PHOENIX GROUP HOLDINGS

INTERIM REPORT FOR THE HALF YEAR ENDED 30 JUNE 2014

PHOENIX GROUP

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GROUP CHIEF EXECUTIVE'S REPORT

INTRODUCTION

The first half of 2014 saw a number of transformational events for the Phoenix Group that together have simplified and strengthened our balance sheet, in line with our aim to achieve an investment grade rating in the future, and have enhanced the Group's ability to deliver on our ambition to lead the consolidation of the UK closed life fund sector.

First, in March we announced the divestment of Ignis Asset Management ('Ignis') to Standard Life Investments (Holdings) Limited ('Standard Life Investments') for £390 million, subject to regulatory approval. This transaction completed on 1 July 2014 and brings significant financial and strategic benefits to the Group, including a reduction in the level of gearing through a £250 million debt prepayment and a strategic alliance with Standard Life Investments. Second, on 7 July the Group issued a £300 million senior unsecured bond at an attractive rate of interest, thereby re-establishing a relationship with the debt capital markets. Finally, on 23 July we unified the two legacy debt silos (Pearl and Impala) into a single £900 million unsecured bank facility and repaid £206 million of bank debt from internal resources, simplifying the Group's debt structure, lowering our interest costs and reducing gearing further.

Together, these actions have reduced gearing to 35% on a Pro Forma Basis[1], supporting our ambition to achieve an investment grade credit rating in due course and providing us with greater flexibility in financing future acquisitions.

This very positive activity for the Group has been completed against a backdrop of uncertainty for the broader insurance industry, with changes to retiree options as a result of the ending of compulsory annuities announced in the March Budget and in relation to the Financial Conduct Authority's ('FCA') planned thematic review of the fair treatment of long-standing customers in life insurance.

During the first half of 2014, our activities in relation to Solvency II have been focused primarily on the preparation of the Group's Internal Model Application, as well as on monitoring the progress of the development of the Solvency II regulations. The UK insurance industry is still awaiting details from regulatory authorities on the specific details in relation to the implementation of Solvency II. Provided that the regulations are in line with our expectations, it is Phoenix's view that the capital position of the Group will remain broadly aligned to the PLHL ICA surplus; however, this is subject to regulatory approvals and should not be seen as representing the views of the Prudential Regulation Authority.

The Board has declared an interim dividend for the first six months of 2014 of 26.7p per share which is scheduled to be paid on 2 October 2014 and is in line with the 2013 interim dividend. Given the long term run-off nature of the Group's business, the Board believes it is prudent to maintain a stable, sustainable dividend whilst the Group builds its financial flexibility to execute its growth strategy and will keep the dividend under review.

PERFORMANCE HIGHLIGHTS

The Group set itself targets at the time of our Annual Results announcement in March and I am pleased to be able to report significant progress.

Against a full year cash generation target of £500 to £550 million, £332 million has been delivered in the first half of the year, primarily reflecting the release of free surplus generated in the life companies and the benefit of management actions, taking the Group over half way towards meeting the full year target. A further £390 million was received at the completion of the divestment of Ignis to Standard Life Investments on 1 July. Our total holding company cash balances were £1,081 million as at 30 June 2014, and this will reduce to £990 million on a Pro Forma Basis.

Group MCEV was £2,328 million as at 30 June 2014, compared to £2,378 million as at the end of December 2013. The movement in the first half primarily reflects the achievement of a total of £153 million of management actions, offset by provisions for recent regulatory changes, economic variances and a £45 million increase in the value of our Tier 1 and Tier 2 Notes during the period, which are deducted from our MCEV at market value. On a Pro Forma Basis MCEV would increase by £274 million to £2,602 million as at 30 June 2014.

In March we announced a new cumulative target of £300 million incremental embedded value from management actions between 2014 and 2016. The Group generated £153 million of incremental MCEV during the first half of 2014 towards this target through a series of actions including enhancements from our new actuarial modelling system and a restructuring of the PGL Pension Scheme longevity arrangements. This outstanding start towards achieving our new target underlines the opportunity for the Group to continue to drive value from the existing book of business.

1 Pro Forma Basis assumes that the proceeds of the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank facility refinancing, inclusive of the £206 million associated debt prepayment, had taken place on 30 June 2014.

Our gearing ratio reduced from 44% as at 31 December 2013 to 43% as at 30 June 2014. On a Pro Forma Basis the gearing ratio is reduced by a further 8 percentage points to 35%, thus achieving our original 40% target 18 months ahead of schedule. Going forward we intend to manage our gearing to a level consistent with our ambition to achieve and maintain an investment grade rating and we expect to start the process of formally engaging with the credit rating agencies during the second half of the year.

Our capital position remains robust with IGD surplus and headroom over our capital policy estimated at £1.3 billion and £0.6 billion respectively at 30 June 2014, compared with the IGD surplus of £1.2 billion and headroom of £0.5 billion at 31 December 2013. IGD surplus and headroom are reduced to £1.1 billion and £0.4 billion respectively on a Pro Forma Basis as at 30 June 2014, primarily as a result of the additional prepayment of debt, funded by internal resources, on drawdown of the new bank facility.

At 30 June 2014, our PLHL ICA surplus was estimated to be £1.0 billion, with headroom over our £150 million capital policy of £0.9 billion, compared to our PLHL ICA surplus and headroom at 31 December 2013 of £1.2 billion and £1.1 billion respectively. The reduction in the period primarily reflects the strengthening of assumptions related to longevity, credit and correlations. On a Pro Forma Basis PLHL ICA surplus and headroom both decreased by £0.3 billion, a combination of the impact arising from the divestment of Ignis and the additional prepayment of debt on the drawdown of the new bank facility.

Finally, the Group achieved IFRS operating profits of £266 million in the first half of 2014 including £114 million from management actions, compared to £186 million in the first half of 2013, which benefited from £24 million of management actions.

DIVESTMENT OF IGNIS AND DEBT REFINANCING

The debt reduction and refinancing that the Group has achieved during the first half of 2014 consists of three separate transactions:

- The divestment of Ignis to Standard Life Investments for £390 million in cash, announced on 26 March. Following completion on 1 July, £250 million of the proceeds were used to prepay existing bank debt.
- The issue of a £300 million 7 year unsecured senior bond at an annual coupon of 5.75% from the Group's new financing subsidiary, PGH Capital Limited. The net proceeds from the bond were used to prepay existing bank debt on 7 July.
- The refinancing of the Group's remaining senior bank debt and PIK notes into a single 5 year £900 million unsecured bank facility at PGH Capital Limited on 23 July. The new facility was agreed with a core set of lending banks, which included some new lenders, and allows further simplification of the Group's corporate structure over time, including the possible further merger of Phoenix's two largest UK life companies (Phoenix Life Limited and Phoenix Life Assurance Limited). As part of the bank refinancing a further prepayment of £206 million of existing debt was made, financed by existing internal resources.

We have therefore replaced the Group's bank and senior debt, which previously consisted of two debt silos as well as associated PIK notes, with a senior bond and a new single bank facility. This refinancing is the culmination of a series of actions that the Group has undertaken to reduce its gearing over the past five years, with total shareholder borrowings, including our Tier 1 bonds, reducing from £3.5 billion at the end of 2009 to £1.8 billion today.

The comprehensive debt refinancing strengthens Phoenix's position as the UK's largest specialist closed life fund consolidator and the Group will continue to progress its aim to achieve an investment grade credit rating, with formal engagement with the rating agencies expected to start during the second half of 2014. This ambition is supported by a Pro Forma Basis gearing level of 35% and, in future, we will look to manage our gearing level in order to achieve and maintain an investment grade credit rating.

GROUP CHIEF EXECUTIVE'S REPORT CONTINUED

PHOENIX LIFE REVIEW

FINANCIAL PERFORMANCE

Phoenix Life contributed IFRS operating profit from continuing operations of £256 million in the first half of 2014, compared to £178 million for the same period in 2013. Management actions included within operating profit totalled £114 million in the first half of 2014, whereas management actions totalled £24 million for the same period in 2013.

In relation to management actions that enhance MCEV, of particular note during the first half of 2014 was the completion of a transaction between Phoenix Life Limited and the Group to rebalance their exposure to longevity risk from the PGL Pension Scheme. This involved Phoenix Life Limited derisking certain with-profit funds (via the closure of a legacy longevity indemnity agreement) and entering into a longevity swap insurance (covering approximately £900 million of PGL Pension Scheme liabilities) which was simultaneously reinsured on a 50% quota share basis. The overall impact from the transaction on the Group MCEV was a gain of £91 million.

Since 30 June 2014, Phoenix Life Limited has entered into a reinsurance agreement to transfer approximately £1.7 billion of in-payment liabilities from three with-profit funds to Guardian Assurance Limited ('Guardian'), effective 1 January 2014. It is expected that the reinsurance agreement will be replaced with a formal Part VII transfer of the annuities to Guardian in 2015, affecting around 60,000 policies. This transaction removes a significant element of longer dated risk from three separate with-profit funds in Phoenix Life Limited.

In addition to these important transactions Phoenix Life continued to make strong progress in other areas:

- Successfully streamlined the Group's actuarial modelling systems, using the new model to produce the 2014 half year results following decommissioning of the legacy models after a successful parallel run for the 2013 year end. The new model simplifies processes and enables consistent capital management across the business.
- Continued to make progress in consolidating its investment fund accounting, unit pricing and custody arrangements from multiple providers to Phoenix Life's single outsource partner, HSBC. Our investment fund accounting services have materially completed their migration to HSBC, streamlining our operations and increasing efficiency, and the wider programme is expected to conclude in 2015.

POLICYHOLDER ACTIONS

Our policyholders remain at the heart of Phoenix's business. As mentioned above, the changes to the compulsory annuitisation of pension pots announced in the March 2014 budget were unexpected. These changes introduced a number of new options for our customers both immediately following the announcement and from April 2015. In an effort to ensure as many customers as possible received the benefits of this new flexibility, both our existing pipeline of vesting customers and our recent annuitised customers were offered a widened set of options, including reinstating their policies to take advantage of the more extensive changes planned in 2015. We also continue to offer policyholders the opportunity to take up an enhanced annuity with a third party provider.

The speed of policy payouts has remained a key focus for us with improvements continuing to be made in our communications and processes. During the first half of the year, and despite the disruption of the budget changes, we continue to deliver our Pensions Transfers and Open Market Options payments made through the Origo Faster Transfers system in around 10 days on average. Complaint handling is also a key area and whilst overall volumes of incoming servicing complaints are only 0.2% of the transactions that we carry out for our customers, we are still very focused on ensuring that our responses meet customers' needs and provide resolution to any issue they had. We continue to make improvements in both the volume of cases referred to the Financial Ombudsman Service and the number where they do not agree with our decision-making, with the FOS overturn rate continuing to show a strong performance at only 21% in the first half (FY 2013 – 21%).

In conjunction with our outsource partner, Diligenta, we continued the migration of in-force policies to the modern BaNCS administration platform, with the transfer of a further 65,000 policies following the expiry of our outsourcing contract with Capita Employee Benefits (formerly Capita Hartshead). We have now migrated a total of 3.24 million in-force policies to BaNCS.

REGULATORY CHANGES

The first half of 2014 saw a number of key regulatory changes to the UK life assurance sector. The financial impacts of several of these changes are still uncertain but the Group continues to take actions to prepare for the possible range of outcomes, including possible changes to policyholder decision-making.

The ending of compulsory annuitisation of pension pots, announced at the time of the Budget, is expected to have a significant impact across the UK life assurance industry. Phoenix only provides annuities for vesting policyholders and wrote a total of £284 million of annuities in the first half of 2014. £201 million of these annuities had guaranteed annuity rates ('GARs'), typically in the region of 11% per annum, and the Group continues to expect that the vast majority of the guaranteed business for higher value pension pots will continue to be written, given the attractive nature of the rates. However, we do expect an increase in cash being taken for lower value pension pots. Whilst it is still too early to draw firm conclusions, we have assumed that the future take-up of guaranteed annuities will decline by around 20% and this has had a small negative impact on our MCEV of £17 million.

With regard to non-GAR annuities again it is still too early to ascertain long term behaviour given that the impact of the Budget announcement will take some time to become clear. Volumes of non-GAR annuities written by the Group have fallen by around 50% in the first half of 2014, compared to the same period in 2013, as policyholders have deferred making decisions with regards to their pension pots following the budget. We have assumed for planning purposes that over the longer term take up of non-GAR annuities by policyholders will fall by around two thirds. The MCEV contribution from writing these annuities was £7 million in the first half of 2014 compared to £10 million for the comparable period in 2013.

The government announced a cap on charges for new auto-enrolment pensions of 75bps in March. Although auto-enrolment is not a market that Phoenix is actively engaging in, we have assessed the impact of applying the cap to our historic workplace schemes, should they wish to use them as qualifying schemes, and this has led to a reduction in the Group MCEV of £40 million being reflected in the 30 June MCEV result.

Finally, the FCA has announced a thematic review of the fair treatment of long-standing customers in life insurance as part of their 2014/2015 business plan. The FCA work is still at an early stage but they have confirmed that the scope of the review will cover firms' strategies with regard to their legacy product portfolios, the performance of legacy products, allocation of expenses between closed and open books of business, customer communication and the level of exit charges.

Given our focus on closed books we can demonstrate a clear strategy for legacy products and given that Phoenix does not write new products (other than vesting annuities) we do not believe that any review of cross-subsidisation between open and closed books would be relevant to us. Furthermore, we believe that the ongoing efforts of the Group to improve performance and service to our policyholders are a clear demonstration of good practice within the closed life fund market. We look forward to actively engaging with the FCA in their review in the coming months and will update the market in due course.

GROUP CHIEF EXECUTIVE'S REPORT CONTINUED

IGNIS ASSET MANAGEMENT REVIEW

The divestment of Ignis completed on 1 July. In addition to the cash consideration of £390 million (subject to adjustment), Ignis also generated a further £32 million of cash in the first half of the year.

Ignis' IFRS operating profits declined to £17 million over the period, compared to £19 million during the first half of 2013. This is primarily a result of life company asset run-off, higher staff incentive costs and lower performance fees, partially offset by continued growth in Ignis' third party business.

Our strategic partnership with Standard Life Investments offers both policyholders and shareholders the opportunity to benefit from the strength and depth of Standard Life Investments' expertise in managing life assurance assets. In addition, Phoenix has agreed a Synergy Sharing Agreement, whereby the Group can continue to benefit from asset management synergies that are generated from any future assets that we place with Standard Life Investments.

I would like to take this opportunity to thank all of the Ignis employees for their hard work during their time with the Group and I wish them well with their future careers.

OUTLOOK

The first half of 2014 has delivered many successes for the Group. The balance sheet has been transformed through the sale of Ignis, issuance of a senior bond and the achievement of a single silo debt facility, all of which completed during July. Our structure has been simplified and our reliance upon bank financing has been reduced. The re-establishment of a relationship with debt capital markets is expected to provide a valuable source of alternative funding for future strategic activity. Together, these transactions, alongside the strategic alliance with Standard Life Investments, have created a solid platform for Phoenix to consider potential acquisition opportunities, enabling us to grow the business and strengthen our existing position as the UK's largest specialist consolidator of closed life funds.

The 2014 Budget announcement on annuities and the FCA's confirmation of a thematic review of the fair treatment of long-standing customers in life insurance as part of its 2014/15 business plan highlight the challenges of regulatory change for our industry. I strongly believe that the impact of the changes to annuities will alter the landscape of the UK life assurance industry, thereby providing Phoenix with a number of opportunities as open life companies are forced to re-appraise their business models and strategies for their legacy policies. The actions we have completed during the first half of 2014 have positioned the Group to take advantage of these industry changes. That said, it is accepted that these announcements may result in a period of hiatus in acquisition activity across the sector whilst the new regulations are implemented and we await the outcome and subsequent recommendations of the FCA review.

Irrespective of the wider ongoing industry challenges, our focus will remain on the continued delivery of strong organic performance across all of our key financial metrics and targets. We have consistently met or exceeded all of our public financial targets and this is a track record that we are committed to continuing.

I would like to thank my colleagues for their hard work during this exceptionally busy period for the Group, and look forward to capitalising on our renewed strength, delivering value for all stakeholders during the remainder of the year.

CLIVE BANNISTER
Group Chief Executive
20 AUGUST 2014

BUSINESS REVIEW

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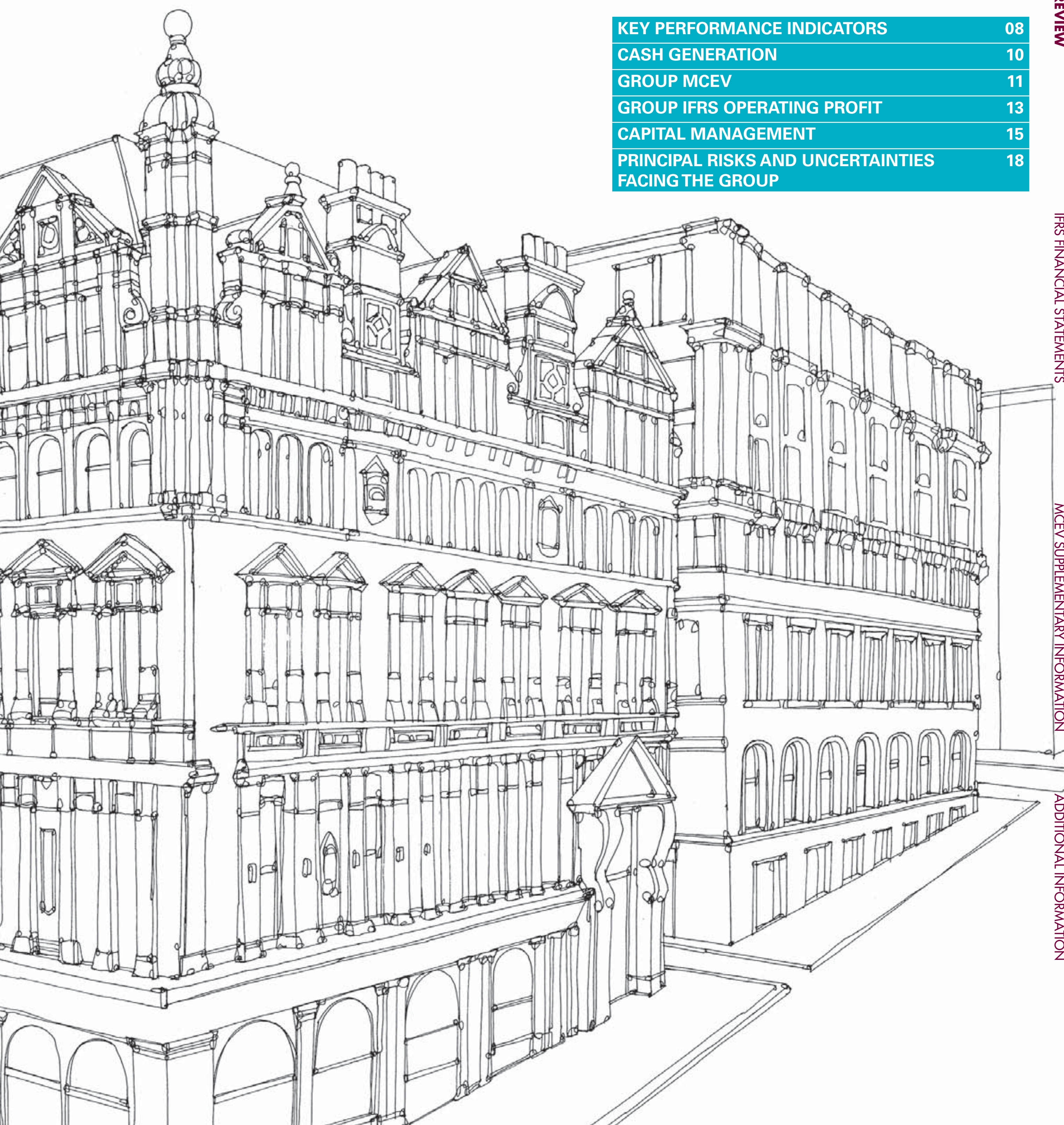

BUSINESS REVIEW

Key performance indicators

OPERATING COMPANIES' CASH GENERATION

£332m
(HY13: £416 MILLION)

With cash generation of £332 million in the period, the Group is on track to meet its full year cash generation target[1] for 2014 of £500 million to £550 million, excluding Ignis divestment proceeds. Management actions have generated cash flows of £149 million in the period.

