companies has been included on an IFRS basis; and

– no allowance for the costs of residual non-hedgeable risk has been made.

Further detail on these exceptions is included in note 1, Basis of preparation.

Specifically, the Directors have:

– determined assumptions on a realistic basis, having regard to past, current and expected future experience and to relevant external data, and then applied them consistently;

– made estimates that are reasonable and consistent; and

– provided additional disclosures when compliance with the specific requirements of the MCEV principles is insufficient to enable users to understand the impact of particular transactions, other events and conditions and the Group's financial position and financial performance.

Clive Bannister
Group Chief Executive Officer

James McConville
Group Finance Director

St Helier
21 March 2013

Independent Auditor's report to the Directors of Phoenix Group Holdings on the consolidated Phoenix Group MCEV

We have audited the Consolidated Phoenix Group MCEV ('Phoenix Group MCEV') supplementary information for the year ended 31 December 2012, which comprises the Summarised consolidated income statement – Group MCEV basis, MCEV earnings per ordinary share, Statement of consolidated comprehensive income – Group MCEV basis, Reconciliation of movement in equity – Group MCEV basis, Group MCEV analysis of earnings, Reconciliation of Group IFRS equity to MCEV net worth and related notes. The Phoenix Group MCEV supplementary information has been prepared by the Directors of Phoenix Group Holdings in accordance with the basis of preparation set out on pages 191 to 194.

Directors' responsibilities for the Phoenix Group MCEV supplementary information

The Directors are responsible for the preparation of this Phoenix Group MCEV supplementary information in accordance with the basis of preparation set out on pages 191 to 194 and for such internal control as the Directors determine is necessary to enable the preparation of supplementary information that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the Phoenix Group MCEV supplementary information based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require us to comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Phoenix Group MCEV supplementary information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Phoenix Group MCEV supplementary information. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Phoenix Group MCEV supplementary information, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Group's preparation of the Phoenix Group MCEV supplementary information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the Phoenix Group MCEV supplementary information.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the Phoenix Group MCEV supplementary information, for the year ended 31 December 2012, has been prepared, in all material respects, in accordance with the basis of preparation set out on pages 191 to 194.

Basis of accounting and restriction on use

Without modifying our opinion, we draw attention to pages 191 to 194 of the Phoenix Group MCEV supplementary information, which describe the basis of preparation. The Phoenix Group MCEV supplementary information is prepared to comply with the basis of preparation set out on pages 191 to 194. As a result, the Phoenix Group MCEV supplementary information may not be suitable for another purpose. This report, including the opinion, has been prepared for and only for the Group's Directors as a body in accordance with our letter of engagement dated 15 June 2011 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other matter

Ernst & Young Accountants LLP have reported separately on the IFRS consolidated financial statements of Phoenix Group Holdings for the year ended 31 December 2012. The information contained in the Phoenix Group MCEV supplementary information should be read in conjunction with the IFRS consolidated financial statements.

Ernst & Young LLP

Ernst & Young LLP
London

21 March 2013

Summarised consolidated income statement – Group MCEV basis

For the year ended 31 December 2012

	2012 £m	2011 Restated[1] £m
Life MCEV operating earnings	**360**	556
Management services operating profit	**28**	17
Ignis Asset Management operating profit	**43**	46
Group costs	**(25)**	(54)
Group MCEV operating earnings before tax	**406**	565
Economic variances on life business	**24**	(426)
Economic variances on non-life business	**(6)**	38
Other non-operating variances on life business	**39**	(12)
Non-recurring items on non- life business	**(39)**	(9)
Finance costs attributable to owners	**(123)**	(123)
Group MCEV earnings before tax	**301**	33
Tax on operating earnings	**(99)**	(148)
Tax on non-operating earnings	**–**	169
Total tax	**(99)**	21
Group MCEV earnings after tax	**202**	54

1 During 2012, the Group has amended its MCEV policy for recognising contributions to Group pension schemes in an IFRS (IAS 19) surplus position (refer note 1 g). The 2011 comparatives have been restated in this regard. The impact of the 2011 restatement is to reduce 'Group costs' by £30 million from £84 million to £54 million, to increase 'Tax on operating earnings' by £7 million from £141 million to £148 million and other comprehensive income reduces by £23 million.

MCEV earnings per ordinary share

For the year ended 31 December 2012

	2012	2011 Restated
Group MCEV operating earnings after tax		
Basic[1]	**177.1p**	243.5p
Diluted[2]	**177.0p**	243.5p
Group MCEV earnings after tax		
Basic[1]	**116.5p**	31.5p
Diluted[2]	**116.5p**	31.5p

1 Based on 173 million shares (2011: 171 million) as set out in note 14 of the IFRS consolidated financial statements.

2 Based on 173 million shares (2011: 171 million) as set out in note 14 of the IFRS consolidated financial statements.

The earnings on life business are calculated on a post-tax basis and are grossed up at the effective rate of shareholder tax for presentation in the income statement. The tax rate used is the UK corporate tax rate of 24.5% (2011: 26.5%).

Statement of consolidated comprehensive income – Group MCEV basis

For the year ended 31 December 2012

	2012 £m	2011 Restated[1] £m
Group MCEV earnings for the year after tax	**202**	54
Other comprehensive income		
Actuarial (losses)/gains on defined benefit pension schemes (net of tax)	**(131)**	9
Total comprehensive income for the year	**71**	63

1 During 2012, the Group has amended its MCEV policy for recognising contributions to Group pension schemes in an IFRS (IAS 19) surplus position (refer note 1 g). The 2011 comparatives have been restated in this regard. The impact of the 2011 restatement is to reduce 'Group costs' by £30 million from £84 million to £54 million, to increase 'Tax on operating earnings' by £7 million from £141 million to £148 million and other comprehensive income reduces by £23 million.

Reconciliation of movement in equity – Group MCEV basis

For the year ended 31 December 2012

	2012 £m	2011 Restated £m
Group MCEV equity at 1 January	**2,118**	2,104
Total comprehensive income for the year	**71**	63
Movement in equity for equity-settled share-based payments	**5**	6
Dividends paid on ordinary shares	**(73)**	(72)
Shares issued in lieu of dividends	**1**	17
Total capital and dividend flows – external	**(67)**	(49)
Group MCEV equity at 31 December	**2,122**	2,118

Group MCEV analysis of earnings
For the year ended 31 December 2012

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Management IFRS £m	Other Group companies[1] IFRS £m	Group MCEV £m
Group MCEV at 1 January 2012	**3,804**	**82**	**68**	**(1,836)**	**2,118**
Operating MCEV earnings (after tax)	**272**	**22**	**32**	**(19)**	**307**
Non-operating MCEV earnings (after tax)	**48**	**(2)**	**3**	**(154)**	**(105)**
Total MCEV earnings	**320**	**20**	**35**	**(173)**	**202**
Other comprehensive income	**–**	**–**	**–**	**(131)**	**(131)**
Capital and dividend flows – internal	**(861)**	**13**	**(17)**	**865**	**–**
Capital and dividend flows – external	**–**	**–**	**–**	**(67)**	**(67)**
Closing value at 31 December 2012	**3,263**	**115**	**86**	**(1,342)**	**2,122**

1 Comprises the Group holding companies that do not form part of the Phoenix Life and Ignis Asset Management divisions.

For the year ended 31 December 2011 (restated)

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Management IFRS £m	Other Group companies[1] IFRS £m	Group MCEV £m
Group MCEV at 1 January 2011	4,517	80	54	(2,547)	2,104
Operating MCEV earnings (after tax)	409	13	34	(39)	417
Non-operating MCEV earnings (after tax)	(322)	15	(1)	(55)	(363)
Total MCEV earnings	87	28	33	(94)	54
Other comprehensive income	–	–	–	9	9
Capital and dividend flows – internal	(800)	(26)	(19)	845	–
Capital and dividend flows – external	–	–	–	(49)	(49)
Closing value at 31 December 2011	3,804	82	68	(1,836)	2,118

1 Comprises the Group holding companies that do not form part of the Phoenix Life and Ignis Asset Management divisions.

Reconciliation of Group IFRS equity to MCEV net worth
For the year ended 31 December 2012

	2012 £m	2011 £m
Group net assets attributable to owners of the parent as reported under IFRS	**1,658**	1,652
Goodwill and other intangibles in accordance with IFRS removed (net of tax)	**(431)**	(440)
Value of in-force business in accordance with IFRS removed (net of tax)	**(1,234)**	(1,289)
Adjustments to IFRS reserving[1]	**(203)**	(47)
Tax adjustments	**6**	8
Revalue listed debt to market value	**123**	161
Eliminate value of contingent loan asset[2]	**–**	(160)
Fair value adjustments[3]	**4**	(43)
Eliminate after tax pension scheme surpluses (including IFRIC 14 adjustments)[4]	**(186)**	(380)
Other adjustments	**8**	27
MCEV net worth attributable to owners of the parent	**(255)**	(511)
MCEV value of in-force business included (net of tax) as set out in note 2	**2,377**	2,629
Closing Group MCEV	**2,122**	2,118

1 Adjustments are made to the IFRS insurance liabilities to bring them into line with the reserving basis assumed in the MCEV value of in-force calculations. This impacts the allocation of MCEV between net worth and value of in-force and does not impact the total MCEV.

2 Removal of value attributed to contingent loans issued by holding companies to long-term funds as their expected repayments are captured within the MCEV VIF calculations.

3 Investments carried at amortised cost under IFRS are revalued at market value.

4 Pension scheme surpluses valued on an IFRS basis are removed. This includes the IFRIC 14 adjustments as described in note 31 to the IFRS consolidated financial statements.

Notes to the MCEV financial statements

1. Basis of preparation

Overview

The supplementary information on pages 187 to 199 has been prepared on a Market Consistent Embedded Value ('MCEV') basis except for the items described further below.

The MCEV methodology adopted by the Group is in accordance with the MCEV principles and guidance published by the CFO Forum in June 2008 and amended in October 2009, except that:

- risk-free rates have been defined as the annually compounded UK Government nominal spot curve plus 10 basis points rather than as a swap rate curve;
- no allowance for the cost of residual non-hedgeable risk ('CNHR') has been made because, in the opinion of the Directors, the Group operates a robust outsourcer model in terms of operational risk, does not write new business, is focused entirely on the back book, and has succeeded in closing out significant legacy risks. The theoretical value of CNHR is disclosed separately in note 1 (b); and
- the asset management and management service companies values are calculated on an IFRS basis. Under CFO Forum principles and guidance productivity gains should not be recognised until achieved. This treatment is inconsistent with the cost profile of a closed fund where continual cost reductions are expected to maintain unit costs as the business runs off. In the opinion of the Directors, if the MCEV principles and guidance were to be applied to the asset management and the management service companies, it would not provide a fair reflection of the Group's financial position. These companies are therefore reported alongside the Group's other holding companies at their IFRS net asset value.

In January 2013 the Group announced the re-terming of the Impala facility and an equity raising of £250 million. The equity raising comprised equity placings with certain Och-Ziff funds and an open offer to raise aggregate gross proceeds of £250 million through the issuance on 21 February 2013 of 50 million ordinary shares. The Group MCEV reported at 31 December 2012 does not include the proceeds of the equity raising net of deduction of commissions, fees and expenses of £232 million and has not allowed for the arrangement and restructuring fees of £21 million paid in connection with the amendments to the Impala facility agreement and £450 million prepayment on 22 February 2013. The value of in-force business has been reduced by £21 million to reflect the lower level of tax attributes expected to be available to relieve tax on emerging surpluses due to the accelerated repayment of debt.

The Finance Act 2012 set the rate of corporation tax at 23% from 1 April 2013. Consequently a rate of 23% has been used for the 2012 closing MCEV. Further reductions to 21% in April 2014 and 20% from April 2015 have been announced and will be introduced by future legislation. The impact on the Group's MCEV from the further 3% reduction in the tax rate is not expected to be significant and will be recognised as the legislation is substantively enacted.

The 2012 MCEV allows for the new rules for the taxation of insurance companies introduced by the Finance Act 2012 with effect from 1 January 2013. The new rules did not have a significant impact on the Group's MCEV.