The cumulative cash flow target[1] for 2014 to 2019 is £2.8 billion, including Ignis divestment proceeds.

The Phoenix Life free surplus decreased to £379 million at 30 June 2014 (YE13: £529 million), reflecting cash distributions to the holding companies of £211million and the impact of strengthening longevity, credit and correlations assumptions, partly offset by capital generation in the period.

GROUP MCEV

ACTUAL:
£2,328m
PRO FORMA BASIS[2]:
£2,602m
(31 DECEMBER 2013: £2,378 MILLION)

Group MCEV decreased by £50 million to £2,328 million at 30 June 2014, reflecting the adverse impacts of recent external regulatory changes, increases in the market value of the Group's Tier 1 and Tier 2 debt and a reduction in future tax benefits following refinancing activities and the divestment of Ignis Asset Management ('Ignis'). This has been partly offset by £153 million of benefits from value enhancing management actions.

MCEV as at 30 June 2014 increases to £2,602 million on a pro forma basis to reflect the divestment of Ignis and the Group's debt refinancing.

The Group's incremental MCEV target[1] is £300 million between 2014 and 2016, of which £153 million has now been delivered.

GEARING RATIO

ACTUAL:
43%
PRO FORMA BASIS[2]:
35%
(31 DECEMBER 2013: 44%)

Gearing reduced to 43% at 30 June 2014, reflecting debt repayments of £85 million made in the period. Gearing reduces to 35% at 30 June 2014 on a pro forma basis reflecting the divestment of Ignis, the related £250 million debt prepayment and the £206 million debt prepayment associated with the Group's bank and senior debt refinancing, thus meeting our original 40% target 18 months ahead of schedule.

GROUP IFRS OPERATING PROFIT[3]

£266m
(HY13: £186 MILLION)

Group IFRS operating profit increased by £80 million to £266 million, principally reflecting the greater benefit derived from actuarial modelling enhancements and balance sheet reviews of £114 million compared to the prior period (HY13: £24 million).

Key performance indicators

IGD SURPLUS (ESTIMATED)

ACTUAL:
£1.3bn

PRO FORMA BASIS[2]:
£1.1bn

(31 DECEMBER 2013: £1.2 BILLION)

The estimated IGD surplus has increased by £0.1 billion to £1.3 billion. The key drivers of the increase in the IGD surplus include capital generation items of £0.2 billion offset by financing and debt repayments of £0.1 billion. Headroom over the Group's capital policy has also increased as a result of these factors to £0.6 billion (31 December 2013: £0.5 billion).

The IGD surplus on a pro forma basis is £0.2 billion lower, driven by the £206 million debt prepayment associated with the refinancing of the Group's bank and senior debt.

PLHL ICA SURPLUS (ESTIMATED)

ACTUAL:
£1.0bn

PRO FORMA BASIS[2]:
£0.7bn

(31 DECEMBER 2013: £1.2 BILLION)

The reduction in the estimated PLHL ICA surplus of £0.2 billion in the period primarily reflects the strengthening of the assumptions related to longevity, credit and correlations.

On a pro forma basis the PLHL ICA surplus decreased by £0.3 billion to £0.7 billion, reflecting the impact arising from the divestment of Ignis and the £206 million prepayment of debt associated with the refinancing of the Group's bank and senior debt.

The Group aims to ensure that PLHL maintains an ICA surplus of at least £150 million.

INTERIM DIVIDEND PER SHARE

26.7p per share

(HY13: 26.7 PENCE PER SHARE)

Interim dividend per share of 26.7p.

The dividend is in line with the 2013 interim and final dividends.

1 This target has been set on the assumption that Solvency II regulations operate as expected.

2 The pro forma basis assumes that the proceeds from the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank refinancing and associated £206 million debt prepayment had taken place on 30 June 2014.

3 Group operating profit is stated before adjusting items and includes discontinued operations.

BUSINESS REVIEW CONTINUED

CASH GENERATION

HOLDING COMPANIES' CASH FLOWS

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 this risk is borne by policyholders.

The following analysis of cash flows reflects the cash paid by the operating companies to the Group's holding companies, as well as the uses of these cash receipts:

Holding companies' cash flows	Half year ended 30 June 2014 Pro forma[1] £m	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
Cash and cash equivalents at start of period	**995**	**995**	1,066
Cash receipts from Phoenix Life	**211**	**211**	411
Cash receipts from Ignis	**32**	**32**	5
Other cash receipts	**89**	**89**	–
Operating companies' cash generation[2]	**332**	**332**	416
Proceeds from divestment of Ignis	**390**	**–**	–
Net proceeds of the equity raise[3]	**–**	**–**	211
Cash receipts	**722**	**332**	627
Uses of cash:			
Operating expenses	**(13)**	**(13)**	(21)
Pension scheme contributions	**(13)**	**(13)**	(16)
Debt interest	**(59)**	**(59)**	(88)
Total recurring cash outflows	**(85)**	**(85)**	(125)
Non-recurring cash outflows	**(41)**	**(16)**	(7)
Uses of cash before debt repayment and shareholder dividend	**(126)**	**(101)**	(132)
Debt repayments	**(541)**	**(85)**	(535)
Shareholder dividend	**(60)**	**(60)**	(60)
Cash and cash equivalents at end of period[4]	**990**	**1,081**	966

1 The pro forma basis assumes that the proceeds from the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank refinancing and associated £206 million debt prepayment had taken place on 30 June 2014. The £300 million proceeds from the senior unsecured bond issue were used to reduce the debt by £296 million and pay costs of £4 million resulting in a cash neutral position in the pro forma analysis of cash flows.

2 Includes amounts received by the holding companies in respect of tax losses surrendered to the operating companies of £4 million (HY13: £15 million).

3 Proceeds of the equity raise in 2013 of £232 million net of associated fees and commission, and after the deduction of £21 million of fees associated with the re-terming of the Impala loan facility.

4 Closing balance at 30 June 2014 includes required prudential cash buffer of £150 million (30 June 2013: £150 million).

Cash receipts

Cash remitted by the operating companies was £332 million (HY13: £416 million), driven largely by the opening free surplus within the life companies. Other cash receipts comprised £68 million from the buy-out of the Pension Indemnity from the with-profit funds and £21 million from the sale of BA(GI) Limited.

On 1 July 2014 the Group completed the divestment of Ignis to Standard Life Investments (Holdings) Limited ('Standard Life Investments') and received gross proceeds of £390 million.

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:

Phoenix Life free surplus movement	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
Opening free surplus[5]	**529**	514
Cash distributed to holding companies	**(211)**	(411)
IFRS operating profit	**256**	178
IFRS economic variances and non-recurring items	**3**	(56)
IFRS taxation	**(52)**	(18)
Movements in capital requirements and policy	**3**	150
Valuation differences and other[6]	**(149)**	49
Closing free surplus	**379**	406

5 The life companies' free surplus is the excess of the net worth over the required capital reflected in the MCEV and represents capital in excess of what is required under the life companies' capital policies.

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

The Phoenix Life free surplus of £379 million has decreased by £150 million in the period reflecting cash distributed to the holding companies of £211 million and the impact of the strengthening of assumptions in respect of longevity, credit and correlations, partly offset by capital generation in the period and the positive impact of the release of capital requirements from the run-off of the life funds.

USES OF CASH

Recurring cash outflows

Operating expenses were lower than 2013 half year results as a result of lower corporate office costs, primarily staff costs. Pension scheme contributions decreased in line with the latest triennial funding valuation. This decrease was partly offset by a one-off £5 million payment to the PGL Pension Scheme.

Debt interest decreased to £59 million (HY13: £88 million), mainly reflecting lower costs associated with the Group's interest rate swap arrangements which were closed out during 2013 and lower debt principal balances following the debt repayments over the period.

Non-recurring cash outflows

Non-recurring cash outflows of £16 million (HY13: £7 million) reflect Group restructuring and corporate related projects. Also included are payments to the Employee Benefit Trust of £7 million.

On a pro forma basis, non-recurring cash outflows increase by £25 million to £41 million as a result of bank and professional fees associated with the refinancing of the Group's bank debt and professional fees and other costs associated with the divestment of Ignis.

Debt repayments and shareholder dividend

Debt repayments in the first half of 2014 include a £30 million targeted prepayment and a scheduled repayment of £30 million in respect of the Group's Impala loan facility, together with a scheduled repayment of £25 million[7] in respect of the Pearl loan facility.

On a pro forma basis debt repayments increase by £456 million to £541 million, reflecting the £250 million debt prepayment following the divestment of Ignis and the £206 million debt prepayment associated with the £900 million debt facility refinancing.

Shareholder dividends paid in the first half of 2014 were £60 million.

7 This includes £2 million paid to Phoenix Life Assurance Limited, a subsidiary undertaking. Phoenix Life Assurance Limited was a lender under the Pearl facility.

GROUP MCEV

GROUP MCEV EARNINGS[8]

The Group generated MCEV operating earnings after tax of £162 million for the period, an increase of £17 million on the comparative period. Following the completion of the divestment of Ignis on 1 July 2014, its results have been classified as arising from discontinued operations in the MCEV financial statements for the period.

Group MCEV earnings	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
Life MCEV operating earnings[9]	181	165
Management services operating profit	16	18
Ignis Asset Management operating profit	17	19
Group costs	(10)	(13)
Group MCEV operating earnings before tax	**204**	189
Tax charge on operating earnings	(42)	(44)
Group MCEV operating earnings after tax	**162**	145
Economic variances on life business	(28)	(30)
Economic variances on non-life business	(37)	(43)
Other non-operating variances on life business	(132)	(3)
Non-recurring items on non-life business	59	(38)
Finance costs attributable to owners	(62)	(84)
Tax on non-operating earnings	20	9
Group MCEV loss after tax	**(18)**	(44)
Analysed between:		
Group MCEV loss after tax from continuing operations	–	(23)
Group MCEV loss after tax from discontinued operations	(18)	(21)
Group MCEV loss after tax	**(18)**	(44)

8 The Phoenix Group Market Consistent Embedded Value methodology (referred to herein and in the supplementary information as MCEV) is set out in note 1 to the supplementary information. The asset management and management services businesses are included in the Group MCEV at the value of their IFRS net assets. The Group MCEV does not include the future earnings from their businesses.

9 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 £181 million (HY13: £165 million) are therefore calculated as £142 million operating earnings (HY13: £127 million) grossed up for tax at 21.5% (HY13: 23.25%)

BUSINESS REVIEW CONTINUED

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	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
New business value	7	10
Expected existing business contribution	72	62
Non-economic experience variances and assumption changes:		
Experience variances	36	26
Assumption changes	(17)	20
Other operating variances	44	9
Total non-economic experience variances and assumption changes	63	55
Life MCEV operating earnings after tax	142	127

New business value generated from vesting annuities during the period was £7 million after tax. New business value represents the value of vesting pension policies not reflected in the opening MCEV. These arise from pension policies which have no attaching annuity guarantees. The decrease compared to the prior period reflects lower premium volumes on vestings without guaranteed annuity rates.

The Group uses long-term investment returns in calculating the expected existing business contribution. The expected contribution of £72 million after tax is £10 million higher than in 2013, primarily due to an increase in the long-term risk-free rate used to calculate operating earnings.

The life division's non-economic variances and assumption changes increased MCEV by £63 million after tax in the period (HY13: £55 million) and primarily relate to one-off positive impacts of £72 million from modelling enhancements reflecting the implementation of the Group's new actuarial system and refinements to the modelling of credit default risk, together with the impact of balance sheet reviews conducted in the period. This has partly been offset by a negative impact of £17 million relating to the impact of the assumed reduction in take-up of guaranteed annuities following the pension reforms announced in the March budget. Net other items have increased MCEV by £8 million.

MANAGEMENT SERVICES AND IGNIS OPERATING PROFIT

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

GROUP COSTS

The Group costs of £10 million (HY13: £13 million) include costs relating to Group functions and project spend of £10 million before tax (HY13: £9 million). The balance of the charge in the prior period relates to charges on the Pearl Group Staff Pension Scheme, which were minimal in the current period.

ECONOMIC VARIANCES

Negative economic variances on life business of £28 million before tax primarily relate to the negative impacts of the difference between actual short-term returns and the long-term investment return assumptions used to determine operating earnings and increases in the market value of the Tier 2 debt, partly offset by positive property and equity returns in the period and the impact of falling yields.

Negative economic variances on non-life business of £37 million before tax largely relate to an increase in the market value of the Tier 1 Notes, which decreased MCEV earnings by £40 million (HY13: £58 million) partly offset by the reduction in the fair value of the Phoenix Group Holdings warrants of £4 million.

OTHER NON-OPERATING VARIANCES ON LIFE BUSINESS

Other non-operating variances on life business decreased Group MCEV by £104 million on a net of tax basis. The decrease primarily relates to a loss of £40 million in relation to an anticipated reduction in future profits arising from external regulatory changes to the cap on workplace pension charges, £25 million relating to anticipated VAT costs on future management investment expenses following the divestment of Ignis, a £14 million loss arising from the reinsurance agreement to transfer annuity in-payment liabilities held within the with-profit funds to Guardian Assurance Limited and a £36 million reduction in the value of in-force business to reflect the impact of debt repayments, refinancing and other corporate activity on expected tax attributes available to the Group to relieve tax on emerging surpluses. This has partly been offset by a gain of £23 million arising from the restructure of Phoenix Life Limited's exposure to longevity risk from the PGL Pension Scheme. Net other items decreased MCEV by £12 million.

NON-RECURRING ITEMS ON NON-LIFE BUSINESS

Overall non-recurring items on non-life business increased embedded value by £59 million before tax. Non-recurring items include £68 million income received by Pearl Group Holdings (No. 1) Limited ('PGH1') from the with-profit funds in relation to the close-out of the PGL Pension Scheme longevity indemnity agreement. Partly offsetting this income are £16 million of Group project and transformation costs, with net other one-off items having a positive impact of £7 million. Non-recurring items in the comparative period included arrangement and structuring fees of £21 million associated with the re-terming of the Impala loan facility and regulatory change, systems transformation costs and other one-off items of £17 million.

FINANCE COSTS ATTRIBUTABLE TO OWNERS

Finance costs attributable to owners comprise:

	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
Debt finance costs[1]	**36**	58
Other (including Tier 1 coupon)	**26**	26
	62	84

1 Finance costs in respect of bank debt (and associated swap interest).

Debt finance costs have decreased by £22 million, mainly reflecting the closure of the Group's interest rate swap arrangements in the second half of 2013 which were responsible for a net finance charge in the comparative period.

GROUP MCEV

The Group MCEV decreased by £50 million over the period to £2,328 million at 30 June 2014 as shown below:

Movement in Group MCEV	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
Group MCEV at 1 January	**2,378**	2,122
Group MCEV loss after tax	**(18)**	(44)
Other comprehensive income	**32**	(2)
Capital and dividend flows	**(64)**	171
Group MCEV at 30 June	**2,328**	2,247

An actuarial gain of £42 million (net of tax) (HY13: £10 million) was recognised in other comprehensive income in respect of the Pearl Group Staff Pension Scheme, partly offset by pension contributions (net of tax) of £10 million (HY13: £12 million) in respect of the PGL Pension Scheme. Capital and dividend flows in the period primarily comprise external dividend payments of £60 million, and movements in the own shares held balance. The comparative period comprised ordinary share capital issued of £233 million (net of associated fees and commissions) less external dividend payments of £60 million and movements in own shares held.

Assuming that the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank refinancing and associated £206 million debt prepayment had taken place on 30 June 2014, Group MCEV would increase to £2,602 million.

GROUP IFRS OPERATING PROFIT

The Group has generated an IFRS operating profit of £266 million for the period (HY13: £186 million).

Following the completion of the divestment of Ignis on 1 July 2014, its results have been classified as arising from discontinued operations in the IFRS financial statements for the period.

Group IFRS operating profit	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
IFRS operating profit		
Phoenix Life	**256**	178
Ignis Asset Management – discontinued operations	**17**	19
Group costs	**(7)**	(11)
Operating profit before adjusting items	**266**	186
Investment return variances and economic assumption changes on long-term business	**59**	(13)
Variance on owners' funds	**–**	(20)
Amortisation of acquired in-force business and other intangibles	**(55)**	(60)
Non-recurring items	**9**	(40)
Profit before finance costs attributable to owners	**279**	53
Finance costs attributable to owners	**(48)**	(65)
Profit/(loss) before finance costs attributable to owners:		
From continuing operations	**258**	16
From discontinued operations	**(27)**	(28)
	231	(12)
Tax charge attributable to owners from continuing operations	**(49)**	(2)
Tax credit attributable to owners from discontinued operations	**9**	6
Profit/(loss) for the period attributable to owners	**191**	(8)

BUSINESS REVIEW CONTINUED

PHOENIX LIFE

Operating profit for Phoenix Life 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. The principal assumptions underlying the calculation of the longer-term investment return are set out in note 5 to the IFRS condensed consolidated interim financial statements.

Operating profit includes the effect of variances in experience for non-economic items, such as mortality and persistency, 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 accounted for outside of operating profit.

Phoenix Life operating profit	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
With-profit	**36**	36
With-profit where internal capital support provided	**(6)**	12
Non-profit and unit-linked	**205**	105
Long-term return on owners' funds	**5**	7
Management services	**16**	18
Phoenix Life operating profit before tax	**256**	178

The with-profit operating profit of £36 million represents the shareholders' one-ninth share of the policyholder bonuses and is in line with the comparative period (HY13: £36 million).