On 27 June 2012 the Group announced that it had entered into a reinsurance agreement, effective 1 July 2012, to transfer approximately £5 billion of annuity in-payment liabilities, around 40% of the Group's annuity portfolio, to Guardian Assurance Limited ('Guardian'). It is expected that the reinsurance agreement will be replaced by a formal Part VII transfer of the annuity liabilities to Guardian in the second half of 2013. The 31 December 2012 Group MCEV allows for the negative impact of the reinsurance agreement of £84 million and the expense savings of £122 million expected following the Part VII transfer of the annuity liabilities to Guardian.

Covered business

The MCEV calculations cover all long-term insurance business written by the Group, but exclude Ignis Asset Management and the management service companies.

Opal Re is included within covered business and is valued on a basis consistent with the annuity business within the life companies.

MCEV methodology

The embedded value of covered business is based on a market-consistent methodology. Under this methodology, assets and liabilities are valued in line with market prices and consistently with each other.

The key components of MCEV are net worth plus the value of in-force covered business.

Notes to the MCEV financial statements
continued

1. Basis of preparation (continued)

a) Net worth
For the Group's life companies, net worth is defined as the market value of shareholder funds plus the shareholders' interest in surplus assets held in long-term business funds less the market value of any outstanding debt of the life companies.

Loans from the life companies to holding companies have been consolidated out such that they do not appear as an asset in the life company or as a liability in the holding company. This presentation has no impact on the overall MCEV but does affect the allocation of net assets between covered and non-covered business.

b) Value of in-force business ('VIF')
The value of in-force covered business consists of the following components:

– present value of future profits;

– time value of financial options and guarantees; and

– frictional costs of required capital.

The market consistent value of in-force business represents the present value of profits attributable to shareholders arising from the in-force business, less an allowance for the time value of financial options and guarantees embedded within life insurance contracts and frictional costs of required capital.

The approach adopted to calculate VIF combines deterministic and stochastic techniques (each of which is discussed in more detail below):

– deterministic techniques have been used to value cash flows whose values vary in a linear fashion with market movements. These cash flows are valued using discount rates that reflect the risk inherent in each cash flow. In practice, it is not necessary to discount each cash flow at a different discount rate, as the same result is achieved by projecting and discounting all cash flows at risk-free rates. This is known as the 'certainty equivalent approach'; and

– stochastic techniques have been used to value cash flows that have an asymmetric effect on cash flows to shareholders. Here, the calculation involves the use of stochastic models developed for the purposes of realistic balance sheet reporting.

Present value of future profits ('PVFP')
The PVFP represents the present value of profits attributable to shareholders arising from the in-force business. The PVFP is calculated by projecting and discounting using risk-free rates, with an allowance for liquidity premiums where appropriate.

The projection is based on actively reviewed best estimate non-economic assumptions. Best estimate assumptions make appropriate allowance for expected future experience where there is sufficient evidence to justify; for example in allowing for future mortality improvements on annuity business.

Time value of financial options and guarantees ('TVFOGs')
The Group's embedded value includes an explicit allowance for the time value of financial options and guarantees embedded within insurance contracts, including investment performance guarantees on participating business and guaranteed vesting annuity rates. The cost of these options and guarantees to shareholders is calculated using market-consistent stochastic models calibrated to the market prices of financial instruments as at the period end.

The TVFOGs allow for the impact of management actions, consistent with those permitted by the Principles and Practices of Financial Management. The modelling of management actions vary for each of the funds but typically include management of bonus rates and policy enhancements, charges to asset shares to cover increases to the cost of guarantees and alterations to investment strategy.

Frictional cost of capital ('COC')
COC is defined as the difference between the market value of shareholder-owned assets backing required capital and the present value of future releases of those assets allowing for future investment returns on that capital, investment expenses and taxes.

Required capital is defined as the minimum regulatory capital requirement, which is the greater of Pillar 1 and Pillar 2 capital requirements, plus the capital required under the Group's capital management policy. This equates to 150% of the Pillar 1 minimum regulatory capital requirement or 129% of the Pillar 2 minimum regulatory capital requirement (2011: 154% Pillar 1,128% Pillar 2).

Solvency II aims to introduce a new capital regime for insurers, these disclosures do not take account of the impact of the expected change in regime as this is still under development. In October 2012, the FSA announced that the implementation date for Solvency II will likely be deferred until at least 1 January 2016.

CNHR
The CNHR should allow for risks that can have an asymmetric impact on shareholder value to the extent these risks have not already been reflected in the PVFP or TVFOGs. The majority of such risks within the Group are operational and tax risks.

No allowance for the CNHR has been made, as in the opinion of the Directors, the CNHR calculated in accordance with CFO Forum principles and guidance does not anticipate further risk management actions and therefore does not provide a fair reflection of the Group's ongoing risk.

However, the CNHR calculated in accordance with the CFO Forum principles and guidance, and therefore without anticipating further risk management actions, has been disclosed below.

For with-profits business the CNHR would increase the TVFOGs by £52 million (2011: £46 million).

For other business the cost would be £127 million (2011: £130 million). This equates to an equivalent average cost of capital charge of 1.5% (2011: 1.2%). The level of capital assumed in this calculation is determined based on a 99.5% confidence level over a one year time horizon, consistent with the ICA methodology. Allowance is made for diversification benefits between non-hedgeable risks, but not between hedgeable and non-hedgeable risks.

c) Valuation of debt
Listed debt issued by the Group is valued at the market value quoted at the reporting date which is consistent with MCEV principles.

The National Provident Life Limited recourse bonds are backed by surpluses that are expected to emerge on blocks of its unit-linked and unitised with-profits business. This securitisation has been valued on a cash flow basis, allowing for payments expected to be due based on the projected level of securitised surpluses emerging. The full VIF of the securitised unit-linked and unitised with-profits business is expected to be payable to bondholders; therefore, no additional value accrues to the embedded value.

Unlisted bank debt owed by the holding companies is included at face value.

d) Taxation
Full allowance has been made for the value of tax that would become payable on the transfer of surplus assets out of non-profit funds. This allowance reflects the projected pace of releases of surplus from non-profit funds that is not required to support with-profit funds.

Allowance has also been made for the tax relief arising from interest payments made on the debt of the holding companies. The value of the tax relief is determined by offsetting the tax payable on profits emerging from covered business against the tax relief afforded by interest payments on the debt. Interest payments are projected assuming that current levels of debt are reduced and then refinanced to maintain a long-term level of debt that the Directors consider to be supported by the projected embedded value of the Group's businesses.

Notes to the MCEV financial statements
continued

1. Basis of preparation (continued)

e) New business
The MCEV places a value on the profits expected to be earned on annuities arising from policies vesting with guaranteed annuity terms. These policies are excluded from the definition of new business on the basis that the annuity being provided is an obligation under an existing policy and the life companies are already reserving for the cost of these guarantees.

New business includes all other annuities written by the life insurance companies.

f) Participating business
Allowance is made for future bonus rates on a basis consistent with the projection assumptions and established company practice.

The time value of options and guarantees used in the calculation of MCEV also allows for expected management action and policyholder response to the varying external economic conditions simulated by the economic scenario generators. Policyholder response has been modelled based on historical experience. Management actions have been set in accordance with each life company's Principles and Practices of Financial Management.

g) Pension schemes
The MCEV allows for pension scheme deficits as calculated on an IFRS (IAS 19) basis, but no benefit is taken for pension scheme surpluses.

Under IFRIC 14, an interpretation of IAS 19, pension funding contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable would result in a surplus that would not be recoverable, a liability is recognised when the obligation arises. The IFRS IFRIC 14 adjustments are not reflected in the Group MCEV as the Group does not anticipate that its ultimate contributions into the pension schemes would result in an unrecoverable surplus.

During 2012, the Group amended its MCEV policy for recognising contributions to pension schemes in an IFRS surplus position. Prior to 2012, these contributions were recognised in 'Group costs'. These contributions are now recognised in other comprehensive income along with actuarial gains and losses on Group schemes that are in an IFRS deficit, so that these non-operating items are treated consistently.

The 2011 comparatives have been restated in this regard. The impact of the 2011 restatement is to reduce 'Group costs' by £30 million from £84 million to £54 million, to increase 'Tax on operating earnings' by £7 million from £141 million to £148 million and other comprehensive income reduces by £23 million. There is no net impact on the closing 2011 MCEV.

2. Components of the MCEV of covered business

	2012 £m	2011 £m
Net worth	**886**	1,175
PVFP	**2,450**	2,846
TVFOG	**(46)**	(108)
COC	**(27)**	(109)
Total VIF	**2,377**	2,629
	3,263	3,804

The net worth of covered business of £886 million at 31 December 2012 (2011: £1,175 million) consists of £514 million of free surplus in excess of required capital (2011: £11 million).

3. Analysis of covered business MCEV earnings (after tax)

	Net worth £m	VIF £m	Total Life MCEV £m
Life MCEV at 1 January 2012	**1,175**	**2,629**	**3,804**
New business value	**10**	**10**	**20**
Expected existing business contribution (reference rate)[1]	**36**	**67**	**103**
Expected existing business contribution (in excess of reference rate)[2]	**36**	**45**	**81**
Transfer from VIF to net worth	**198**	**(198)**	**–**
Experience variances	**40**	**(27)**	**13**
Assumption changes	**(23)**	**(14)**	**(37)**
Other operating variances	**66**	**26**	**92**
Life MCEV operating earnings	**363**	**(91)**	**272**
Economic variances	**(66)**	**84**	**18**
Other non-operating variances	**211**	**(181)**	**30**
Total Life MCEV earnings	**508**	**(188)**	**320**
Capital and dividend flows	**(797)**	**(64)**	**(861)**
Life MCEV at 31 December 2012	**886**	**2,377**	**3,263**

1 Expected existing business contribution (reference rate) represents the expected return on the opening MCEV at the long-term risk-free rate.

2 Expected existing business contribution (in excess of reference rate) represents the additional expected return above the risk-free rate arising from long-term risk premiums on equities, property and corporate bonds.

	Net worth £m	VIF £m	Total Life MCEV £m
Life MCEV at 1 January 2011	1,770	2,747	4,517
New business value	7	6	13
Expected existing business contribution (reference rate)[1]	65	115	180
Expected existing business contribution (in excess of reference rate)[2]	33	41	74
Transfer from VIF to net worth	212	(212)	–
Experience variances	122	59	181
Assumption changes	(28)	10	(18)
Other operating variances	8	(29)	(21)
Life MCEV operating earnings	419	(10)	409
Economic variances	(272)	(41)	(313)
Other non-operating variances	(4)	(5)	(9)
Total Life MCEV earnings	143	(56)	87
Capital and dividend flows	(738)	(62)	(800)
Life MCEV at 31 December 2011	1,175	2,629	3,804

1 Expected existing business contribution (reference rate) represents the expected return on the opening MCEV at the long-term risk-free rate.

2 Expected existing business contribution (in excess of reference rate) represents the additional expected return above the risk-free rate arising from long-term risk premiums on equities, property and corporate bonds.

Notes to the MCEV financial statements
continued

4. New business

The value generated by new business written during the period is calculated as the present value of the projected stream of after-tax distributable profits from that business. This contribution has been valued using economic and non-economic assumptions at the point of sale. The value of new business is shown after the effect of frictional costs of holding required capital on the same basis as for the in-force covered business.

	Premium £m	MCEV £m	MCEV/ Premium
Year ended 31 December 2012	**414**	**20**	**5%**
Year ended 31 December 2011	274	13	5%

5. Maturity profile of business

This note sets out how the PVFP is expected to emerge into net worth over future years. Surpluses are projected on a certainty equivalent basis with allowance for liquidity premiums as appropriate and are discounted at risk-free rates.

	Years					
Present value of future profits (PVFP)	1-5 £m	6-10 £m	11-15 £m	16-20 £m	20+ £m	Total £m
31 December 2012	**1,058**	**596**	**369**	**231**	**196**	**2,450**
31 December 2011	1,135	683	455	291	282	2,846

6. Assumptions

Reference rates

(a) Risk-free rates

Risk-free rates are based on the annually compounded UK Government bond nominal spot curve plus 10 basis points, extrapolated as necessary to meet the term of the liabilities.