The operating profit for with-profit funds where internal capital support has been provided has decreased by £18 million, resulting in an operating loss for the period of £6 million (HY13: profit £12 million). The decrease compared to the prior period reflects the one-off adverse impact of modelling enhancements in the period of £24 million partly offset by the impact of changes to persistency assumptions in light of the pensions reforms announced in the March budget which have reduced the expected costs of policyholder guarantees.

The operating profit for non-profit and unit-linked funds was £205 million (HY13: £105 million). The increase compared to the prior period reflects higher one-off positive impacts of £138 million (HY13: £24 million) from modelling enhancements reflecting the implementation of the Group's new actuarial modelling system and refinements to the modelling of credit default risk, together with the impact of balance sheet reviews conducted in the period.

Of the £205 million of non-profit and unit-linked IFRS operating profits, £14 million was generated on annuity new business (HY13: £20 million). Of this, £4 million related to policies without guaranteed annuity rates.

The long-term return on owners' funds of £5 million reflects the asset mix of owners' funds, primarily cash-based assets and fixed interest securities. The investment policy for managing these funds remains prudent.

The operating profit for the management services companies comprises income from the life companies in accordance with the respective management services agreements less fees related to the outsourcing of services and other operating costs. The current period operating profit of £16 million has decreased compared to the prior period (HY13: £18 million), reflecting the impacts of life company run-off and the transfer of annuity policies to Guardian Assurance Limited in 2013, partly offset by lower staff costs.

IGNIS ASSET MANAGEMENT

The operating profit of the asset management business of £17 million was lower than the comparative period (HY13: £19 million). Operating profit has been impacted by lower life company revenue from asset run-off, higher staff incentive costs and lower performance fees, partly offset by continued growth in third party business. Ignis has been classified as a discontinued operation in the period.

GROUP COSTS

Group costs were £7 million in the period (HY13: £11 million). The decrease in Group costs compared to the prior period relates to lower pension scheme costs, reflecting a lower opening IAS 19 pension scheme liability for the Pearl Staff Pension Scheme and a higher opening IAS 19 pension scheme asset for the PGL Pension Scheme. Group costs in the period have also benefited from reduced Group recharges reflecting lower staff costs.

ADJUSTING ITEMS

Overall, the life companies had positive investment return variances and economic assumption changes of £59 million in the period, which includes the minority share of the result of the consolidated UKCPT property investment structure of £37 million. The remaining positive variance reflects the impact of positive property returns and changes in inflation assumptions, partly offset by losses on equity hedging positions held by certain life funds on an economic basis.

The negative variance on owners' funds of £20 million in the prior period primarily related to fair value losses on swap and equity hedging positions held within the shareholder funds. Interest rate swaps held by the holding companies and the life company shareholder funds were closed out in the second half of 2013 and the remaining instruments held have given rise to minor offsetting movements in the period.

Acquired in-force business and other intangibles of £2.7 billion were recognised on the acquisition of the operating companies in 2009. The acquired in-force business is being amortised in line with the run-off of the life companies. Amortisation of acquired in-force business during the period totalled £48 million (HY13: £51 million). Amortisation of other intangible assets totalled £7 million in the period (HY13: £9 million).

Non-recurring items includes income received by PGH1 of £68 million in relation to the close-out of the PGL Pension Scheme longevity indemnity agreement with the with-profit funds, partly offset by costs of £14 million arising from external regulatory changes with respect to the cap on workplace pension charges, £27 million of capitalised costs in respect of VAT on future investment management expenses arising as a result of the divestment of Ignis, corporate project costs of £11 million (HY13: £3 million) and £7 million of costs associated with net other items. In 2013 non-recurring items included arrangement and structuring fees of £21 million associated with the re-terming of the Impala loan facility.

FINANCE COSTS ATTRIBUTABLE TO OWNERS

Finance costs attributable to owners comprise:

	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m
Debt finance costs[1]	**36**	58
Other finance costs	**12**	7
Finance costs attributable to owners	**48**	65

1 Finance costs in respect of bank debt (and associated swap interest).

Debt finance costs have decreased by £17 million, mainly reflecting the closure of the Group's interest rate swap arrangements in the second half of 2013 which were responsible for a net finance charge in the comparative period.

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.

With effect from the acquisition of the operating subsidiaries 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 0% tax rate on its income. Consequently tax charged in these accounts primarily represents UK tax on profits earned in the UK, where the principal operating companies, excluding Opal Re, have their centre of operations.

The Group tax charge for the period attributable to owners is £40 million (£49 million from continuing operations and £9 million tax credit from discontinued operations), based on a profit (after policyholder tax) of £231 million (£258 million from continuing operations and £27 loss from discontinued operations). The actual charge is lower than the expected charge (based on the UK corporation tax rate of 21.5%) of £50 million, primarily due to certain profit being either non-taxable or taxable at rates other than the standard rate (see note 6 to the IFRS condensed consolidated interim financial statements for analysis with respect to continuing operations).

CAPITAL MANAGEMENT

The Group has continued to focus on capital and gearing during the period. Our capital position remains robust, the IGD surplus is £1.3 billion and the PLHL ICA surplus is £1.0 billion at 30 June 2014. The gearing ratio as at 30 June 2014 is 43%.

REGULATORY CAPITAL REQUIREMENTS

IGD surplus (estimated)

Each UK life company must retain sufficient capital at all times to meet the regulatory capital requirements mandated by the PRA. These measures are aggregated under the European Union Insurance Groups' Directive ('IGD') to calculate regulatory capital adequacy at a group level.

The Group's IGD assessment is made at the level of the highest EEA level insurance group holding company, which is Phoenix Life Holdings Limited ('PLHL'), a subsidiary of Phoenix Group Holdings.

The estimated IGD surplus at 30 June 2014 is £1.3 billion. The components of the estimated IGD calculation are shown below:

	30 June 2014 Pro forma[2] £bn	**30 June 2014 £bn**	31 December 2013 £bn
Group capital resources ('GCR')	**5.1**	**5.3**	5.4
Group capital resource requirement ('GCRR')	**(4.0)**	**(4.0)**	(4.2)
IGD surplus (estimated)	**1.1**	**1.3**	1.2

2 The pro forma basis assumes that the proceeds from the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank refinancing and associated £206 million debt prepayment had taken place on 30 June 2014.

BUSINESS REVIEW CONTINUED

The key drivers of the increase in the IGD surplus include capital generation items of £0.2 billion including capital benefits in relation to the close-out of the PGL Pension Scheme longevity indemnity agreement, offset by debt financing and repayments of £0.1 billion.

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

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

– 145% of the GCRR less the WPICC.

The Group's headroom at 30 June 2014 was £0.6 billion (31 December 2013: £0.5 billion).

The Group's IGD surplus on a pro forma basis is £0.2 billion lower and this reduction is primarily driven by the £206 million debt prepayment following the £900 million debt facility refinancing. The divestment of Ignis and the subsequent £250 million prepayment is broadly neutral for IGD.

PLHL ICA surplus (estimated)

In accordance with PRA requirements the Group undertakes an Individual Capital Assessment ('ICA') at the level of the highest EEA insurance group holding company, which is PLHL. This involves 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 PRA, the Group aims to ensure that PLHL maintains an ICA surplus of at least £150 million. PLHL's ICA position at 30 June 2014 is set out below:

	30 June 2014 Pro forma[1] £bn	30 June 2014 £bn	31 December 2013 £bn
Capital resources[2]	1.0	1.4	1.5
Capital resource requirements[3]	(0.3)	(0.4)	(0.3)
PLHL ICA surplus (estimated)	0.7	1.0	1.2

1 The pro forma basis assumes that the proceeds from the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank refinancing and associated £206 million debt prepayment had taken place on 30 June 2014.

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.

Headroom over the Group's £150 million capital policy was £0.9 billion as at 30 June 2014 (31 December 2013: £1.1 billion).

The reduction in the PLHL ICA surplus and headroom of £0.2 billion primarily reflects the strengthening of the assumptions related to longevity, credit and correlations. On a pro forma basis the PLHL ICA surplus and headroom both decreased by £0.3 billion, a combination of the impact arising from the divestment of Ignis and the £206 million prepayment of debt following the £900 million debt facility refinancing.

Sensitivity 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 30 June 2014 £bn	Estimated PLHL ICA surplus 30 June 2014 £bn
Sensitivity analysis		
Base: 30 June 2014	1.3	1.0
Following a 20% fall in equity markets	1.3	0.9
Following a 15% fall in property values	1.3	0.9
Following a 75 bps increase in nominal yields[4]	1.3	1.1
Following a 75 bps decrease in nominal yields[5]	1.4	0.9
Following credit spread widening[6]	1.4	0.8

4 75 bps parallel increase in nominal yields and a 75 bps increase in inflation.

5 75 bps parallel decrease in nominal yields and a 75 bps decrease in inflation.

6 11-15 year term: AAA 44bps, AA 93bps, A 111bps, BBB 187bps.

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 sensitivities reflect the impact of market movements not only on the Group's life companies, but also on its staff pension schemes.

SHAREHOLDER DEBT

In managing capital the Group seeks to optimise the level of debt in its statement of consolidated financial position. 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 monitors the level of debt in its statement of consolidated financial position by reference to the gearing ratio calculated as gross shareholder debt[7] as a percentage of gross MCEV[8]. The gearing ratio as at 30 June 2014 under the Group's methodology is 43% (31 December 2013: 44%). Assuming that the proceeds from the divestment of Ignis and subsequent £250 million debt prepayment, the £300 million 5.75% 7 year senior unsecured bond issue and the £900 million unsecured bank refinancing and associated £206 million debt prepayment had taken place on 30 June 2014, the Group's gearing level reduces to 35%, thus meeting our original 40% target 18 months ahead of schedule.

Gross shareholder debt and shareholder debt (including hybrid debt) included in MCEV as at 30 June 2014 are shown below:

	30 June 2014 Pro forma[1] £m	30 June 2014 £m	31 December 2013 £m
Shareholder debt (including hybrid debt)			
Bank debt			
Pearl facility	–	**304**	327
Pearl loan notes	–	**77**	76
Impala facility	–	**1,122**	1,182
Royal London PIK notes and facility	–	**124**	121
PGH Capital facility	**886**	–	–
PGH Capital senior bond	**296**	–	–
PLL subordinated debt	**155**	**155**	151
Tier 1 bonds at 50% of IFRS carrying value (see note 10 to the IFRS condensed consolidated interim financial statements)	**199**	**199**	204
Gross shareholder debt	**1,536**	**1,981**	2,061
Adjustments to include the following items at market value:			
PLL subordinated debt	**59**	**59**	54
PGH Capital senior bond	**4**	–	–
Tier 1 bonds (100% of market value)	**190**	**190**	146
Adjustment to include the following item at face value:			
PGH Capital facility	**14**	–	–
Shareholder debt (including hybrid debt) included in MCEV	**1,803**	**2,230**	2,261

Gross shareholder debt has fallen by £80 million in the period, reflecting a £30 million targeted repayment and a £30 million scheduled repayment made during the period in respect of the Impala facility and a scheduled repayment of £25 million in respect of the Pearl loan facilitiy[9].

The Group's shareholder debt decreases on a pro forma basis by £445 million to £1,536 million. This reflects the £250 million prepayment following the divestment of Ignis and the £206 million prepayment relating to the £900 million debt facility refinancing. The PGH Capital facility and PGH Capital Senior bond are stated at their IFRS value and are therefore recognised net of fees and commissions associated with the issuance of the instruments. On an MCEV basis, the PGH Capital facility will be recognised at its face value and the PGH Capital senior bond at its listed market value.

Further detail in respect of shareholder debt is included in note 13 to the IFRS condensed consolidated interim financial statements.

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

8 Gross MCEV is defined as the sum of Group MCEV and the value of the shareholder and hybrid debt as included in the MCEV.

9 This includes £2 million paid to Phoenix Life Assurance Limited ('PLAL') a subsidiary undertaking. PLAL was a lender under the Pearl facility.

BUSINESS REVIEW
CONTINUED

The Group operates a Risk Management Framework ('RMF') which seeks to establish a coherent and proactive set of arrangements and processes to support the effective management of risk throughout the Group. 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 found 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 evolving regulatory requirements including Solvency II.

This has included, for example, an increasing focus on independent reviews by the Group Risk function of the risk profile of the Group.

PRINCIPAL RISKS AND UNCERTAINTIES FACING THE GROUP

Risk	Impact	Mitigation
The Group is exposed to market risk and in times of severe market turbulence could suffer a loss of value.	The emerging cash flows of the Group may be impacted during periods of severe 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 substantial cash buffers in its holding companies to reduce reliance on emerging cash flows.
The potential limitation on distributions from the Group's PRA / FCA regulated companies may impair the ability of the Group to meet its cash flow obligations.	The Group has cash flow obligations and targets. In the event that transfers from the Group's insurance 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 regulatory directives and other legislative changes such as 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. Phoenix Life is also exposed to the risk of its trading counterparties failing to meet all or part of their obligations, such as outsourcers failing to deliver against their commitments or reinsurers failing to meet obligations assumed under Reinsurance arrangements. An increase in credit spreads on debt 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. Outsourcer arrangements are closely monitored.
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.
Uncertainty in policyholder behaviour in light of the current significant level of change in the regulatory landscape.	A significant degree of uncertainty for policyholders has been created by announcements in the first half of 2014 relating to workplace pensions, annuities and products sold to long standing customers. Helping customers to make informed decisions that are appropriate for their personal circumstances is a priority for the Group.	The Group has initiated projects to manage both the operational and strategic implications of these key regulatory changes. It is actively involved in related industry working groups ensuring we gain early insight into emerging thinking, but also providing an opportunity to influence industry direction.

IFRS FINANCIAL STATEMENTS

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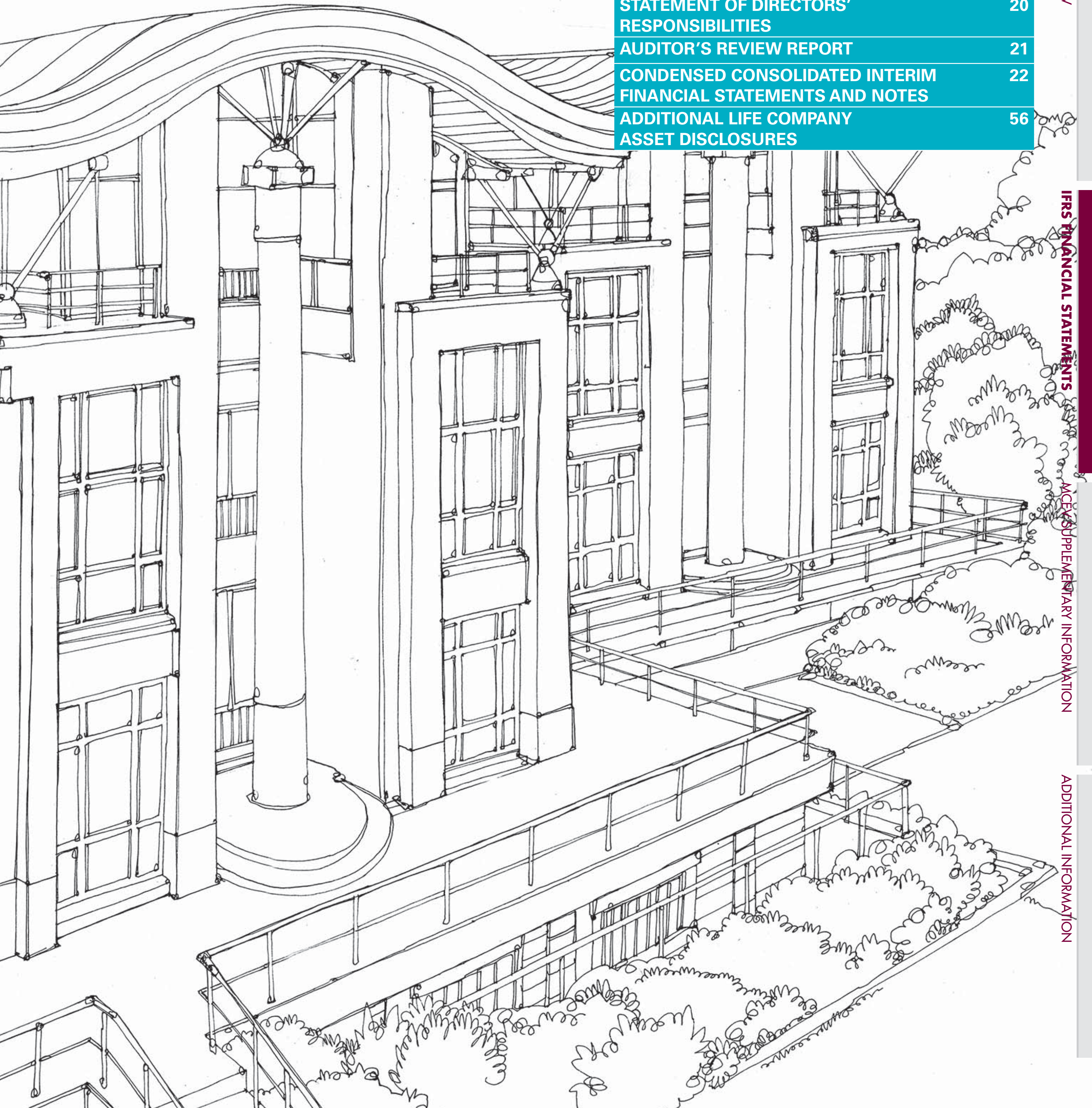


STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

- the condensed consolidated interim financial statements for the half year ended 30 June 2014, which have been prepared in accordance with IAS 34 Interim Financial Reporting, gives a fair view of the assets, liabilities, financial position and results of Phoenix Group Holdings and its consolidated subsidiaries taken as whole;
- the Interim Report includes a fair view of the state of affairs of Phoenix Group Holdings and its consolidated subsidiaries as at 30 June 2014 and for the financial half year to which the Interim Report relates. This includes a description of the important events that occurred during the first half of the year and refers to the principal risks and uncertainties facing Phoenix Group Holdings and its consolidated subsidiaries for the remaining six months of the year; and
- the Interim Report includes a fair view of the information required on material transactions with related parties and any material changes in the related party transactions described in the last annual report.

CLIVE BANNISTER
Group Chief Executive

JAMES McCONVILLE
Group Finance Director

St Helier, Jersey
20 AUGUST 2014

AUDITOR'S REVIEW REPORT

To: The Board of Directors of Phoenix Group Holdings

INTRODUCTION

We have been engaged by the Company to review the condensed set of financial statements in the Interim Report for the six months ended 30 June 2014 which comprises the condensed consolidated income statement, the condensed statement of consolidated comprehensive income, the pro forma reconciliation of Group operating profit to result attributable to owners, the condensed statement of consolidated financial position, the condensed statement of consolidated cash flows, the condensed statement of consolidated changes in equity and the related notes on pages 31 to 55. We have read the other information contained in the Interim Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

DIRECTORS' RESPONSIBILITIES

The Interim Report is the responsibility of, and has been approved by, the Directors.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards ('IFRS'). The condensed set of financial statements included in this Interim Report has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting'.