The risk-free rates assumed for a sample of terms were as follows:

	2012		2011	
Term	Gilt yield + 10 bps	Swap yield	Gilt yield +10 bps	Swap yield
1 year	**0.32%**	**0.57%**	0.32%	1.09%
5 years	**1.01%**	**1.04%**	1.14%	1.61%
10 years	**1.99%**	**1.92%**	2.20%	2.32%
15 years	**2.70%**	**2.58%**	2.85%	2.79%
20 years	**3.18%**	**2.96%**	3.21%	3.02%

Had the Group used the swap rate curve as set out in the CFO Forum principles, the MCEV would have been £168 million lower (2011: £50 million lower).

(b) Liquidity premiums

In October 2009, the CFO Forum published an amendment to the MCEV principles to reflect the inclusion of a liquidity premium. The changes affirm that the reference rate may include a liquidity premium over and above the risk-free yield curve for liabilities which are not liquid, given that the matching assets are able to be held to maturity.

The liabilities to which a liquidity premium is applied include immediate annuities, pensions policies with benefits defined as an annuity or in-the-money guaranteed annuity options. The liquidity premium is determined by reference to the yield on the bond portfolios held after allowing for credit risk by deducting margins for best estimate defaults and unexpected default risk premiums. The additional yield above risk-free rates implied by the calculated liquidity premium is as follows:

	2012	2011
Additional yield over risk-free rates	**0.60%**	0.90%

The Group holds £3.6 billion of corporate bonds which are used to back annuity in-payment liabilities in non-profit funds. The MCEV includes an aggregate credit default provision of £312 million, to fund against the risk of default on these corporate bonds.

Inflation

For purposes of the MCEV calculation, the rate of increase in the UK Retail Price Index ('RPI') as at 31 December 2012 was taken from the implied inflation curve at a term appropriate to the liabilities. The rate of increase in UK National Average Earnings inflation is assumed to be RPI plus 100 basis points as at 31 December 2012 (2011: RPI plus 100 basis points).

Stochastic economic assumptions

The time value of options and guarantees is calculated using an economic scenario generator. The model is calibrated to market conditions as at 31 December 2012. The scenario generator and calibration are consistent with that used for realistic balance sheet reporting.

A LIBOR Market Model is used to generate risk-free rates over a complete yield curve, calibrated to the UK nominal spot curve plus 10 basis points, consistent with the deterministic projections. Interest rate volatility is calibrated to swaption implied volatilities, as per the sample below.

	Option term (years)					
Interest rate volatility	**5**	**10**	**15**	**20**	**25**	**30**
2012 Swap term (years)						
5	**27.1%**	**18.3%**	**16.0%**	**15.5%**	**15.9%**	**15.3%**
10	**22.7%**	**17.1%**	**15.2%**	**14.8%**	**14.9%**	**14.5%**
20	**19.4%**	**16.0%**	**14.2%**	**13.4%**	**13.5%**	**13.4%**
30	**18.4%**	**15.3%**	**13.5%**	**12.8%**	**12.6%**	**12.3%**

	Option term (years)					
Interest rate volatility	5	10	15	20	25	30
2011 Swap term (years)						
5	28.1%	19.5%	17.6%	16.1%	16.4%	16.2%
10	24.1%	18.0%	16.2%	15.3%	15.4%	14.9%
20	21.2%	16.1%	14.8%	13.8%	13.5%	13.0%
30	20.0%	15.0%	13.4%	12.3%	12.0%	11.5%

Real interest rates have been modelled using the two-factor Vasicek model, calibrated to index-linked gilts.

Equity volatility is calibrated to replicate the prices on a range of FTSE equity options, and extrapolated beyond terms available in the market. The equity volatility model used allows volatility to vary with both term and the level of the equity index.

	Term (years)					
Equity implied volatility (ATM)	**5**	**10**	**15**	**20**	**25**	**30**
2012	**23.4%**	**26.3%**	**27.6%**	**28.3%**	**28.7%**	**29.0%**
2011	25.8%	27.2%	27.5%	27.7%	27.8%	27.9%

Best estimate levels of volatility are assumed for directly held property. The model implied volatility for 2012 is 15% (2011: 15%).

The modelling of corporate bonds allows for credit transitions and defaults, calibrated to historic data, with an additional allowance for the credit risk premium, derived from current markets.

Notes to the MCEV financial statements
continued

6. Assumptions (continued)

Operating earnings

The Group uses normalised investment returns in calculating the expected existing business contribution. The Group considers that an average return over the remaining term of its in-force business is more appropriate than using a short-term rate and is more consistent with the Group's expectation of longer-term rates of return. Therefore, the Group calculates the expected contribution on existing business using a 15-year gilt rate at the beginning of the reporting period plus 10 basis points and long-term expectations of excess investment returns.

The table below sets outs the asset risk premiums used:

	2012	2011
Equities	**3.0%**	3.0%
Property	**2.0%**	2.0%
Gilts	**0.0%**	0.0%

The return assumed on corporate bond portfolios is the redemption yield for the portfolio less an allowance for credit risk.

Expenses

Each life company's projected per policy expenses are based on existing management services agreements with the Group's management service companies, adjusted to allow for additional costs incurred directly by the life companies, including, for example, regulatory fees and one-time expenses.

The life companies' projected investment expenses are based on the fees agreed with Ignis Asset Management, (or external fund managers, where appropriate), allowing for current and projected future asset mixes.

Valuation of debt and non-controlling interests

The Group's consolidated balance sheet as at 31 December 2012 includes Perpetual Reset Capital Securities with principal outstanding of £425 million (2011: £425 million) and subordinated debt with a face value of £200 million (2011: £200 million). These listed securities have been included within the MCEV at their market value quoted at the reporting date.

The table below summarises the value of these debt obligations:

	2012		2011	
	Face value (including accrued interest) £m	**Market value £m**	Face value (including accrued interest) £m	Market value £m
Listed debt and non-controlling interests				
Perpetual Reset Capital Securities	**444**	**286**	444	256
Phoenix Life Limited subordinated debt	**211**	**173**	211	139

Unlisted debt has been included at face value:

	2012 Face value £m	2011 Face value £m
Unlisted debt		
Pearl and Impala facilities	**2,307**	2,471
Royal London PIK notes and facility	**116**	111

7. Sensitivity to assumptions

The table below summarises the key sensitivities of the MCEV of covered business at 31 December 2012:

	2012 Life MCEV £m	2011 Life MCEV £m
(1) Base	**3,263**	3,804
(2) 1% decrease in risk-free rates	**91**	153
(3) 1% increase in risk-free rates	**(95)**	(157)
(4) 10% decrease in equity market values	**(70)**	(75)
(5) 10% increase in equity market values	**69**	71
(6) 10% decrease in property market values	**(48)**	(72)
(7) 10% increase in property market values	**47**	72
(8) 100 bps increase in credit spreads[1]	**(150)**	(170)
(9) 100 bps decrease in credit spreads[1]	**175**	196
(10) 25% increase in equity/property implied volatilities	**(9)**	(20)
(11) 25% increase in swaption implied volatilities	**(1)**	11
(12) 25% decrease in lapse rates and paid-up rates	**(38)**	(43)
(13) 5% decrease in annuitant mortality	**(148)**	(203)
(14) 5% decrease in non-annuitant mortality	**29**	27
(15) Required capital equal to the minimum regulatory capital[2]	**15**	32

1 25 bps is assumed to relate to default risk.

2 Minimum regulatory capital is defined as the greater of Pillar 1 and Pillar 2 capital requirements without any allowance for the Group's capital management policy.

No expense sensitivity has been shown as maintenance costs incurred by the covered business are largely fixed under the terms of agreements with the management services companies.

Additional information

In this section

Shareholder information

Annual General Meeting

Our Annual General Meeting ('AGM') will be held on 2 May 2013 at 1pm.

The voting results for our 2013 AGM, including proxy votes and votes withheld, will be available on the Group's website shortly after the meeting.

Share price performance

Phoenix Group Holdings share price performance
Price (rebased to PHNX) pence

Shareholder profile as at 31 December 2012

Range of shareholdings	No. of shareholders	%	No. of shares	%
1-1,000	183	28.68	100,250	0.06
1,001-5,000	145	22.73	372,928	0.21
5,001-10,000	54	8.46	381,743	0.22
10,001-250,000	165	25.86	10,565,980	6.05
250,001-500,000	25	3.92	8,948,605	5.13
500,001 and above	66	10.35	154,217,642	88.33
Total	638	100.00	174,587,148	100.00

Shareholder information
continued

Shareholder services

Managing your shareholding

Our registrar, Computershare, maintains the Company's Register of Members. Shareholders may request a hard copy of this Annual Report from our registrar and if you have any further queries in respect of your shareholding, please contact them directly using the contact details set out below.

Registrar details

Computershare Investor Services (Cayman) Limited
c/o Queensway House
Hilgrove Street
St Helier
Jersey JE1 1ES

Shareholder helpline number	+44 (0) 870 707 4040
Fax number	+44 (0) 870 873 5851
Shareholder helpline e-mail address	info@computershare.co.je

Dividend mandates

Shareholders may find it convenient to have their dividends paid directly to their bank or building society account. If you wish to take advantage of this facility please call Computershare and request a 'Dividend Mandate' form.

Scrip dividend alternative

The Company does not currently offer a scrip dividend alternative.

Warning to shareholders

Over recent years, many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas-based 'brokers' who target UK shareholders, offering to sell them what often turn out to be worthless or high-risk shares in US or UK investments. These operations are commonly known as 'boiler rooms'.

Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free reports about the Company.

If you receive any unsolicited investment advice:

– Make sure you get the correct name of the person and organisation

– Check that they are properly authorised by the FSA before getting involved by visiting www.fsa.gov.uk/register/home.do

– Report the matter to the FSA by calling 0845 606 1234

– If the calls persist, hang up.

If you deal with an unauthorised firm, you would not be eligible to receive payment under the Financial Services Compensation Scheme. The FSA can also be contacted by completing an online form available at www.fsa.gov.uk/pages/doing/Regulated/Law/Alerts/form.shtml.

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FSA website available at www.fsa.gov.uk/pages/consumerinformation.

Share price

You can access the current share price of Phoenix Group Holdings on the Group's website.

Group financial calendar for 2013

Annual General Meeting	2 May 2013
Announcement of first quarter interim management statement	3 May 2013
Announcement of unaudited six months' interim results	23 August 2013
Announcement of third quarter interim management statement	25 October 2013
Ordinary shares – 2012 final dividend	
Ex-dividend date	3 April 2013
Record date	5 April 2013
Payment date for the recommended final dividend	3 May 2013

Forward-looking statements

The 2012 Annual Report and Accounts contains, and we may make other statements (verbal or otherwise) containing, forward-looking statements about the Group's current plans, goals and expectations relating to future financial conditions, performance, results, strategy and/or objectives.

Statements containing the words: 'believes', 'intends', 'expects', 'plans', 'seeks', 'targets', 'continues' and 'anticipates' or other words of similar meaning are forward-looking. Forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control. For example, certain insurance risk disclosures are dependent on the Group's choices about assumptions and models, which by their nature are estimates. As such, actual future gains and losses could differ materially from those that we have estimated. Other factors which could cause actual results to differ materially from those estimated by forward-looking statements include but are not limited to:

- Domestic and global economic and business conditions
- Asset prices
- Market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally
- The policies and actions of governmental and/or regulatory authorities, including, for example, new government initiatives related to the financial crisis and the effect of the FSA's planned 'ICA +' regime and ultimate transition to the European Union's 'Solvency II' on the Group's capital maintenance requirements
- The impact of inflation, and deflation
- Market competition
- Changes in assumptions in pricing and reserving for insurance business (particularly with regard to mortality and morbidity trends, gender pricing and lapse rates)
- The timing, impact and other uncertainties of future acquisitions or combinations within relevant industries
- Risks associated with arrangements with third parties, including joint ventures
- Inability of reinsurers to meet obligations or unavailability of reinsurance coverage
- The impact of changes in capital, solvency or accounting standards, and tax and other legislation and regulations in the jurisdictions in which members of the Group operate.

As a result, the Group's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set out in the forward-looking statements within the 2012 Annual Report and Accounts. The Group undertakes no obligation to update any of the forward-looking statements contained within the 2012 Annual Report and Accounts or any other forward-looking statements it may make.