OUR RESPONSIBILITY

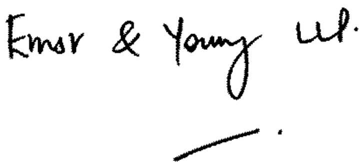
Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the Interim Report based on our review.

SCOPE

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim Report for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with International Accounting Standard 34.



ERNST & YOUNG LLP
London
20 AUGUST 2014

CONDENSED CONSOLIDATED INCOME STATEMENT

For the half year ended 30 June 2014

	Notes	**Half year ended 30 Jun 2014 £m**	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Continuing operations				
Gross premiums written		**513**	672	1,333
Less: premiums ceded to reinsurers		**(31)**	(37)	11
Net premiums written		**482**	635	1,344
Fees		**59**	67	132
Net investment income		**2,043**	942	2,747
Total revenue, net of reinsurance payable		**2,584**	1,644	4,223
Gain on transfer of business	3	**4**	–	42
Other operating income		**5**	4	7
Net income		**2,593**	1,648	4,272
Policyholder claims		**(1,888)**	(2,443)	(4,830)
Less: reinsurance recoveries		**109**	274	464
Change in insurance contract liabilities		**56**	2,526	3,411
Change in reinsurers' share of insurance contract liabilities		**12**	(832)	(710)
Transfer to unallocated surplus		**(19)**	(38)	(77)
Net policyholder claims and benefits incurred		**(1,730)**	(513)	(1,742)
Change in investment contract liabilities		**(187)**	(573)	(1,156)
Acquisition costs		**(5)**	(5)	(10)
Change in present value of future profits		**(8)**	6	9
Amortisation of acquired in-force business		**(53)**	(58)	(111)
Amortisation of customer relationships		**(7)**	(7)	(16)
Administrative expenses		**(202)**	(211)	(444)
Net income attributable to unitholders		**(29)**	(171)	(331)
Total operating expenses		**(2,221)**	(1,532)	(3,801)
Profit before finance costs and tax		**372**	116	471
Finance costs		**(82)**	(129)	(230)
Profit/(loss) for the period before tax		**290**	(13)	241
Tax attributable to policyholders' returns		**(32)**	29	27
Profit before the tax attributable to owners		**258**	16	268
Tax (charge)/credit	6.1	**(81)**	27	1
Add: tax attributable to policyholders' returns		**32**	(29)	(27)
Tax charge attributable to owners		**(49)**	(2)	(26)
Profit from continuing operations for the period attributable to owners		**209**	14	242
Discontinued operations				
Loss from discontinued operations, net of tax	3.1	**(18)**	(22)	(35)
Profit/(loss) for the period attributable to owners		**191**	(8)	207

CONDENSED CONSOLIDATED INCOME STATEMENT CONTINUED

	Notes	**Half year ended 30 Jun 2014 £m**	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Attributable to				
Owners of the parent		**144**	(27)	145
Non-controlling interests		**47**	19	62
		191	(8)	207
Earnings/(loss) per share				
Basic earnings/(loss) per share	7.1	**64.1p**	(13.1)p	68.2p
Diluted earnings/(loss) per share	7.2	**64.1p**	(13.1)p	68.1p
Earnings/(loss) per share from continuing operations				
Basic earnings/(loss) per share from continuing operations	7.1	**72.3p**	(3.0)p	85.3p
Diluted earnings/(loss) per share from continuing operations	7.2	**72.3p**	(3.0)p	85.2p

CONDENSED STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME

For the half year ended 30 June 2014

	Notes	**Half year ended 30 Jun 2014 £m**	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Profit for the period from continuing operations		**209**	14	242
Loss from discontinued operations		**(18)**	(22)	(35)
		191	(8)	207
Other comprehensive income/(expense):				
Items that are or may be reclassified to profit or loss:				
Foreign exchange rate movements		**(8)**	13	–
Reclassification adjustments relating to foreign collective investment schemes disposed of in the period		**–**	–	8
Items that will not be reclassified to profit or loss:				
Remeasurements of net defined benefit asset/liability		**71**	(9)	–
Tax relating to other comprehensive income items	6.2	**8**	–	(12)
Total comprehensive income/(expense) for the period		**262**	(4)	203
Attributable to:				
Owners of the parent		**215**	(23)	141
Non-controlling interests	10	**47**	19	62
		262	(4)	203

PRO FORMA RECONCILIATION OF GROUP OPERATING PROFIT TO RESULT ATTRIBUTABLE TO OWNERS

For the half year ended 30 June 2014

	Notes	**Half year ended 30 Jun 2014 £m**	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Operating profit				
Phoenix Life		**256**	178	414
Ignis Asset Management – discontinued operation		**17**	19	49
		273	197	463
Group costs		**(7)**	(11)	(24)
Total operating profit before adjusting items		**266**	186	439
Investment return variances and economic assumption changes on long-term business	5.3	**59**	(13)	64
Variance on owners' funds	5.2	**–**	(20)	(31)
Amortisation on acquired in-force business		**(48)**	(51)	(99)
Amortisation of customer relationships		**(7)**	(9)	(19)
Non-recurring items	4.2	**9**	(40)	(11)
Profit before finance costs attributable to owners		**279**	53	343
Finance costs attributable to owners		**(48)**	(65)	(126)
Profit/(loss) before the tax attributable to owners:				
From continuing operations		**258**	16	268
From discontinued operations	3.1	**(27)**	(28)	(51)
		231	(12)	217
Tax charge attributable to owners from continuing operations	6.1	**(49)**	(2)	(26)
Tax credit attributable to owners from discontinued operations	3.1	**9**	6	16
Profit/(loss) for the period attributable to owners		**191**	(8)	207

CONDENSED STATEMENT OF CONSOLIDATED FINANCIAL POSITION

As at 30 June 2014

	Notes	**30 Jun 2014 £m**	30 Jun 2013 Restated £m	31 Dec 2013 Restated £m
EQUITY AND LIABILITIES				
Equity attributable to owners of the parent				
Share capital	9	**–**	–	–
Share premium		**1,038**	1,156	1,097
Shares held by employee benefit trust and Group entities		**(14)**	(14)	(13)
Foreign currency translation reserve		**85**	98	93
Retained earnings		**951**	566	732
Total equity attributable to owners of the parent		**2,060**	1,806	1,909
Non-controlling interests	10	**825**	711	778
Total equity		**2,885**	2,517	2,687
Liabilities				
Pension scheme liability	11	**98**	192	137
Insurance contract liabilities				
Liabilities under insurance contracts	12	**42,657**	43,587	42,729
Unallocated surplus		**989**	931	970
		43,646	44,518	43,699
Financial liabilities				
Investment contracts		**8,508**	8,327	8,578
Borrowings	13	**2,285**	2,527	2,359
Deposits received from reinsurers		**384**	412	385
Derivatives		**1,616**	2,783	2,161
Net asset value attributable to unitholders		**5,431**	5,767	5,744
Obligations for repayment of collateral received		**5,324**	9,344	7,284
	14.1	**23,548**	29,160	26,511
Provisions		**26**	58	53
Deferred tax		**335**	364	373
Reinsurance payables		**12**	12	12
Payables related to direct insurance contracts		**402**	414	395
Current tax		**149**	73	107
Accruals and deferred income		**92**	129	139
Other payables		**1,514**	2,468	307
Liabilities classified as held for sale	3.2	**111**	5,121	49
Total liabilities		**69,933**	82,509	71,782
Total equity and liabilities		**72,818**	85,026	74,469

CONDENSED STATEMENT OF CONSOLIDATED FINANCIAL POSITION CONTINUED

As at 30 June 2014

	Notes	**30 Jun 2014 £m**	30 Jun 2013 Restated £m	31 Dec 2013 Restated £m
ASSETS				
Pension scheme asset	11	**276**	139	160
Intangible assets				
Goodwill		**39**	96	96
Acquired in-force business		**1,458**	1,564	1,511
Customer relationships and other intangibles		**225**	376	368
Present value of future profits		**24**	29	32
		1,746	2,065	2,007
Property, plant and equipment		**15**	23	23
Investment property		**1,683**	1,657	1,603
Financial assets				
Loans and receivables		**1,560**	2,271	1,977
Derivatives		**1,349**	2,674	1,966
Equities		**13,869**	13,539	13,913
Investment in joint ventures		**118**	104	125
Fixed and variable rate income securities		**35,643**	38,529	35,460
Collective investment schemes		**2,438**	4,088	3,767
	14.1	**54,977**	61,205	57,208
Insurance assets				
Reinsurers' share of insurance contract liabilities		**2,854**	2,724	2,851
Reinsurance receivables		**35**	28	34
Insurance contract receivables		**10**	9	12
		2,899	2,761	2,897
Current tax		**7**	7	6
Prepayments and accrued income		**421**	488	462
Other receivables		**1,737**	2,379	743
Cash and cash equivalents		**8,692**	9,334	9,294
Assets classified as held for sale	3.2	**365**	4,968	66
Total assets		**72,818**	85,026	74,469

CONDENSED STATEMENT OF CONSOLIDATED CASH FLOWS

For the half year ended 30 June 2014

	Notes	**Half year ended 30 Jun 2014 £m**	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Cash flows from operating activities				
Cash (utilised)/generated by operations		**(310)**	765	1,023
Taxation paid		**(30)**	(4)	(11)
Net cash flows from operating activities		**(340)**	761	1,012
Cash flows from investing activities				
Proceeds from disposal of business	3.3	**21**	–	–
Cash flows from financing activities				
Proceeds from issuing ordinary shares, net of associated commission and expenses		**–**	233	233
Proceeds from issuing shares in subsidiaries to non-controlling interests		**33**	–	37
Ordinary share dividends paid	8	**(60)**	(60)	(120)
Coupon on Perpetual Reset Capital Securities paid		**(26)**	(26)	(26)
Dividends paid to non-controlling interests	10	**(12)**	(12)	(25)
Arrangement and structuring fees associated with the re-terming of the Impala loan facility		**–**	(21)	(21)
Repayment of policyholder borrowings		**(15)**	(11)	(33)
Repayment of shareholder borrowings		**(83)**	(533)	(694)
Interest paid on policyholder borrowings		**(4)**	(4)	(18)
Interest paid on shareholder borrowings		**(48)**	(78)	(136)
Net cash flows from financing activities		**(215)**	(512)	(803)
Net (decrease)/increase in cash and cash equivalents		**(534)**	249	209
Cash and cash equivalents at the beginning of the period		**9,294**	9,085	9,085
Cash and cash equivalents at the end of the period		**8,760**	9,334	9,294

Cash flows relating to discontinued operations are disclosed in note 3.1.

CONDENSED STATEMENT OF CONSOLIDATED CHANGES IN EQUITY

For the half year ended 30 June 2014

	Share capital (note 9) £m	Share premium £m	Shares held by employee benefit trust and Group entities £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 10) £m	Total £m
At 1 January 2014	–	1,097	(13)	93	732	1,909	778	2,687
Profit for the period	–	–	–	–	144	144	47	191
Other comprehensive (expense)/income for the period	–	–	–	(8)	79	71	–	71
Total comprehensive (expense)/income for the period	–	–	–	(8)	223	215	47	262
Dividends paid on ordinary shares (note 8)	–	(60)	–	–	–	(60)	–	(60)
Dividends paid on shares held by the employee benefit trust and Group entities	–	1	–	–	–	1	–	1
Dividends paid to non-controlling interests	–	–	–	–	–	–	(12)	(12)
Coupon paid to non-controlling interests, net of tax relief	–	–	–	–	–	–	(21)	(21)
Credit to equity for equity-settled share-based payments	–	–	–	–	3	3	–	3
Shares subscribed for by non-controlling interests	–	–	–	–	–	–	33	33
Shares distributed by employee benefit trust	–	–	7	–	(7)	–	–	–
Shares acquired by employee benefit trust	–	–	(8)	–	–	(8)	–	(8)
At 30 June 2014	–	1,038	(14)	85	951	2,060	825	2,885

CONDENSED STATEMENT OF CONSOLIDATED CHANGES IN EQUITY

For the half year ended 30 June 2014

	Share capital (note 9) £m	Share premium £m	Other reserves £m	Shares held by employee benefit trust and Group entities £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 10) £m	Total £m
At 1 January 2013	–	982	5	(10)	85	596	1,658	724	2,382
(Loss)/profit for the period	–	–	–	–	–	(27)	(27)	19	(8)
Other comprehensive income/(expense) for the period	–	–	–	–	13	(9)	4	–	4
Total comprehensive income/(expense) for the period	–	–	–	–	13	(36)	(23)	19	(4)
Issue of ordinary share capital, net of associated commissions and expenses	–	233	–	–	–	–	233	–	233
Dividends paid on ordinary shares (note 8)	–	(60)	–	–	–	–	(60)	–	(60)
Dividends paid on shares held by the employee benefit trust and Group entities	–	1	–	–	–	–	1	–	1
Dividends paid to non-controlling interests	–	–	–	–	–	–	–	(12)	(12)
Coupon paid to non-controlling interests, net of tax relief	–	–	–	–	–	–	–	(20)	(20)
Credit to equity for equity-settled share-based payments	–	–	–	–	–	3	3	–	3
Shares distributed by employee benefit trust	–	–	–	2	–	(2)	–	–	–
Shares acquired by employee benefit trust	–	–	–	(6)	–	–	(6)	–	(6)
Expired contingent rights	–	–	(5)	–	–	5	–	–	–
At 30 June 2013	–	1,156	–	(14)	98	566	1,806	711	2,517

CONDENSED STATEMENT OF CONSOLIDATED CHANGES IN EQUITY

For the half year ended 30 June 2014

	Share capital (note 9) £m	Share premium £m	Other reserves £m	Shares held by employee benefit trust and Group entities £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 10) £m	Total £m
At 1 January 2013	–	982	5	(10)	85	596	1,658	724	2,382
Profit for the period	–	–	–	–	–	145	145	62	207
Other comprehensive income/ (expense) for the period	–	–	–	–	8	(12)	(4)	–	(4)
Total comprehensive income for the period	–	–	–	–	8	133	141	62	203
Issue of ordinary share capital, net of associated commissions and expenses	–	233	–	–	–	–	233	–	233
Dividends paid on ordinary shares	–	(120)	–	–	–	–	(120)	–	(120)
Dividends paid on shares held by the employee benefit trust and Group entities	–	2	–	–	–	–	2	–	2
Dividends paid to non-controlling interests	–	–	–	–	–	–	–	(25)	(25)
Coupon paid to non-controlling interests, net of tax relief	–	–	–	–	–	–	–	(20)	(20)
Credit to equity for equity-settled share-based payments	–	–	–	–	–	6	6	–	6
Shares in subsidiaries subscribed for by non-controlling interests	–	–	–	–	–	–	–	37	37
Shares distributed by employee benefit trust	–	–	–	8	–	(8)	–	–	–
Shares acquired by employee benefit trust	–	–	–	(11)	–	–	(11)	–	(11)
Expired contingent rights	–	–	(5)	–	–	5	–	–	–
At 31 December 2013	–	1,097	–	(13)	93	732	1,909	778	2,687

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. BASIS OF PREPARATION

The condensed consolidated interim financial statements ('the interim financial statements') for the half year ended 30 June 2014 comprise the interim financial statements of Phoenix Group Holdings ('the Company') and its subsidiaries (together referred to as 'the Group') as set out on pages 22 to 55 and were authorised by the Board of Directors for issue on 20 August 2014. The interim financial statements are unaudited but have been reviewed by the auditors, Ernst & Young LLP and their review report appears on page 21.

The interim financial statements have been prepared, effective from 1 January 2014, in accordance with the International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB'). The interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting as issued by the IASB and in accordance with the accounting policies set out in the 2013 consolidated financial statements except for the following:

- the basis of preparation for the Group's consolidated financial statements has been amended from IFRSs adopted for use in the European Union to IFRSs issued by the IASB, effective from 1 January 2014;
- the adoption of IFRS 10 Consolidated Financial statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, and IAS 28 Investments in Associates and Joint Ventures (Revised). As a result of adopting the new basis of preparation in 2014, these standards have an initial application date of 1 January 2013; and
- the adoption of other new accounting standards, interpretations and amendments effective as of 1 January 2014 which are referred to below.

The interim financial statements do not include all the information and disclosures required in the 2013 consolidated financial statements, and should be read in conjunction with the Group's 2013 Annual Report and Accounts.

The adoption of IFRS 10 and IFRS 11 with an initial application date of 1 January 2013, requires the restatement of previous financial statements. The impact of IFRS 10 on the interim financial statements is explained in note 2. The adoption of IFRS 11 results in the presentation of a property investment structure as an investment in joint ventures within financial assets (previously disclosed as an equity investment). As a result of the Group's accounting policy to value interests in joint ventures at fair value through profit or loss there has been no change in the measurement basis. The application of IFRS 12 will result in additional disclosures in the 2014 annual consolidated financial statements.

In preparing the interim financial statements the Group has adopted the following standards, interpretations and amendments effective from 1 January 2014:

- Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27). These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10 Consolidated Financial Statements. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss.
- Offsetting Financial Assets and Financial Liabilities – Amendments for IAS 32. These amendments clarify the meaning of 'currently has a legally enforceable right to set-off' and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting.
- Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39. These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria.
- Receivable Amount Disclosures for Non-Financial Assets. These amendments remove the unintended consequences of IFRS 13 Fair Value Measurement on the disclosures required under IAS 36 Impairment of Assets. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units for which an impairment loss has been recognised or reversed during the period.

These standards, interpretations or amendments have been applied for the first time in 2014 and do not impact the 2014 interim financial statements. There is also not expected to be a significant impact on the 2014 consolidated financial statements.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the interim financial statements.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

2. CHANGES IN ACCOUNTING POLICIES

The accounting policies adopted in the preparation of the interim financial statements are consistent with those followed in the preparation of the 2013 consolidated financial statements except for the adoption of IFRS 10 Consolidated Financial Statements.

As a result of the Group changing its basis of preparation to IFRSs issued by the IASB, the effective date of application of IFRS 10 by the Group is now 1 January 2013.

IFRS 10 replaces the parts of the previously existing IAS 27 Consolidated and Separate Financial Statements that dealt with consolidated financial statements and SIC-12 Consolidation – Special Purpose Entities, and establishes a single control model that applies to all entities including special purpose entities. IFRS 10 changes the definition of control such that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Subsidiary undertakings are those entities over which the Group has control. The Group controls an investee if and only if the Group has all the following:

- Power over the investee;
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect its returns.

The Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including: relevant activities, substantive and protective rights, voting rights and purpose and design of an investee. The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

The Group is invested in a number of collective investment schemes which in turn invest in a range of financial assets. The Group's percentage ownership in these collective investment schemes can fluctuate according to the Group's and third party participation in them. When assessing the control over these collective investment schemes the Group considers the scope of its decision making authority including its ability to direct the relevant activities of the fund, powers of veto and exposure to variability of returns. The Group also assesses substantive removal rights that may affect the Group's ability to direct the relevant activities.