The 2012 Annual Report and Accounts has been prepared for the members of the Company and no one else. The Company, its Directors or agents do not accept or assume responsibility to any other person in connection with this document and any such responsibility or liability is expressly disclaimed. Nothing in the 2012 Annual Report and Accounts should be construed as a profit forecast.

Glossary

ABI	Association of British Insurers – A trade association for the UK's insurance industry
ABS	Asset Backed Securities – A collateralised security whose value and income payments are derived from a specified pool of underlying assets
ACSM	Alternative Coupon Satisfaction Mechanism – The mechanism under the Tier 1 Notes, under which, if Pearl Group Holdings (No. 1) Limited opts to defer a coupon payment, the deferred coupon payment may only be satisfied through the proceeds of the issue of certain forms of securities, which may be made at any time
ALM	Asset Liability Management – Management of mismatches between assets and liabilities within risk appetite
Annuity policy	A policy that pays out regular benefit amounts, either immediately and for the remainder of a policyholder's lifetime (immediate annuity), or deferred to commence at some future date (deferred annuity)
Asset management	The management of assets using a structured approach to guide the act of acquiring and disposing of assets, with the objective of meeting defined investment goals and maximising value for investors, including policyholders
AST	Actuarial Systems Transformation – A project set up to rationalise and streamline the Group's actuarial systems, models and processes into a single actuarial modelling platform that is state of the art, scalable and able to meet our future demands
Black-Scholes	A mathematical model used to calculate the value of an option
CFO Forum	A high-level discussion group formed of the Chief Financial Officers of major European insurance companies. Its aim is to influence the development of financial reporting and related regulatory developments for insurance companies on behalf of its members
Closed life fund	A fund that no longer accepts new business. The fund continues to be managed for the existing policyholders
COC	Frictional Cost of Capital – The difference between the market value of shareholder-owned assets backing required capital and the present value of future releases of those assets allowing for future investment returns on that capital, investment expenses and taxes
CNHR	Cost of residual non-hedgeable risk – The expected cost of non-hedgeable risks that can have an asymmetric impact on shareholder value to the extent these risks have not already been reflected in the present value of future profits or time value of financial options and guarantees within the MCEV
DPF	Discretionary Participation Feature – A contractual right under an insurance contract to receive, as a supplement to guaranteed benefits, additional benefits whose amount or timing is contractually at the discretion of the issuer
EBT	Employee Benefit Trust – A trust set up to enable its Trustee to purchase and hold shares to satisfy employee share-based incentive plan awards. The Company's EBT is the Phoenix Group Holdings Employee Benefit Trust

Economic assumptions	Assumptions related to future interest rates, inflation, market value movements and tax
EEA	European Economic Area – Established on 1 January 1994 and is an agreement between Norway, Iceland, Liechtenstein and the European Union. It allows these countries to participate in the EU's single market without joining the EU
Euronext	A pan-European Stock Exchange based in Amsterdam, Holland
Embedded value	The value to equity shareholders of the net assets and expected future profits of a life company
Experience variances	Current period differences between the actual experience incurred and the assumptions used in the calculation of MCEV or IFRS insurance liabilities
Financial Reporting Council	The UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment
Free surplus	The amount of capital held in life companies in excess of that needed to support their minimum regulatory capital requirement, which is the greater of Pillar 1 and Pillar 2 capital requirements, plus the capital required under the Group's capital management policy
FSA	Financial Services Authority – Regulator of all providers of financial services in the UK; Bank of England retains responsibility for systemic risk
GAR	Guaranteed Annuity Rate – A rate available to certain pension policyholders to acquire an annuity at a contractually guaranteed conversion rate
Gearing – existing methodology	Net shareholder debt as a percentage of the sum of Group MCEV, net shareholder debt and the present value of future profits of Ignis Asset Management. Net shareholder debt is defined as shareholder debt (including the Tier 1 Notes) less Holding Company cash and cash equivalents
Gearing – new methodology	Gross shareholder debt as a percentage of the gross MCEV
Gross MCEV	Gross MCEV is the sum of the Group MCEV and the value of the shareholder and hybrid debt as included in the MCEV
Gross shareholder debt	Gross shareholder debt is defined as the sum of the IFRS carrying value of shareholder debt (as disclosed in the Borrowings note in the IFRS financial statements) and 50% of the IFRS carrying value of the Tier 1 Notes given the hybrid nature of that instrument
Group AUM	Group assets under management – This represents life company assets (excluding collateral on stock lending arrangements), Holding Company cash and third party assets managed by Ignis Asset Management
HMRC	Her Majesty's Revenue and Customs
Holding Companies	Refers to Phoenix Group Holdings, Phoenix Life Holdings Limited, Pearl Group Holdings (No. 2) Limited, Impala Holdings Limited, Pearl Group Holdings (No. 1) Limited, PGH (TC1) Limited, PGH (TC2) Limited, PGH (MC1) Limited, PGH (MC2) Limited, PGH (LCA) Limited, PGH (LCB) Limited, PGH (LC1) Limited, PGH (LC2) Limited and Pearl Life Holdings Limited