The following table summarises the financial effects on the condensed consolidated income statement, condensed statement of consolidated financial position and condensed statement of consolidated cash flows on implementation of the new accounting policy:

	Year ended 31 Dec 2013 £m	Half year ended 30 Jun 2013 £m
Condensed consolidated income statement		
Net investment income	80	44
Other operating income	(1)	–
Administrative expenses	(1)	(2)
Net income attributable to unitholders	(79)	(42)
Finance costs	1	–
Profit for the period	–	–
Condensed statement of consolidated financial position		
Total assets:		
Derivatives	18	4
Equities	2,602	2,336
Investment in joint ventures	125	104
Fixed and variable rate income securities	198	301
Collective investment schemes	(2,623)	(2,317)
Cash and cash equivalents	70	71
Other assets	6	14
Total assets	**396**	**513**
Total liabilities:		
Derivatives	5	5
Net asset value attributable to unitholders	435	498
Other payables	(44)	10
Total liabilities	**396**	**513**

	Year ended 31 Dec 2013 £m	Half Year ended 30 Jun 2013 £m
Condensed statement of consolidated cash flows		
Cash (utilised)/generated by operations	13	14

The change in accounting policy had no impact on net assets or on earnings per share as at 31 December 2013 or 30 June 2013.

3. DISCONTINUED OPERATIONS AND ASSETS AND LIABILITIES HELD FOR SALE

This note provides details of the discontinued operations of Ignis Asset Management, assets and liabilities held for sale at the period end and the disposal of a general insurance subsidiary undertaking.

3.1 DISCONTINUED OPERATIONS

On 25 March 2014, the Group and Standard Life Investments (Holdings) Limited ('Standard Life Investments') signed a disposal agreement under which Standard Life Investments agreed to acquire the entire issued share capital of Ignis Asset Management in return for gross cash consideration of £390 million. The divestment was completed on 1 July 2014. The business has been included in the Ignis Asset Management operating segment at 30 June 2014. The results of Ignis Asset Management are as follows:

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Fees	**26**	19	48
Net investment income	**(6)**	–	7
Total revenue	**20**	19	55
Amortisation of customer relationships	**–**	(2)	(3)
Administrative expenses	**(47)**	(45)	(103)
Total operating expenses	**(47)**	(47)	(106)
Loss before tax	**(27)**	(28)	(51)
Tax credit attributable to owners	**9**	6	16
Loss after tax for the period from a discontinued operation	**(18)**	(22)	(35)

The loss before tax for the period from a discontinued operation excludes intra-group fee income of £38 million (half year ended 30 June 2013: £43 million; year ended 31 December 2013: £102 million). This intra-group fee income represents the difference between the loss before tax for the period from discontinued operations and the Ignis Asset Management segmental result before tax attributable to owners result shown in note 4.1.

The loss for the period from discontinued operations was entirely attributable to the owners of the parent.

The net cash flows generated/(utilised) by Ignis Asset Management are as follows:

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Cash flows from operating activities	**31**	11	17
Cash flows from financing activities	**(29)**	–	(14)
Net cash inflow	**2**	11	3
Loss per share			
Basic loss per share from discontinued operations (note 7.1)	**(8.2)p**	(10.1)p	(17.1)p
Diluted loss per share from discontinued operations (note 7.2)	**(8.2)p**	(10.1)p	(17.1)p

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

3. DISCONTINUED OPERATIONS AND ASSETS AND LIABILITIES HELD FOR SALE CONTINUED

3.2 ASSETS AND LIABILITIES OF OPERATIONS CLASSIFIED AS HELD FOR SALE

The balances transferred to assets and liabilities classified as held for sale in the statement of consolidated financial position as at 30 June 2014 relate to Ignis Asset Management (see 3.1 above). The balances as at 31 December 2013 related to BA(GI) Limited ('BAGI') (see 3.3 below) and the balances as at 30 June 2013 related to the Part VII transfer of a portfolio of wholly reinsured annuity liabilities to Guardian Assurance Limited ('Guardian') which completed in September 2013 and BAGI.

	Carrying amount 30 Jun 2014 £m	Carrying amount 30 Jun 2013 £m	Carrying amount 31 Dec 2013 £m
Assets classified as held for sale:			
Goodwill	**57**	19	–
Acquired in-force business	**–**	138	–
Customer relationships and other intangibles	**136**	–	–
Financial assets	**37**	55	55
Reinsurer's share of insurance contract liabilities	**–**	4,747	–
Property, plant and equipment	**8**	–	–
Cash and cash equivalents	**68**	–	–
Other assets	**59**	9	11
	365	4,968	66
Liabilities classified as held for sale:			
Liabilities under insurance contracts	**–**	5,050	–
Deferred tax liabilities	**27**	23	–
Payables related to direct insurance contracts	**–**	47	48
Provisions	**23**	–	–
Other liabilities	**61**	1	1
	111	5,121	49

3.3 DISPOSAL OF BAGI

The Group completed the sale of its entire interest in BAGI to National Indemnity Company on 18 March 2014 for cash consideration of £21 million. The carrying value of the net assets transferred was £17 million, resulting in a pre-tax gain of £4 million. Assets and liabilities classified as held for sale as at 30 June 2013 and 31 December 2013 are no longer included in the consolidated statement of financial position.

3.4 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. The business was transferred to Guardian on 30 September 2013 using a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 12 September 2013.

As part of the Part VII transfer, the Group paid £78 million consideration to Guardian in connection with the ongoing servicing of the transferred policies. Net liabilities disposed of were £143 million and the Group recognised a gain on transfer of £65 million, comprising £42 million within gain on transfer of business and £23 million within tax (charge)/credit attributable to owners in the consolidated income statement for the year ending 31 December 2013.

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 had two operating segments during the reporting period 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. This segment has been disposed of effective 1 July 2014 (see note 3).

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.

4.1 SEGMENTAL RESULT

Half year ended 30 June 2014

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Eliminations £m	Discontinued operation eliminations £m	Total £m
Net premiums written from:						
External customers	482	–	–	–	–	482
Fees from:						
External customers	59	26	–	–	(26)	59
Other segment	–	38	–	(38)	–	–
	59	64	–	(38)	(26)	59
Net investment income:						
Recurring	2,035	–	6	–	–	2,041
Non-recurring	–	(6)	2	–	6	2
	2,035	(6)	8	–	6	2,043
Other operating income:						
Recurring	5	–	–	–	–	5
Gain on transfer of business:						
Non-recurring	–	–	4	–	–	4
Net income	2,581	58	12	(38)	(20)	2,593
Net policyholder claims and benefits incurred:						
Recurring	(1,730)	–	–	–	–	(1,730)
Depreciation and amortisation:						
Depreciation of property, plant and equipment	–	–	–	–	–	–
Amortisation of acquired in-force business	(53)	–	–	–	–	(53)
Amortisation of customer relationships	(7)	–	–	–	–	(7)
	(60)	–	–	–	–	(60)
Other operating expenses:						
Recurring	(464)	(47)	(14)	38	47	(440)
Non-recurring	(57)	–	66	–	–	9
	(521)	(47)	52	38	47	(431)
Total operating expenses	(2,311)	(47)	52	38	47	(2,221)
Profit before finance costs and tax	270	11	64	–	27	372
Finance costs	(34)	–	(48)	–	–	(82)
Profit before tax	236	11	16	–	27	290
Tax attributable to policyholders' returns	(32)	–	–	–	–	(32)
Segmental result before the tax attributable to owners	204	11	16	–	27	258

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

4. SEGMENTAL ANALYSIS CONTINUED

4.1 SEGMENTAL RESULT CONTINUED

Half year ended 30 June 2013 Restated

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Eliminations £m	Discontinued operation eliminations £m	Total £m
Net premiums written from:						
External customers	635	–	–	–	–	635
Fees from:						
External customers	67	19	–	–	(19)	67
Other segment	–	43	–	(43)	–	–
	67	62	–	(43)	(19)	67
Net investment income:						
Recurring	942	–	–	–	–	942
Other operating income:						
Recurring	4	–	–	–	–	4
Net income	1,648	62	–	(43)	(19)	1,648
Net policyholder claims and benefits incurred:						
Recurring	(513)	–	–	–	–	(513)
Depreciation and amortisation:						
Depreciation of property, plant and equipment	–	(2)	–	–	2	–
Amortisation of acquired in-force business	(58)	–	–	–	–	(58)
Amortisation of customer relationships	(7)	(2)	–	–	2	(7)
	(65)	(4)	–	–	4	(65)
Other operating expenses:						
Recurring	(959)	(41)	–	43	41	(916)
Non-recurring	(11)	(2)	(27)	–	2	(38)
	(970)	(43)	(27)	43	43	(954)
Total operating expenses	(1,548)	(47)	(27)	43	47	(1,532)
Profit/(loss) before finance costs and tax	100	15	(27)	–	28	116
Finance costs	(64)	–	(65)	–	–	(129)
Profit/(loss) before tax	36	15	(92)	–	28	(13)
Tax attributable to policyholders' returns	29	–	–	–	–	29
Segmental result before the tax attributable to owners	65	15	(92)	–	28	16

Year ended 31 December 2013 Restated

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Eliminations £m	Discontinued operation eliminations £m	Total £m
Net premiums written from:						
External customers	1,344	`–	–	–	–	1,344
Fees from:						
External customers	132	48	–	–	(48)	132
Other segment	–	102	–	(102)	–	–
	132	150	–	(102)	(48)	132
Net investment income						
Recurring	2,748	–	(1)	–	–	2,747
Non-recurring	–	7	–	–	(7)	–
	2,748	7	(1)	–	(7)	2,747
Other operating income:						
Recurring	7	–	–	–	–	7
Gain on transfer of business:						
Non-recurring	42	–	–	–	–	42
Net income	4,273	157	(1)	(102)	(55)	4,272
Net policyholder claims and benefits incurred:						
Recurring	(1,742)	–	–	–	–	(1,742)
Depreciation and amortisation:						
Depreciation of property, plant and equipment	–	(3)	–	–	3	–
Amortisation of acquired in-force business	(111)	–	–	–	–	(111)
Amortisation of customer relationships	(16)	(3)	–	–	3	(16)
	(127)	(6)	–	–	6	(127)
Other operating expenses:						
Recurring	(1,989)	(98)	13	102	98	(1,874)
Non-recurring	(11)	(2)	(47)	–	2	(58)
	(2,000)	(100)	(34)	102	100	(1,932)
Total operating expenses	(3,869)	(106)	(34)	102	106	(3,801)
Profit before finance costs and tax	404	51	(35)	–	51	471
Finance costs	(104)	–	(126)	–	–	(230)
Profit/(loss) before tax	300	51	(161)	–	51	241
Tax attributable to policyholders' returns	27	–	–	–	–	27
Segmental result before the tax attributable to owners	327	51	(161)	–	51	268

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

4. SEGMENTAL ANALYSIS CONTINUED

4.2 RECONCILIATION OF OPERATING PROFIT/(LOSS) BEFORE ADJUSTING ITEMS TO THE SEGMENTAL RESULT

Half year ended 30 June 2014

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Total £m
Operating profit/(loss) before adjusting items	**256**	**17**	**(7)**	**266**
Investment return variances and economic assumption changes on long-term business	**59**	**–**	**–**	**59**
Variance on owners' funds	**1**	**–**	**(1)**	**–**
Amortisation of acquired in-force business	**(48)**	**–**	**–**	**(48)**
Amortisation of customer relationships	**(7)**	**–**	**–**	**(7)**
Non-recurring items	**(57)**	**(6)**	**72**	**9**
Finance costs attributable to owners	**–**	**–**	**(48)**	**(48)**
Segment result before the tax attributable to owners	**204**	**11**	**16**	**231**
Adjust for:				
Loss before the tax attributable to owners from discontinued operations (see note 3.1)				**27**
Profit before tax attributable to owners from continuing operations				**258**

Non-recurring items include:

– income received in relation to the close-out of the PGL Pension Scheme longevity agreement with the with-profit funds of £68 million;

– capitalised VAT costs on future investment management expenses arising as a result of the divestment of Ignis of £27 million;

– costs associated with external regulatory changes with regard to the cap on workplace pension charges of £14 million;

– corporate project costs of £11 million; and

– net other one-off items totalling a cost of £7 million.

Half year ended 30 June 2013

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Total £m
Operating profit/(loss) before adjusting items	178	19	(11)	186
Investment return variances and economic assumption changes on long-term business	(13)	–	–	(13)
Variance on owners' funds	(31)	–	11	(20)
Amortisation of acquired in-force business	(51)	–	–	(51)
Amortisation of customer relationships	(7)	(2)	–	(9)
Non-recurring items	(11)	(2)	(27)	(40)
Finance costs attributable to owners	–	–	(65)	(65)
Segment result before the tax attributable to owners	65	15	(92)	(12)
Adjust for:				
Loss before the tax attributable to owners from discontinued operations (see note 3.1)				28
Profit before tax attributable to owners from continuing operations				16

Non-recurring items include:

– arrangement and structuring fees of £21 million associated with the re-terming of the Impala loan facility;

– regulatory change and systems transformation costs of £10 million; and

– restructuring costs and other one-off items of £9 million.

Year ended 31 December 2013

	Phoenix Life £m	Ignis Asset Management £m	Unallocated Group £m	Total £m
Operating profit/(loss) before adjusting items	414	49	(24)	439
Investment return variances and economic assumption changes on long-term business	64	–	–	64
Variance on owners' funds	(67)	–	36	(31)
Amortisation of acquired in-force business	(99)	–	–	(99)
Amortisation of customer relationships	(16)	(3)	–	(19)
Non-recurring items	31	5	(47)	(11)
Finance costs attributable to owners	–	–	(126)	(126)
Segment result before the tax attributable to owners	327	51	(161)	217
Adjust for:				
Loss before the tax attributable to owners from discontinued operations (see note 3.1)				51
Profit before tax attributable to owners from continuing operations				268

Non-recurring items include:

- arrangement and structuring fees of £21 million associated with the extinguishment and re-terming of the Impala loan facility;
- gain on transfer of business of £42 million (see note 3.4);
- regulatory change and systems transformation costs of £25 million;
- net settlement cost of pension liability management initiatives of £9 million; and
- net other items of positive £2 million includes a gain on the reinsurance agreement with Guardian offset by corporate project costs.

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.

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.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

5. INVESTMENT RETURN VARIANCES AND ECONOMIC ASSUMPTION CHANGES CONTINUED

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 long-term return and short-term fluctuations.

The variances excluded from operating profit in relation to owners' funds are as follows:

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Variance on owners' funds of:			
Subsidiary undertakings	(4)	(19)	(29)
The Company	4	(1)	(2)
	–	(20)	(31)

The negative variance on owners' funds of subsidiary undertakings of £4 million primarily relates to fair value losses on swap and equity hedging positions held within the shareholder funds. The variance on owners' funds of the Company comprises 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 long-term investment return are:

	Half year ended 30 Jun 2014 %	Half year ended 30 Jun 2013 %	Year ended 31 Dec 2013 %
Equities	**6.6**	5.4	5.4
Properties	**5.6**	4.4	4.4
Gilts (15 year gilt)	**3.6**	2.4	2.4
Other fixed interest	**4.6**	3.4	3.4

6. TAX CHARGE/(CREDIT)

6.1 CURRENT PERIOD TAX CHARGE/(CREDIT) FROM CONTINUING OPERATIONS

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Current tax:			
UK corporation tax	**74**	11	62
Overseas tax	**14**	9	14
	88	20	76
Adjustment in respect of prior years	**(1)**	(4)	(8)
Total current tax charge	**87**	16	68
Deferred tax:			
Origination and reversal of temporary differences	**(7)**	(64)	(62)
Change in the rate of UK corporation tax	**1**	–	(32)
Movement in unrecognised deferred tax	**–**	21	25
Total deferred tax credit	**(6)**	(43)	(69)
Total tax charge/(credit)	**81**	(27)	(1)
Attributable to:			
– Policyholders	**32**	(29)	(27)
– Owners	**49**	2	26
	81	(27)	(1)

The Group, as a proxy for policyholders in the UK, is required to pay taxes on policyholder investment income and gains each year. Accordingly, the tax benefit or charge attributable to UK life assurance policyholder earnings is included in income tax. The tax charge/(benefit) attributable to policyholder earnings was £32 million (half year ended 30 June 2013: £(29) million; year ended 31 December 2013: £(27) million).

The tax credit for the period from discontinued operations is shown in note 3.1.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

6. TAX CHARGE/(CREDIT) CONTINUED

6.2 TAX (CREDITED)/CHARGED TO OTHER COMPREHENSIVE INCOME FROM CONTINUING OPERATIONS

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Deferred tax (credit)/charge on defined benefit schemes	**(8)**	–	12

6.3 RECONCILIATION OF TAX CHARGE/(CREDIT) FROM CONTINUING OPERATIONS

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Profit/(loss) before tax	**290**	(13)	241
Policyholder tax (charge)/credit	**(32)**	29	27
Profit before the tax attributable to owners	**258**	16	268
Tax charge at standard UK[1] rate of 21.5% (2013: 23.25%)	**56**	4	63
Non-taxable income and gains	**(1)**	(5)	4
Disallowable expenses	**3**	3	6
Adjustment to shareholders' tax charge in respect of prior periods	**(1)**	9	23
Movement on acquired in-force amortisation at less than 21.5% (2013: 23.25%)	**1**	(1)	–
Profits taxed at rates other than 21.5% (2013: 23.25%)	**(5)**	(20)	(39)
Deferred tax rate change	**–**	–	(33)
Current year losses not valued	**–**	13	–
Temporary differences not valued	**(5)**	(1)	4
Other	**1**	–	(2)
Owners' tax charge	**49**	2	26
Policyholder tax charge/(credit)	**32**	(29)	(27)
Total tax charge/(credit) for the period	**81**	(27)	(1)

1 The Group's two operating segments operate predominately in the UK. The reconciliation of the tax credit 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.

The Finance Act 2012 set the rate of corporation tax at 23% from 1 April 2013 and further reductions to 21% from 1 April 2014 and 20% from 1 April 2015 were set by the Finance Act 2013. Consequently, a blended rate of tax has been used for the purposes of providing for deferred tax in these financial statements.

Deferred income tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable.

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Deferred tax assets have not been recognised in respect of:			
Tax losses carried forward	**46**	67	50
Excess expenses and deferred acquisition costs	**1**	2	2
Provisions and other temporary differences	**8**	2	9
Capital losses[2]	**119**	191	121

2 These can only be recognised against future capital gains and have no expiry date.

7. EARNINGS PER SHARE

The earnings/(loss) per share is calculated by reference to the profit/(loss) attributable to owners of the parent divided by the weighted average numbers of shares in issue during each period.

7.1 BASIC EARNINGS/(LOSS) PER SHARE

The result attributable to owners of the parent for the purposes of computing earnings per share has been calculated as set out below. This is after adjusting for the result attributable to non-controlling interests.

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Profit/(loss) for the period	**191**	(8)	207
Share of result attributable to non-controlling interests	**(47)**	(19)	(62)
Profit/(loss) attributable to owners of the parent	**144**	(27)	145
Analysed as:			
Profit/(loss) attributable to owners of the parent from continuing operations	**162**	(5)	180
Loss attributable to owners of the parent from discontinued operations	**(18)**	(22)	(35)

The weighted average number of ordinary shares outstanding during the period is calculated as follows:

	Half year ended 30 Jun 2014 No. million	Half year ended 30 Jun 2013 No. million	Year ended 31 Dec 2013 No. million
Issued ordinary shares at beginning of the period	**225**	174	174
Effect of ordinary shares issued	**1**	37	39
Own shares held by employee benefit trust and Group entities	**(1)**	(2)	(1)
Weighted average number of ordinary shares	**225**	209	212

Basic earnings/(loss) per share is as follows:

	Half year ended 30 Jun 2014 pence	Half year ended 30 Jun 2013 pence	Year ended 31 Dec 2013 pence
Basic earnings/(loss) per share from continuing operations	**72.3p**	(3.0)p	85.3p
Basic loss per share from discontinued operations	**(8.2)p**	(10.1)p	(17.1)p
Total basic earnings/(loss) per share	**64.1p**	(13.1)p	68.2p

7.2 DILUTED EARNINGS/(LOSS) PER SHARE

The result attributable to owners for the parent used in the calculation of diluted earnings/(loss) per share is the same as that used in the basic earnings/(loss) per share calculation in 7.1 above. The diluted weighted average number of ordinary shares outstanding during the period is 225 million (half year ended 30 June 2013: 209 million; year ended 31 December 2013: 212 million). The Group's deferred BSP share-based scheme increased the weighted average number of shares on a diluted basis by 85,037 for the half year ended 30 June 2014 and by 176,832 shares for the year ended 31 December 2013. As losses have an anti-dilutive effect none of the share-based awards have a dilutive effect for the half year ended 30 June 2013.

Diluted earnings/(loss) per share is as follows:

	Half year ended 30 Jun 2014 pence	Half year ended 30 Jun 2013 pence	Year ended 31 Dec 2013 pence
Diluted earnings/(loss) per share from continuing operations	**72.3p**	(3.0)p	85.2p
Diluted loss per share from discontinued operations	**(8.2)p**	(10.1)p	(17.1)p
Total diluted earnings/(loss) per share	**64.1p**	(13.1)p	68.1p

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

7. EARNINGS PER SHARE CONTINUED

7.2 DILUTED EARNINGS/(LOSS) PER SHARE CONTINUED

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 they did not have a dilutive effect for the periods presented due to the exercise price of the warrants being significantly higher than the share price of the Company:

– 5 million warrants issued to certain entities providing finance to the Group 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.

8. DIVIDENDS ON ORDINARY SHARES

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 £m	Year ended 31 Dec 2013 £m
Dividend declared and paid in 2014 at 26.7p per share (half year ended 30 June 2013: 26.7p; year ended 31 December 2013: 53.4p)	**60**	60	120

On 25 March 2014, the Board recommended a dividend of 26.7p per share in respect of the year ended 31 December 2014. The dividend was approved at the Company's Annual General Meeting, which was held on 30 April 2014. The dividend was settled on 2 May 2014.

9. SHARE CAPITAL

	30 Jun 2014 £	30 Jun 2013 £	31 Dec 2013 £
Authorised:			
410 million (30 June 2013: 410 million; 31 December 2013: 410 million) ordinary shares of €0.0001 each	**31,750**	31,750	31,750
Issued and fully paid:			
224.9 million (30 June 2013: 224.8 million; 31 December 2013: 224.8 million) ordinary shares of €0.0001 each	**18,421**	18,415	18,418

Movements in share capital during the period:

	Number	**£**
Shares in issue at 1 January 2014	**224,818,301**	**18,418**
Other ordinary shares issued in the period	**38,860**	**3**
Shares in issue at 30 June 2014	**224,857,161**	**18,421**

	Number	£
Shares in issue at 1 January 2013	174,587,148	14,174
Placement and open offer ordinary shares	50,000,000	4,224
Other ordinary shares issued in the period	198,441	17
Shares in issue at 30 June 2013	224,785,589	18,415
Other ordinary shares issued in the period	32,712	3
Shares in issue at 31 December 2013	224,818,301	18,418

During the year, the Company issued 38,860 shares at a total premium of £213,000 in order to satisfy its obligation to employees under the Group's share schemes.

10. NON-CONTROLLING INTERESTS

	Perpetual Reset Capital Securities £m	UK Commercial Property Trust Limited £m	Total £m
At 1 January 2014	**408**	**370**	**778**
Profit for the period	**10**	**37**	**47**
Dividends paid	**–**	**(12)**	**(12)**
Coupons paid, net of tax relief	**(21)**	**–**	**(21)**
Shares in subsidiaries subscribed for by non-controlling interests	**–**	**33**	**33**
At 30 June 2014	**397**	**428**	**825**

	Perpetual Reset Capital Securities £m	UK Commercial Property Trust Limited £m	Total £m
At 1 January 2013	408	316	724
Profit for the period	10	9	19
Dividends paid	–	(12)	(12)
Coupons paid, net of tax relief	(20)	–	(20)
At 30 June 2013	398	313	711
Profit for the period	10	33	43
Dividends paid	–	(13)	(13)
Shares in subsidiaries subscribed for by non-controlling interests	–	37	37
At 31 December 2013	408	370	778

10.1 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'). Following amendments made to the Notes during 2010, the aggregate amount payable on redemption of the Notes is £425 million. On 25 April 2014, the 2014 coupon that was due on the Notes was settled in full by PGH1, other than to two companies within the Group which waived their right to receive that coupon.

10.2 UK COMMERCIAL PROPERTY TRUST LIMITED

UK Commercial Property Trust Limited is a property investment vehicle which is domiciled in Guernsey and is admitted to the Official List of the UK Listing Authority and to trading on the London Stock Exchange. The Group holds 56% as at 30 June 2014 (year ended 31 December 2013: 58%) of the issued share capital of UKCPT.

11. PENSION SCHEMES

The condensed statement of consolidated financial position incorporates the pension scheme asset of the PGL Pension Scheme and the pension scheme liability of the Pearl Group Staff Pension Scheme as at 30 June 2014. The pension scheme asset of the PGL Pension Scheme amounted to £276 million (30 June 2013: £139 million, 31 December 2013: £160 million); this has been adjusted by £22 million (30 June 2013: £94 million, 31 December 2013: £95 million) to eliminate on consolidation the carrying value of insurance policies effected by the PGL Pension Scheme with the Group. The pension scheme liability of the Pearl Group Staff Pension Scheme amounted to £98 million (30 June 2013: £192 million, 31 December 2013: £137 million). Pension scheme assets are stated after deduction of the provision for tax on that part of the economic surplus available as a refund on a winding-up of the scheme. Pension scheme assets and liabilities are stated after adjusting for the irrecoverable amount of minimum funding requirement obligations.

In accordance with an agreement dated November 2005 in respect of the PGL Pension Scheme, certain of the Group's with-profit funds had indemnified the shareholders in respect of contribution calls equal to their share of the cost of changes in longevity assumptions. In January 2014 PGH1 received £8 million under this agreement. In June 2014 PGH1 and Phoenix Life Limited ('PLL') entered into an agreement whereby in exchange for a payment by the PLL with-profit funds to PGH1 of £68 million, PGH1 released the with-profit funds from any future obligations to indemnify the company.

On the same date, the PGL Pension Scheme entered into a longevity swap with PLL with effect from 1 January 2014, under which the Scheme has transferred the risk of longevity improvements in respect of its in-payment members to PLL.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

12. LIABILITIES UNDER INSURANCE CONTRACTS – ASSUMPTIONS

12.1 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.

12.2 VALUATION OF NON-PARTICIPATING INSURANCE CONTRACTS

The non-participating insurance contract liabilities are determined using either a net premium or gross premium valuation method.

12.3 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.

During the period, persistency assumptions have been updated to reflect the anticipated impact of pensions reforms announced in the March Budget, which is expected to reduce the cost of meeting valuable policyholder guarantees. This change reduced insurance liabilities by £12 million in the period.

In the prior period, longevity improvement assumptions were updated to reflect latest available published tables, reducing insurance liabilities by £12 million.

	Decrease in insurance liabilities 30 Jun 2014 £m	Decrease in insurance liabilities 30 Jun 2013 £m	(Decrease)/ increase in insurance liabilities 31 Dec 2013 £m
Change in longevity assumptions	**–**	(12)	(6)
Change in persistency assumptions	**(12)**	–	6
Change in expense assumptions	**–**	–	(7)

13. BORROWINGS

	30 Jun 2014 £m	30 Jun 2013 £m	31 Dec 2013 £m
Carrying value			
Limited recourse bonds 2022 7.59%	**88**	95	86
Property reversions loan	**185**	192	186
£80 million facility agreement	**80**	80	80
£150 million term facility	**150**	148	150
Total policyholder borrowings	**503**	515	502
£200 million 7.25% unsecured subordinated loan	**155**	147	151
£2,260 million syndicated loan	**1,122**	1,342	1,182
£100 million PIK notes and facility	**124**	119	121
£75 million secured loan note	**77**	76	76
£425 million loan facility	**304**	328	327
Total shareholder borrowings	**1,782**	2,012	1,857
Total borrowings	**2,285**	2,527	2,359

On 30 June 2014, a scheduled repayment of £30 million was made in respect of the £2,260 million syndicated loan ('Impala facility') in addition to a targeted repayment of £30 million made on 30 April 2014.

On 30 June 2014, a scheduled repayment of £23 million was made on the £425 million loan facility ('Pearl facility').

A number of repayments have been made since the end of the reporting period as set out below.

On 1 July 2014 a £250 million debt prepayment was made in respect of the £2,260 million syndicated loan following the divestment of Ignis Asset Management to Standard Life Investments.

On 7 July 2014 the Group's new financing subsidiary, PGH Capital Limited, issued a £300 million 7 year senior unsecured bond at an annual coupon rate of 5.75%. The net proceeds from the bond issue of £296 million were used to prepay the Impala facility.

On 23 July 2014 PGH Capital Limited entered into a new £900 million five year unsecured bank facility to refinance the Group's existing bank facilities and PIK notes with a single debt facility. A further £206 million debt prepayment was made on draw down of this facility. The new facility, together with the £206 million debt prepayment has fully refinanced the Impala facility, the £100 million PIK notes and facility, the £75 million secured loan note and the £425 million loan facility. Further details of the new £900 million debt facility are included in note 18.

14. FINANCIAL INSTRUMENTS

14.1 FAIR VALUES

The table below sets out a comparison of the carrying amounts and fair values of financial instruments as at 30 June 2014:

Financial assets

	30 Jun 2014		30 Jun 2013 Restated		31 Dec 2013 Restated	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Loans and receivables at amortised cost	**1,560**	**1,568**	2,271	2,274	1,977	1,985
Financial assets at fair value through profit or loss:						
Held for trading – derivatives	**1,349**	**1,349**	2,674	2,674	1,966	1,966
Designated upon initial recognition:						
Equities	**13,869**	**13,869**	13,539	13,539	13,913	13,913
Investment in joint ventures	**118**	**118**	104	104	125	125
Fixed and variable rate income securities	**35,643**	**35,643**	38,580	38,580	35,510	35,510
Collective investment schemes	**2,475**	**2,475**	4,092	4,092	3,772	3,772
	55,014	**55,022**	61,260	61,263	57,263	57,271
Less amounts classified as held for sale (note 3.2)	**(37)**	**(37)**	(55)	(55)	(55)	(55)
	54,977	**54,985**	61,205	61,208	57,208	57,216

Financial liabilities

	30 Jun 2014		30 Jun 2013 Restated		31 Dec 2013 Restated	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial liabilities at fair value through profit or loss:						
Held for trading – derivatives	**1,616**	**1,616**	2,783	2,783	2,161	2,161
Designated upon initial recognition:						
Borrowings	**185**	**185**	192	192	186	186
Net asset value attributable to unitholders	**5,431**	**5,431**	5,767	5,767	5,744	5,744
Investment contract liabilities	**8,508**	**8,508**	8,327	8,327	8,578	8,578
Financial liabilities measured at amortised cost:						
Borrowings	**2,100**	**2,147**	2,335	2,270	2,173	2,194
Obligations for repayment of collateral received	**5,324**	**–**	9,344	–	7,284	–
Deposits received from reinsurers	**384**	**384**	412	412	385	385
	23,548	**18,271**	29,160	19,751	26,511	19,248

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

14. FINANCIAL INSTRUMENTS CONTINUED

14.2 FAIR VALUE HIERARCHY

14.2.1 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 exchange traded securities and derivatives) is based on quoted market prices at the period end provided by recognised pricing services. Market depth and bid ask spreads are used to corroborate whether an active market exists for an instrument. Greater depth and narrower bid-ask spread indicates a higher liquidity in the instrument and are classed as Level 1 inputs. For collective investment schemes, fair value is by reference to published bid prices.

Level 2 financial instruments

Financial instruments traded in active markets with less depth or wider bid-ask spreads which do not meet the classification as Level 1 inputs, are classified as Level 2. The fair values of financial instruments not traded in active markets are determined using broker quotes or valuation techniques with observable market inputs. Financial instruments valued using broker quotes are classified at Level 2, only where there is a sufficient range of available quotes. The fair value of unquoted equities, over-the-counter derivatives, loans and deposits and collective investment schemes, where published bid prices are not available, are estimated using 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 flows 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 instruments determined by valuation techniques using non-observable market inputs are based on a combination of independent third party evidence and internally developed models. In relation to investments in hedge funds and private equity investments, non-observable third party evidence in the form of net asset valuation statements are used as the basis for the valuation. Adjustments may be made to the net asset valuation where other evidence, for example recent sales of the underlying investments in the fund, indicates this is required. Securities that are valued using broker quotes which could not be corroborated across a sufficient range of quotes are considered as Level 3. For a small number of investment vehicles and debt securities, standard valuation models are used, as due to their nature and complexity they have no external market. Inputs into such models are based on observable market data where applicable. The fair value of loans and some borrowings with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

For financial instruments that are recognised at fair value on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the start of each reporting period.

14.2.2 Fair value hierarchy of financial instruments measured at fair value

At 30 June 2014

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivatives	14	1,335	–	1,349
Financial assets designated at fair value through profit or loss upon initial recognition:				
Equities	13,107	148	614	13,869
Fixed and variable rate income securities	25,119	9,586	938	35,643
Investment in joint ventures	–	–	118	118
Collective investment schemes	1,413	947	115	2,475
	39,639	10,681	1,785	52,105
Less amounts classified as held for sale (note 3.2)	(1)	(36)	–	(37)
Total financial assets at fair value	39,652	11,980	1,785	53,417

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities at fair value				
Derivatives	**6**	**1,605**	**5**	**1,616**
Financial liabilities designated at fair value through profit or loss upon initial recognition:				
Investment contract liabilities	**–**	**8,508**	**–**	**8,508**
Borrowings	**–**	**–**	**185**	**185**
Net asset value attributable to unitholders	**5,431**	**–**	**–**	**5,431**
	5,431	**8,508**	**185**	**14,124**
Total financial liabilities at fair value	**5,437**	**10,113**	**190**	**15,740**

At 30 June 2013

	Level 1 Restated £m	Level 2 Restated £m	Level 3 Restated £m	Total fair value Restated £m
Financial assets at fair value				
Derivatives	27	2,643	4	2,674
Financial assets designated at fair value through profit or loss upon initial recognition:				
Equities	12,599	143	797	13,539
Investment in joint ventures	–	–	104	104
Fixed and variable rate income securities	28,559	9,621	400	38,580
Collective investment schemes	2,864	1,055	173	4,092
	44,022	10,819	1,474	56,315
Less amounts classified as held for sale (note 3.2)	(55)	–	–	(55)
Total financial assets at fair value	43,994	13,462	1,478	58,934

	Level 1 Restated £m	Level 2 Restated £m	Level 3 £m	Total fair value Restated £m
Financial liabilities at fair value				
Derivatives	13	2,770	–	2,783
Financial liabilities designated at fair value through profit or loss upon initial recognition:				
Investment contract liabilities	–	8,327	–	8,327
Borrowings	–	192	–	192
Net asset value attributable to unitholders	5,729	–	38	5,767
	5,729	8,519	38	14,286
Total financial liabilities at fair value	5,742	11,289	38	17,069

At 31 December 2013

	Level 1 Restated £m	Level 2 Restated £m	Level 3 Restated £m	Total fair value Restated £m
Financial assets at fair value				
Derivatives	49	1,917	–	1,966
Financial assets designated at fair value through profit or loss upon initial recognition:				
Equities	13,136	149	628	13,913
Investment in joint ventures	–	–	125	125
Fixed and variable rate income securities	25,494	9,081	935	35,510
Collective investment schemes	2,591	1,065	116	3,772
	41,221	10,295	1,804	53,320
Less amounts classified as held for sale (note 3.2)	(55)	–	–	(55)
Total financial assets at fair value	41,215	12,212	1,804	55,231

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

14. FINANCIAL INSTRUMENTS CONTINUED

14.2 FAIR VALUE HIERARCHY CONTINUED

14.2.2 FAIR VALUE HIERARCHY OF FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE CONTINUED

At 31 December 2013

	Level 1 Restated £m	Level 2 Restated £m	Level 3 Restated £m	Total fair value Restated £m
Financial liabilities at fair value				
Derivatives	40	2,118	3	2,161
Financial liabilities designated at fair value through profit or loss upon initial recognition:				
Investment contract liabilities	–	8,578	–	8,578
Borrowings	–	–	186	186
Net asset value attributable to unitholders	5,744	–	–	5,744
	5,744	8,578	186	14,508
Total financial liabilities at fair value	5,784	10,696	189	16,669

14.2.3 Level 3 financial instrument sensitivities

Included in Level 3 investments are two property investment structures with a value of £29 million within fixed and variable rate income securities (30 June 2013 Restated: £18 million; 31 December 2013 Restated: £15 million) and £118 million within investment in joint ventures (30 June 2013 Restated: £104 million; 31 December 2013 Restated: £125 million).

Both investments have been valued by taking the fair value of the property within the structures, which have been independently valued, less the fair value of the debt within the structures. The valuations are sensitive to movements in yields on the underlying property portfolio. An increase in yields of 25bps would reduce the value of the first investment by £8 million (30 June 2013: £9 million; 31 December 2013: £8 million) and the second investment by £21 million (30 June 2013: £22 million; 31 December 2013: £23 million). A reduction in yields of 25bps would increase the value of the first investments by £9 million (30 June 2013: £10 million; 31 December 2013: £9 million) and the second investment by £25 million (30 June 2013: £25 million; 31 December 2013: £25 million).

Level 3 investments in indirect property, equities (including private equity) and collective investment schemes (including 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.

Borrowings measured at fair value and categorised as Level 3 financial liabilities comprise the property reversion loans, measured using an internally developed model. The valuation is sensitive to increases (decreases) in the fair value of relevant residential property reversions which would result in a higher (lower) fair value of property reversion loans. Details of the valuation of the underlying residential property reversions are included in note 13.