Glossary
continued

ICA	Individual Capital Assessment – A life company's Pillar 2 assessment of its capital requirements to ensure that assets exceed liabilities 99.5% of the time over a 1-year period or (in other words) to be able to withstand a 1 in 200 year event
ICA+	The FSA has indicated that due to continuing uncertainties over the timetable for the introduction of Solvency II, it will work with the industry to enhance the existing Pillar 2 ICA regime to an 'ICA+' regime leveraging the investments firms have made preparing for Solvency II
IFRS	International Financial Reporting Standards – Accounting standards, Interpretations and the Framework adopted by the International Accounting Standards Board
IGD	Insurance Groups Directive – The European Directive setting out the current capital adequacy regime for insurance groups as implemented by the FSA. IGD surplus is defined as Group Capital Resource ('GCR') less the Group Capital Resource Requirement ('GCRR')
IMC	Investment Management Contract – A contract between an investor and an investment manager
In-force	Long-term business written before the period end and which has not terminated before the period end
Inherited estate	The assets of the long-term with-profit funds less the realistic reserves for non-profit policies written into the non-profit fund, less asset shares aggregated across the with-profit policies and any additional amounts expected at the valuation date to be paid to in-force policyholders in the future in respect of smoothing costs and guarantees
LDI	Liability Driven Investment – Refers to investing in assets which move in line with the value of liabilities. Ignis LDI strategies typically involve purchasing a mix of government bonds and other instruments which have similar sensitivity to interest rates and inflation as the liabilities, to protect against changes in the deficit between asset and liability values
LIBOR	London Interbank Offer Rate – The average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another
LSE	London Stock Exchange
LTIP	Long-Term Incentive Plan – The part of an executive's remuneration designed to incentivise long-term value for shareholders through an award of shares with vesting contingent on employment and the satisfaction of stretching performance conditions linked to Group strategy
MCEV	Market Consistent Embedded Value – A measure of the consolidated value of shareholders' interests calculated using the Group's MCEV methodology as described in the Basis of preparation section of the MCEV supplementary information
MSA	Management Services Agreement - Contracts that exists between Phoenix Life and management services companies or between management services companies and their outsource partners
Net shareholder debt	Shareholder debt (including the Tier 1 Notes) less Holding Company cash and cash equivalents
Non-economic assumptions	Assumptions related to future levels of mortality, morbidity, persistency and expenses
Non-profit fund	A fund which is not a with-profit fund (see below), where risks and rewards of the fund fall wholly to shareholders

Open Ended Investment Companies	A type of company or a fund in the UK that is structured to invest in other companies with the ability to adjust its investment criteria and fund size
Operating companies	Refers to the trading companies within Phoenix Life (which includes Opal Reassurance Limited) and all trading companies within Ignis Asset Management
Part VII transfer	The transfer of insurance policies under Part VII of FSMA 2000. The insurers involved can be in the same corporate group or in different groups. Transfers require the consent of the High Court, which will consider the views of the FSA and of an Independent Expert
Participating business	See with-profit fund
Pearl businesses	PGH (LCA) Limited, PGH (LCB) Limited, PGH (TC1) Limited, PGH (TC2) Limited and Opal Reassurance Limited, together with their subsidiaries, being the five companies acquired by Phoenix Group Holdings on 2 September 2009
Peripheral Eurozone	Refers to Portugal, Ireland, Italy, Greece and Spain
PIK	Payment-in-kind - Interest on a bond is paid other than in cash, most commonly by increasing the principal
Pillar 1	EU-directive-based capital requirements as implemented by the FSA for insurance companies. The Pillar 1 surplus is the excess of available capital resources over the regulatory capital resource requirements
Pillar 2	The FSA's Pillar 2 risk-based capital requirements for insurance companies that have been implemented in the UK. The Pillar 2 surplus is the excess of available capital resources over capital calculated on an economic basis required to ensure entities can meet their liabilities. It is based on a self-assessment methodology called the ICA (Individual Capital Assessment)
PLHL ICA	PLHL ICA is an assessment, on an economic basis, of the capital resources and requirements arising from the obligations and risks which exist outside the Group's life companies
PPFM	Principles and Practices of Financial Management – A publicly available document which explains how a company's with-profit business is run. As part of demonstrating that customers are treated fairly, the Board certifies that the PPFM has been complied with
Protection policy	A policy which provides benefits payable on certain events. The benefits may be a single lump sum or a series of payments and may be payable on death, serious illness or sickness
PVFP	Present Value of Future Profits – The present value of profits attributable to shareholders arising from the relevant in-force business
RCR	Resilience Capital Requirement – Additional amounts of capital required to be held by certain life companies for regulatory purposes as a result of 2 stress tests under Pillar 1
Scrip issue	The issue of new shares to existing shareholders in lieu of a cash dividend
Solvency II	A fundamental review of the capital adequacy regime for the European insurance industry. Solvency II aims to establish a set of EU-wide capital requirements and risk management standards that will replace the current Solvency I requirements

Glossary
continued

TCF	Treating Customers Fairly – A central FSA principle that aims to ensure fair outcomes for customers
Tier 1 Notes	£500 million Perpetual Reset Capital Securities issued by Pearl Group Holdings (No. 1) Limited. Following amendments to the Notes in 2010, the principal amount outstanding now is £425 million
Total Shareholder Return	The total return, over a fixed period, to an investor in terms of share price growth and dividends (assuming that dividends paid are re-invested, on the ex-dividend date, in acquiring further shares)
UK Corporate Governance Code	Standards of good corporate governance practice in the UK relating to issues such as board composition and development, remuneration, accountability, audit and relations with shareholders
UKCPT	UK Commercial Property Trust Limited – A property subsidiary of the Group which is domiciled in Guernsey and listed on the London Stock Exchange
UK GAAP	Generally Accepted Accounting Principles adopted within the UK
Unit-linked policy	A policy where the benefits are determined by the investment performance of the underlying assets in the unit linked fund
VIF	The Value of In-Force business in the MCEV –The Present Value of Future Profits ('PVFP') plus the Time Value of Financial Options and Guarantees ('TVFOG') less the Frictional Cost of Required Capital ('COC')
With-profit fund	A fund where policyholders are entitled to a share of the profits of the fund. Normally, policyholders receive their share of the profits through bonuses. Also known as a participating fund as policyholders have a participating interest in the with-profit funds and any declared bonuses. Generally, policyholder and shareholder participation in the with-profit funds in the UK is split 90:10
WPICC	With-Profit Insurance Capital Component. The WPICC is the amount by which the regulatory surplus exceeds the realistic surplus for with-profit funds

Reducing our environmental impact

In line with our Corporate Responsibility programme, and as part of our desire to reduce our environmental impact, you can view key information on our website at www.thephoenixgroup.com.

Our Investor Relations section includes information such as our most recent news and announcements, results presentations, annual and interim reports, share-price performance, AGM and EGM information, FSA returns and contact information.

To stay up-to-date with Phoenix Group news and other changes to our site's content, you can sign up for e-mail alerts, which will notify you when content is added. To sign up visit http://www.thephoenixgroup.com/investor-relations/email-alerts.aspx.

For mobile phone users we also have a useful mini-site at http://m.thephoenixgroup.com which contains links to our latest news items, share price, financial calendar and contact details.

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