14.2.4 Transfers of financial instruments between Level 1 and Level 2

30 June 2014

	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	**86**	**539**
Collective investment schemes	**2**	**–**

30 June 2013

	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	241	528
Collective investment schemes	210	–

31 December 2013

	From Level 1 to Level 2 Restated £m	From Level 2 to Level 1 Restated £m
Financial assets at fair value		
Financial assets designated at fair value through profit or loss upon initial recognition:		
Derivatives	–	5
Fixed and variable rate income securities	724	238
Collective investment schemes	243	–
Financial liabilities at fair value		
Derivatives	–	20

Consistent with the prior year, all the Group's Level 1 and Level 2 assets have been valued using standard market pricing sources.

The application of the Group's fair value hierarchy classification methodology at an individual security level in particular observations with regard to measures of market depth and bid-ask spreads, have resulted in an overall net movement of financial assets from Level 2 to Level 1 in the period.

14.2.5 Movement in Level 3 financial instruments measured at fair value

30 June 2014

	At 1 January 2014 £m	Total gains/ (losses) in income statement £m	Purchases £m	Sales £m	Transfers from Level 1 and Level 2 £m	Transfers to Level 1 and Level 2 £m	At 30 June 2014 £m	Unrealised gains on assets held at end of period £m
Financial assets								
Financial assets designated at fair value through profit or loss upon initial recognition:								
Equities	628	18	28	(61)	1	–	614	9
Investment in joint ventures	125	(7)	–	–	–	–	118	–
Fixed and variable rate income securities	935	29	193	(202)	34	(51)	938	25
Collective investment schemes	116	8	–	(16)	7	–	115	6
Total financial assets	**1,804**	**48**	**221**	**(279)**	**42**	**(51)**	**1,785**	**40**

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

14. FINANCIAL INSTRUMENTS CONTINUED

14.2 FAIR VALUE HIERARCHY CONTINUED

14.2.5 Movement in Level 3 financial instruments measured at fair value continued

30 June 2014

	At 1 January 2014 £m	Total losses in income statement £m	Purchases £m	Sales £m	Transfers from Level 1 and Level 2 £m	Transfers to Level 1 and Level 2 £m	At 30 June 2014 £m	Unrealised gains on liabilities held at end of period £m
Financial liabilities								
Derivatives	**3**	**2**	**–**	**–**	**–**	**–**	**5**	**(1)**
Financial liabilities designated at fair value through profit or loss upon initial recognition:								
Borrowings	**186**	**14**	**–**	**(15)**	**–**	**–**	**185**	**(1)**
Total financial liabilities	**189**	**16**	**–**	**(15)**	**–**	**–**	**190**	**(2)**

During the period, updates to the Group's observations with regard to the extent to which inputs to the valuation of fixed and variable rate income securities are market observable resulted in a net transfer from Level 3 to Levels 1 and 2.

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.

30 June 2013

	At 1 January 2013 Restated £m	Total (losses)/gains in income statement Restated £m	Purchases Restated £m	Sales Restated £m	Transfers from Level 1 and Level 2 Restated £m	Transfers to Level 1 and Level 2 Restated £m	At 30 June 2013 Restated £m	Unrealised (losses)/gains on assets held at end of period Restated £m
Financial assets								
Derivatives	12	(7)	–	(1)	–	–	4	(8)
Financial assets designated at fair value through profit or loss upon initial recognition:								
Equities	715	23	53	(30)	41	(5)	797	47
Investment in joint ventures	95	9	–	–	–	–	104	–
Fixed and variable rate income securities	500	27	12	(115)	13	(37)	400	23
Collective investment schemes	158	17	17	(36)	17	–	173	15
	1,468	76	82	(181)	71	(42)	1,474	85
Total financial assets	1,480	69	82	(182)	71	(42)	1,478	77

30 June 2013

	At 1 January 2013 £m	Total (gains)/losses in income statement £m	Purchases £m	Sales £m	Transfers from Level 1 and Level 2 £m	Transfers to Level 1 and Level 2 £m	At 30 June 2013 £m	Unrealised losses on liabilities held at end of period £m
Financial liabilities								
Derivatives	3	(3)	–	–	–	–	–	–
Financial liabilities designated at fair value through profit or loss upon initial recognition:								
Net asset value attributable to unitholders	70	6	–	(38)	–	–	38	6
Total financial liabilities	73	3	–	(38)	–	–	38	6

31 December 2013

	At 1 January 2013 Restated £m	Total (losses)/gains in income statement Restated £m	Purchases £m	Sales Restated £m	Transfers from Level 1 and Level 2 £m	Transfers to Level 1 and Level 2 £m	At 31 December 2013 Restated £m	Unrealised (losses)/gains on assets held at end of period Restated £m
Financial assets								
Derivatives	12	(12)	–	–	–	–	–	(12)
Financial assets designated at fair value through profit or loss upon initial recognition:								
Equities	715	(45)	50	(131)	39	–	628	2
Investment in joint ventures	95	30	–	–	–	–	125	–
Fixed and variable rate income securities	500	104	827	(862)	390	(24)	935	70
Collective investment schemes	158	10	1	(40)	1	(14)	116	10
	1,468	99	878	(1,033)	430	(38)	1,804	82
Total financial assets	1,480	87	878	(1,033)	430	(38)	1,804	70

	At 1 January 2013 £m	Total losses in income statement Restated £m	Purchases Restated £m	Sales Restated £m	Transfers from Level 1 and Level 2 £m	Transfers to Level 1 and Level 2 £m	At 31 December 2013 Restated £m	Unrealised (gains)/losses on liabilities held at end of period £m
Financial liabilities								
Derivatives	3	4	–	(4)	–	–	3	(8)
Financial liabilities designated at fair value through profit or loss upon initial recognition:								
Borrowings	–	14	–	(22)	194	–	186	(15)
Net asset value attributable to unitholders	70	–	–	(70)	–	–	–	–
	70	14	–	(92)	194	–	186	(15)
Total financial liabilities	73	18	–	(96)	194	–	189	(23)

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS CONTINUED

15. CASH FLOWS FROM OPERATING ACTIVITIES

	Half year ended 30 Jun 2014 £m	Half year ended 30 Jun 2013 Restated £m	Year ended 31 Dec 2013 Restated £m
Profit/(loss) for the period before tax from continuing operations	**290**	(13)	241
Loss for the period before tax from discontinued operations (note 3.1)	**(27)**	(28)	(51)
Profit/(loss) for the period before tax	**263**	(41)	190
Non-cash movements in profit/(loss) for the period before tax			
Fair value (gains)/losses on:			
Investment property	**(120)**	10	(72)
Financial assets	**(670)**	285	(299)
Change in fair value of borrowings	**20**	24	36
Depreciation of property, plant and equipment	**–**	2	3
Amortisation of intangible assets	**60**	67	130
Change in present value of future profits	**8**	(6)	(9)
Change in unallocated surplus	**19**	38	77
Share-based payment charge	**–**	3	6
Interest expense on borrowings	**82**	129	230
Net interest (income)/expense on Group defined benefit pension scheme asset/liability	**(6)**	(1)	1
Other losses on pension schemes	**–**	–	12
Gain on transfer of business	**(4)**	–	(42)
Decrease in investment assets	**2,073**	2,854	6,913
(Increase)/decrease in reinsurance assets	**(4)**	481	349
Decrease in insurance contract and investment contract liabilities	**(133)**	(1,890)	(2,519)
Decrease in deposits received from reinsurers	**(1)**	(42)	(69)
Decrease in obligation for repayment of collateral received	**(1,961)**	(1,114)	(3,174)
Net increase in working capital	**64**	(34)	(740)
Cash (utilised)/generated by operations	**(310)**	765	1,023

Cash flows from operating activities generated by discontinued operations are disclosed in note 3.1.

16. RELATED PARTY TRANSACTIONS

The nature of the related party transactions of the Group has not changed from those referred to in the Group's consolidated financial statements for the year ended 31 December 2013.

During the period, the PGL Pension Scheme entered into a longevity swap with PLL with effect from 1 January 2014, under which the Scheme has transferred the risk of longevity improvements in respect of its in-payment members to PLL. This transaction has been eliminated upon consolidation and therefore has had no impact on the interim financial statements.

There were no other transactions with related parties during the six months ended 30 June 2014, which have had a material effect on the results or financial position of the Group.

17. 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.

18. EVENTS AFTER THE REPORTING PERIOD

On 1 July 2014 the Group completed the divestment of Ignis Asset Management to Standard Life Investments and gross cash consideration of £390 million was received. £250 million of these proceeds were used to prepay the Impala loan facility.

On 7 July 2014 the Group's new financing subsidiary, PGH Capital Limited, issued a £300 million 7 year senior unsecured bond at an annual coupon rate of 5.75%. The net proceeds from the bond issue of £296 million were used to prepay the Impala loan facility.

On 23 July 2014 PGH Capital Limited entered into a new £900 million 5 year unsecured bank facility which along with a £206 million debt prepayment from internal resources was used to refinance the entirety of the Group's existing two bank facilities and PIK notes, replacing the Pearl and Impala loan facilities with a single debt facility.

The new facility comprises a £450 million revolving credit facility ('RCF') loan and a £450 million amortising term loan. Both loans are repayable by July 2019 with an option to request an extension to the term of the RCF loan by two years to July 2021. Further terms of the facilities agreement include:

- Term facility repayment instalments of £30 million are due semi-annually on 30 June and 31 December each year. Additional target repayments of £30 million may be paid semi-annually on 30 June and 31 December each year from 30 June 2015, non-payment of which would trigger restrictions on the Group regarding the declaration of dividends;
- The term loan bears interest at LIBOR plus an opening margin of 3.50% p.a. and the RCF loan at LIBOR plus an opening margin of 3.25% p.a.. After six months the margins will change in accordance with a margin ratchet which operates by reference to the Group's gearing ratio. Margins will reduce by 0.50% on achievement of an investment grade rating.
- Amongst other fees, a utilisation fee of 0.25% p.a. is payable in respect of the RCF loan for so long as the amount outstanding under the RCF exceeds 50% of the total commitments of the RCF loan.

On 31 July 2014 the Group entered into a reinsurance agreement, effective 1 January 2014, to transfer approximately £1.7 billion of annuity in-payment liabilities, currently held within the Group's with-profit funds, to Guardian Assurance Limited ('Guardian'). On 11 August 2014 the Group made an associated transfer of £1.7 billion of assets to Guardian as the related reinsurance premium for the transferred annuity liabilities.

On 20 August 2014, the Board declared an interim dividend per share of 26.7p for the half year ended 30 June 2014 (30 June 2013: 26.7p). The cost of this dividend has not been recognised as a liability in the interim financial statements for the period to 30 June 2014 and will be charged to the statement of consolidated changes in equity when paid.

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 UKCPT and is 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:

30 June 2014

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[1]	1,734	754	5,521	1,033	9,042
Debt securities – gilts	1,203	2,108	8,089	647	12,047
Debt securities – bonds	6,098	1,828	8,711	774	17,411
Equity securities	334	64	6,015	8,041	14,454
Property investments	151	81	1,002	344	1,578
Other investments[4]	328	(59)	1,704	1	1,974
As at 30 June 2014	**9,848**	**4,776**	**31,042**	**10,840**	**56,506**
Collective investment schemes					5,477
UKCPT					667
Cash held in other Group entities					1,086
Total Group consolidated assets					**63,736**
Comprised of:					
Investment property					1,683
Financial assets					54,977
Cash and cash equivalents					8,692
Derivative liabilities					(1,616)
					63,736

1 Includes assets where shareholders of the life companies bear the investment risk.

2 Includes assets where policyholders bear most of the investment risk.

3 This information is presented on a look through basis to underlying funds where available.

4 Includes repurchase loans of £1,404 million, policy loans of £29 million, other loans of £12 million, net derivatives liabilities of £186 million and other investments of £715 million.

31 December 2013 Restated

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	1,439	849	6,221	994	9,503
Debt securities – gilts	1,216	2,132	8,442	486	12,276
Debt securities – bonds	5,974	1,889	9,223	1,009	18,095
Equity securities	380	28	6,104	8,260	14,772
Property investments	199	80	876	286	1,441
Other investments[5]	292	(88)	2,204	58	2,466
As at 31 December 2013	9,500	4,890	33,070	11,093	58,553

	Total[3] Restated £m
Collective investment schemes	5,717
UKCPT	584
Cash held in other Group entities	1,085
General insurance business	9
Corporate derivative liabilities	(5)
Adjustments on consolidation	1
Total Group consolidated assets	65,944
Comprised of:	
Investment property	1,603
Financial assets	57,208
Cash and cash equivalents	9,294
Derivative liabilities	(2,161)
	65,944

5 Includes repurchase loans of £1,789 million, policy loans of £13 million, other loans of £67 million, net derivatives of £211 million and other investments of £807 million.

The following table analyses by type the debt securities of the life companies:

30 June 2014

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	**1,203**	**2,108**	**8,089**	**647**	**12,047**
Other government and supranational[6]	**1,099**	**709**	**2,552**	**110**	**4,470**
Corporate – financial institutions	**2,084**	**474**	**3,111**	**173**	**5,842**
Corporate – other	**2,344**	**304**	**2,191**	**430**	**5,269**
Asset backed securities ('ABS')	**571**	**341**	**857**	**61**	**1,830**
As at 30 June 2014	**7,301**	**3,936**	**16,800**	**1,421**	**29,458**

6 Includes debt issued by governments; public and statutory bodies; government backed institutions and supranationals.

31 December 2013

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	1,216	2,132	8,442	486	12,276
Other government and supranational[6]	1,061	678	2,517	290	4,546
Corporate – financial institutions	2,051	513	3,417	216	6,197
Corporate – other	2,285	349	2,238	439	5,311
Asset backed securities ('ABS')	577	349	1,051	64	2,041
As at 31 December 2013	7,190	4,021	17,665	1,495	30,371

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:

30 June 2014

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	1,321	2,177	8,525	661	12,684
European Investment Bank	524	324	709	27	1,584
USA	3	6	58	11	78
Germany	380	230	868	28	1,506
France	44	55	56	–	155
Netherlands	–	1	–	–	1
Portugal	–	–	–	–	–
Italy	–	–	–	2	2
Ireland	–	–	–	–	–
Greece	–	–	–	–	–
Spain	–	5	–	2	7
Other – non-Eurozone	16	10	333	23	382
Other – Eurozone	14	9	92	3	118
As at 30 June 2014	**2,302**	**2,817**	**10,641**	**757**	**16,517**

31 December 2013

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	1,326	2,207	8,831	671	13,035
European Investment Bank	507	324	669	37	1,537
USA	3	16	42	11	72
Germany	406	243	1,010	23	1,682
France	4	–	6	1	11
Netherlands	7	–	22	1	30
Portugal	–	–	–	–	–
Italy	–	–	–	3	3
Ireland	–	–	–	–	–
Greece	–	–	–	–	–
Spain	–	4	–	2	6
Other – non-Eurozone	13	7	305	24	349
Other – Eurozone	11	9	74	3	97
As at 31 December 2013	2,277	2,810	10,959	776	16,822

The following table sets out a breakdown of the life companies' financial institution corporate debt security holdings by country:

30 June 2014

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	**1,085**	**278**	**1,231**	**79**	**2,673**
USA	**380**	**77**	**536**	**13**	**1,006**
Germany	**66**	**6**	**83**	**3**	**158**
France	**131**	**14**	**243**	**12**	**400**
Netherlands	**217**	**57**	**517**	**39**	**830**
Portugal	**–**	**–**	**–**	**–**	**–**
Italy	**1**	**–**	**17**	**–**	**18**
Ireland	**–**	**–**	**–**	**–**	**–**
Greece	**–**	**–**	**–**	**–**	**–**
Spain	**2**	**–**	**27**	**–**	**29**
Other – non-Eurozone	**156**	**36**	**404**	**28**	**624**
Other – Eurozone	**46**	**6**	**53**	**(1)**	**104**
As at 30 June 2014	**2,084**	**474**	**3,111**	**173**	**5,842**

31 December 2013

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	1,062	291	1,323	91	2,767
USA	357	69	440	15	881
Germany	120	32	296	25	473
France	80	5	184	19	288
Netherlands	187	57	518	36	798
Portugal	–	–	–	–	–
Italy	29	–	13	–	42
Ireland	1	–	1	–	2
Greece	–	–	–	–	–
Spain	2	–	9	–	11
Other – non-Eurozone	141	45	457	26	669
Other – Eurozone	72	14	176	4	266
As at 31 December 2013	2,051	513	3,417	216	6,197

ADDITIONAL LIFE COMPANY ASSET DISCLOSURES CONTINUED

The following table sets out a breakdown of the life companies' corporate – other debt security holdings by country:

30 June 2014

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	**1,196**	**144**	**1,145**	**345**	**2,830**
USA	**350**	**67**	**276**	**14**	**707**
Germany	**212**	**39**	**190**	**15**	**456**
France	**188**	**28**	**205**	**19**	**440**
Netherlands	**59**	**4**	**43**	**3**	**109**
Portugal	**–**	**–**	**–**	**–**	**–**
Italy	**60**	**1**	**80**	**4**	**145**
Ireland	**1**	**–**	**5**	**–**	**6**
Greece	**2**	**–**	**–**	**–**	**2**
Spain	**26**	**–**	**39**	**1**	**66**
Other – non-Eurozone	**149**	**18**	**124**	**16**	**307**
Other – Eurozone	**101**	**3**	**84**	**13**	**201**
As at 30 June 2014	**2,344**	**304**	**2,191**	**430**	**5,269**

31 December 2013

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	1,169	141	1,156	335	2,801
USA	299	67	240	16	622
Germany	201	46	259	24	530
France	191	73	204	14	482
Netherlands	61	–	40	2	103
Portugal	–	–	–	–	–
Italy	61	1	70	7	139
Ireland	10	–	1	–	11
Greece	2	–	–	–	2
Spain	26	–	30	3	59
Other – non-Eurozone	168	18	145	20	351
Other – Eurozone	97	3	93	18	211
As at 31 December 2013	2,285	349	2,238	439	5,311

The following table sets out a breakdown of the life companies' ABS holdings by country:

30 June 2014

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	489	333	688	58	1,568
USA	38	–	7	–	45
Germany	1	–	46	–	47
France	–	1	–	–	1
Netherlands	22	–	33	2	57
Portugal	–	–	–	–	–
Italy	–	–	13	–	13
Ireland	–	–	43	–	43
Greece	–	–	–	–	–
Spain	–	–	3	–	3
Other – non-Eurozone	20	2	17	1	40
Other – Eurozone	1	5	7	–	13
As at 30 June 2014	**571**	**341**	**857**	**61**	**1,830**

31 December 2013

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	478	329	818	59	1,684
USA	41	–	11	–	52
Germany	2	5	104	–	111
France	2	2	8	–	12
Netherlands	22	2	51	5	80
Portugal	–	–	–	–	–
Italy	–	1	16	–	17
Ireland	14	2	22	–	38
Greece	–	–	–	–	–
Spain	–	–	4	–	4
Other – non-Eurozone	17	2	17	–	36
Other – Eurozone	1	6	–	–	7
As at 31 December 2013	577	349	1,051	64	2,041

ADDITIONAL LIFE COMPANY ASSET DISCLOSURES CONTINUED

The following table sets out the credit rating analysis of the debt portfolio:

30 June 2014

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	**1,182**	**766**	**2,306**	**99**	**4,353**
AA	**1,703**	**2,486**	**9,262**	**728**	**14,179**
A	**1,559**	**475**	**1,905**	**106**	**4,045**
BBB	**1,952**	**161**	**2,486**	**189**	**4,788**
BB	**368**	**8**	**269**	**11**	**656**
B and below	**354**	**–**	**23**	**6**	**383**
Non-rated	**183**	**40**	**549**	**282**	**1,054**
As at 30 June 2014	**7,301**	**3,936**	**16,800**	**1,421**	**29,458**

31 December 2013

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	1,096	674	2,183	89	4,042
AA	1,783	2,640	10,121	553	15,097
A	1,498	502	2,155	163	4,318
BBB	1,883	174	2,469	212	4,738
BB	218	7	249	20	494
B and below	353	1	31	5	390
Non-rated	359	23	457	453	1,292
As at 31 December 2013	7,190	4,021	17,665	1,495	30,371

MCEV SUPPLEMENTARY INFORMATION

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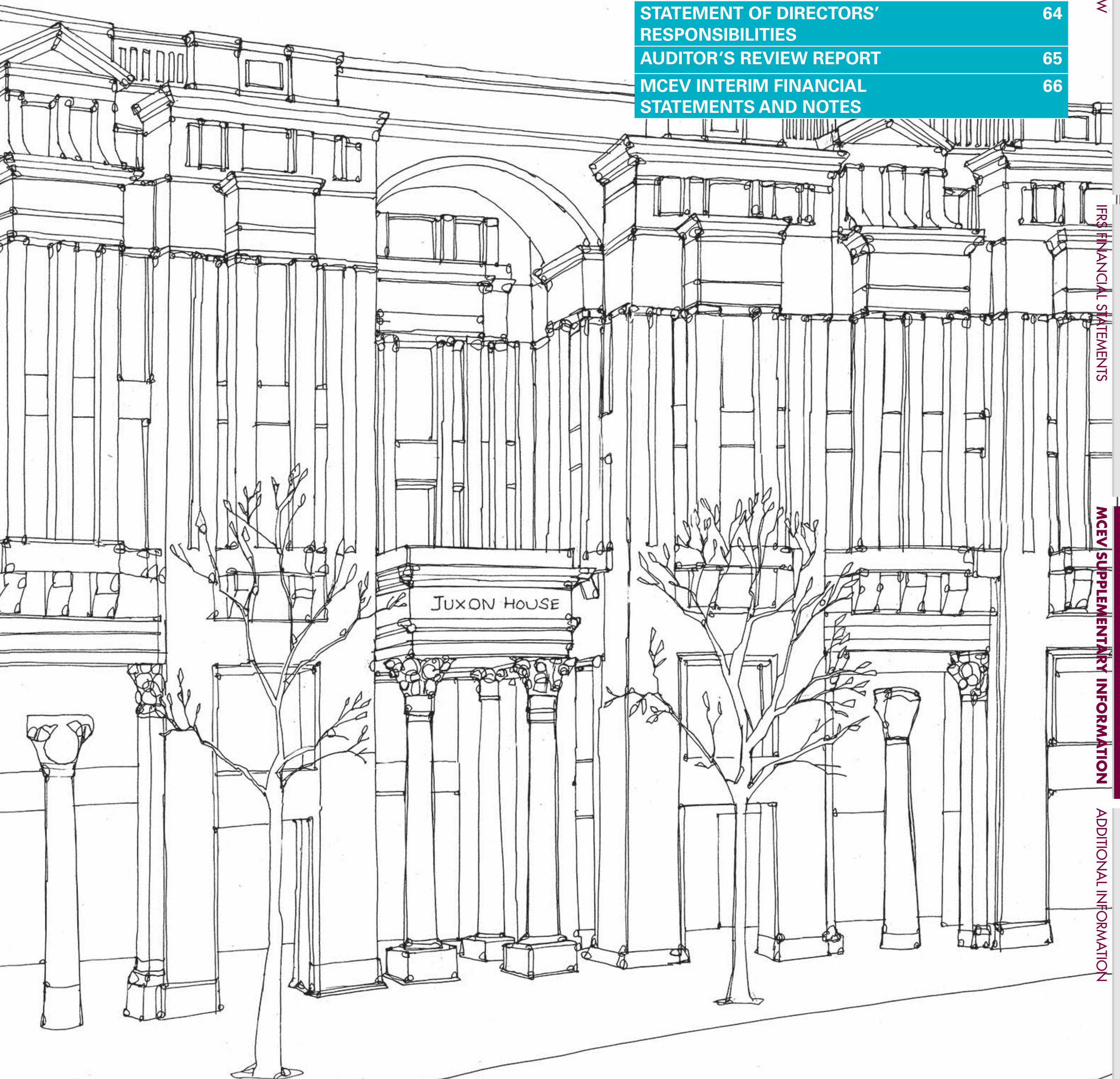


STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE MARKET CONSISTENT EMBEDDED VALUE ('MCEV')

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 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
St Helier, Jersey
20 August 2014

JAMES McCONVILLE
Group Finance Director

AUDITOR'S REVIEW REPORT

INDEPENDENT REVIEW REPORT TO THE DIRECTORS OF PHOENIX GROUP HOLDINGS ON THE CONSOLIDATED PHOENIX GROUP MARKET CONSISTENT EMBEDDED VALUE ('MCEV')

We have been engaged by the Company to review the Consolidated Phoenix Group Holdings MCEV ('Phoenix Group Holdings MCEV') in the interim report for the half year ended 30 June 2014 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 the related notes on pages 71 to 80. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the Phoenix Group Holdings MCEV.

Ernst & Young LLP have reported separately on the condensed consolidated financial statements of Phoenix Group Holdings prepared on an IFRS basis for the half year ended 30 June 2014. The information contained in the Phoenix Group Holdings MCEV should be read in conjunction with the condensed consolidated financial statements prepared on an IFRS basis.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's Directors, for our work, for this report, or for the conclusions we have formed.

DIRECTORS' RESPONSIBILITIES

The Phoenix Group Holdings MCEV in the interim report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Phoenix Group MCEV in accordance with the basis of preparation set out on pages 71 to 75.

OUR RESPONSIBILITY

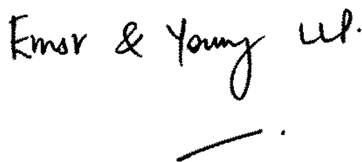
Our responsibilities for the Phoenix Group Holdings MCEV are set out in our engagement letter with you dated 1 August 2014. We report to you our opinion as to whether the Phoenix Group Holdings MCEV in the interim report has been properly prepared, in all material respects, in accordance with the Basis of preparation set out on pages 71 to 75.

SCOPE OF REVIEW

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the Phoenix Group Holdings MCEV in the interim report for the half year ended 30 June 2014 has not been prepared, in all material respects, in accordance with the basis of preparation set out on pages 71 to 75.



Ernst & Young LLP
London
20 August 2014

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES

SUMMARISED CONSOLIDATED INCOME STATEMENT – GROUP MCEV BASIS

For the half year ended 30 June 2014

	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m	Year ended 31 December 2013 £m
Life MCEV operating earnings	**181**	165	401
Management services operating profit	**16**	18	32
Ignis Asset Management operating profit – discontinued operations	**17**	19	49
Group costs	**(10)**	(13)	(27)
Group MCEV operating earnings before tax	**204**	189	455
Economic variances on life business	**(28)**	(30)	138
Economic variances on non-life business	**(37)**	(43)	(48)
Other non-operating variances on life business	**(132)**	(3)	(35)
Non-recurring items on non-life business	**59**	(38)	(61)
Finance costs attributable to owners	**(62)**	(84)	(140)
Group MCEV earnings before tax	**4**	(9)	309
Tax on operating earnings	**(42)**	(44)	(105)
Tax on non-operating earnings	**20**	9	(42)
Total tax	**(22)**	(35)	(147)
Group MCEV earnings after tax	**(18)**	(44)	162

Analysed between:			
Group MCEV earnings after tax from continuing operations	**–**	(23)	204
Group MCEV earnings after tax from discontinued operations	**(18)**	(21)	(42)
Group MCEV earnings after tax	**(18)**	(44)	162

MCEV EARNINGS PER ORDINARY SHARE

For the half year ended 30 June 2014

	Half year ended 30 June 2014	Half year ended 30 June 2013	Year ended 31 December 2013
Group MCEV operating earnings per share after tax			
Basic[1]	**72.3p**	69.1p	165.5p
Diluted[2]	**72.2p**	69.1p	165.3p
Group MCEV earnings per share after tax			
Basic[1]	**(8.0p)**	(20.9p)	76.2p
Diluted[2]	**(8.0p)**	(20.9p)	76.1p

1 Based on 225 million shares (half year ended 30 June 2013: 209 million; year ended 31 December 2013: 212 million) as set out in note 7.1 of the IFRS condensed consolidated interim financial statements.

2 Based on 225 million shares (half year ended 30 June 2013: 209 million; year ended 31 December 2013: 212 million), allowing for share options in issue as set out in note 7.2 of the IFRS condensed consolidated interim 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 average UK corporate tax rate of 21.5% (half year ended 30 June 2013: 23.25%; year ended 31 December 2013: 23.25%).

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES CONTINUED

STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME – GROUP MCEV BASIS

For the half year ended 30 June 2014

	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m	Year ended 31 December 2013 £m
Group MCEV earnings after tax	**(18)**	(44)	162
Other comprehensive income			
Actuarial gains/(losses) and pension scheme contributions on defined benefit pension schemes (net of tax)	**32**	(2)	(16)
Total comprehensive income	**14**	(46)	146

RECONCILIATION OF MOVEMENT IN EQUITY – GROUP MCEV BASIS

For the half year ended 30 June 2014

	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m	Year ended 31 December 2013 £m
Opening Group MCEV equity	**2,378**	2,122	2,122
Total comprehensive income for the period	**14**	(46)	146
Movement in equity for equity-settled share-based payments	**3**	3	6
Dividends paid on ordinary shares	**(60)**	(60)	(120)
Issue of ordinary share capital, net of associated commissions and expenses	**–**	233	233
Dividends paid on shares held by the employee benefit trust and Group entities	**1**	1	2
Shares acquired by employee benefit trust	**(8)**	(6)	(11)
Total capital and dividend flows – external	**(64)**	171	110
Closing Group MCEV equity	**2,328**	2,247	2,378

GROUP MCEV ANALYSIS OF EARNINGS

For the half year ended 30 June 2014

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Management[1] IFRS £m	Other Group companies[2] IFRS £m	Group MCEV £m
Group MCEV at 1 January 2014	3,059	134	108	(923)	2,378
Operating MCEV earnings (after tax)	142	13	14	(7)	162
Non-operating MCEV earnings (after tax)	(126)	(6)	(2)	(46)	(180)
Total MCEV earnings	16	7	12	(53)	(18)
Other comprehensive income	–	–	–	32	32
Capital and dividend flows – internal	(242)	2	(29)	269	–
Capital and dividend flows – external	–	–	–	(64)	(64)
Closing value at 30 June 2014	2,833	143	91	(739)	2,328

1 Relates to the Ignis Asset Management division disposed of on 1 July 2014 (see note 1), classified as discontinued operations. The Asset Management MCEV earnings after tax of £12 million includes intragroup fee income after tax of £30 million.

2 Comprises the Group holding companies that do not form part of the Phoenix Life and Ignis Asset Management divisions.

For the half year ended 30 June 2013

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Management IFRS £m	Other Group companies IFRS £m	Group MCEV £m
Group MCEV at 1 January 2013	3,263	115	86	(1,342)	2,122
Operating MCEV earnings (after tax)	127	14	15	(11)	145
Non-operating MCEV earnings (after tax)	(25)	(4)	(3)	(157)	(189)
Total MCEV earnings	102	10	12	(168)	(44)
Other comprehensive income	–	–	–	(2)	(2)
Capital and dividend flows – internal	(422)	1	–	421	–
Capital and dividend flows – external	–	–	–	171	171
Closing value at 30 June 2013	2,943	126	98	(920)	2,247

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES CONTINUED

GROUP MCEV ANALYSIS OF EARNINGS CONTINUED

For the year ended 31 December 2013

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Management IFRS £m	Other Group companies IFRS £m	Group MCEV £m
Group MCEV at 1 January 2013	3,263	115	86	(1,342)	2,122
Operating MCEV earnings (after tax)	308	25	38	(21)	350
Non-operating MCEV earnings (after tax)	79	(8)	(2)	(257)	(188)
Total MCEV earnings	387	17	36	(278)	162
Other comprehensive income	–	–	–	(16)	(16)
Capital and dividend flows – internal	(591)	2	(14)	603	–
Capital and dividend flows – external	–	–	–	110	110
Closing value at 31 December 2013	3,059	134	108	(923)	2,378

RECONCILIATION OF GROUP IFRS EQUITY TO MCEV NET WORTH

	30 June 2014 £m	30 June 2013 £m	31 December 2013 £m
Group net assets attributable to owners of the parent as reported under IFRS	**2,060**	1,806	1,909
Goodwill and other intangibles in accordance with IFRS removed (net of tax)	**(383)**	(411)	(391)
Value of in-force business in accordance with IFRS removed (net of tax)	**(1,044)**	(1,196)	(1,083)
Adjustments to IFRS reserving	**(111)**	(168)	(144)
Tax adjustments	**27**	25	33
Revalue listed debt to market value	**(51)**	42	5
Fair value adjustments[1]	**(2)**	7	(4)
Eliminate after tax pension scheme surpluses (including IFRIC14 adjustments)[2]	**(258)**	(194)	(210)
Other adjustments	**5**	(4)	6
MCEV net worth attributable to owners of the parent	**243**	(93)	121
MCEV value of in-force business included (net of tax) as set out in note 2	**2,085**	2,340	2,257
Closing Group MCEV	**2,328**	2,247	2,378

1 Investments carried at amortised cost under IFRS are revalued at market value.

2 Pension scheme surpluses valued on an IFRS basis are removed. This includes the adjustments for the irrecoverable amounts of minimum funding requirement obligations as described in note 11 of the IFRS interim financial statements and notes.

1. BASIS OF PREPARATION

OVERVIEW

The supplementary information on pages 66 to 80 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 non-life holding companies at their IFRS net asset value.

The Finance Act 2012 set the rate of corporation tax at 23% from 1 April 2013 and further reductions to 21% from 1 April 2014 and 20% from 1 April 2015 were set by the Finance Act 2013. The impact of these tax rate reductions has been reflected in the Group MCEV.

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 UK life companies.

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES CONTINUED

1. BASIS OF PREPARATION CONTINUED

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.

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 market consistent VIF 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 TVFOGs 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')
Cost of capital 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 Pillar 1 capital or 128% of Pillar 2 capital (30 June 2013: Pillar 1: 147%, Pillar 2: 129%; 31 December 2013: Pillar 1: 145%, Pillar 2: 128%).

Solvency II aims to introduce a new capital regime for insurers. no allowance has been made within the Group's MCEV information for the impact of this developing regime.

Costs of residual non-hedgeable risks ('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 £21 million (30 June 2013: £40 million; 31 December 2013: £25 million).

For other business the cost would be £107 million (30 June 2013: £118 million; 31 December 2013: £105 million). This equates to an equivalent average cost of capital charge of 1.1% (30 June 2013: 1.5%; 31 December 2013: 1.3%). The level of capital assumed in this calculation is determined based on a 99.5% confidence level over a 1-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.

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES 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. The value is calculated based on management's assumptions as to long-term profit margins and projected take-up rates. As at 30 June 2014, the Group MCEV included £133 million in respect of these policies (31 December 2013: £191 million). 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 and policyholder responses 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 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.

h) Events after the reporting period

On 1 July 2014, the Group completed the divestment of Ignis Asset Management to Standard Life Investments (Holdings) Limited ('Standard Life Investments') and gross cash consideration of £390 million was received. £250 million of these proceeds were used to prepay the Impala loan facility. Ignis Asset Management has been classified as a discontinued operation and generated a loss after tax for the period of £18 million (30 June 2013: £21 million, 31 December 2013: £42 million). This loss after tax excludes intragroup fee income after tax of £30 million in the period (30 June 2013: £33 million, 31 December 2013: £78 million).

On 7 July 2014 the Group's new financing subsidiary, PGH Capital Limited, issued a £300 million 7 year senior unsecured bond at an annual coupon rate of 5.75%. The net proceeds from the bond issue of £296 million were used to prepay the Impala loan facility.

On 23 July 2014 PGH Capital Limited entered into a new £900 million 5 year unsecured bank facility which along with a £206 million debt prepayment from internal resources was used to refinance the entirety of the Group's existing two bank facilities and PIK notes, replacing the Pearl and Impala loan facilities with a single debt facility.

The new facility comprises a £450 million revolving credit facility ('RCF') loan and a £450 million amortising term loan. Both loans are repayable by July 2019 with an option to request an extension to the term of the RCF loan by two years to July 2021. Further terms of the facilities agreement include:

- Term facility repayment instalments of £30 million are due semi-annually on 30 June and 31 December each year. Additional target repayments of £30 million may be paid semi-annually on 30 June and 31 December each year from 30 June 2015, non-payment of which would trigger restrictions on the Group regarding the declaration of dividends;
- The term loan bears interest at LIBOR plus an opening margin of 3.50% p.a. and the RCF loan at LIBOR plus an opening margin of 3.25% p.a.. After six months the margins will change in accordance with a margin ratchet which operates by reference to the Group's gearing ratio. Margins will reduce by 0.50% on achievement of an investment grade rating.
- Amongst other fees, a utilisation fee of 0.25% p.a. is payable in respect of the RCF loan for so long as the amount outstanding under the RCF exceeds 50% of the total commitments of the RCF loan.

The value of in-force business as at 30 June 2014 has been reduced by £36 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 following the divestment of Ignis and the refinancing of the Pearl and Impala facilities.

On 31 July 2014 the Group entered into a reinsurance agreement, effective 1 January 2014, to transfer approximately £1.7 billion of annuity in-payment liabilities, currently held within the Group's with-profit funds, to Guardian Assurance Limited ('Guardian'). On 11 August 2014 the Group made an associated transfer of £1.7 billion of assets to Guardian as the related reinsurance premium for the transferred annuity liabilities. The impact of this transaction has been recognised as at 30 June 2014 and has decreased the MCEV by £14 million.

On 20 August 2014, the Board declared an interim dividend per share of 26.7p for the half year ended 30 June 2014. The cost of this dividend has not been recognised as a liability in the interim financial statements for the period to 30 June 2014 and will be charged to the reconciliation of movement in equity when paid.

2. COMPONENTS OF THE MCEV OF COVERED BUSINESS

	Half year ended 30 June 2014 £m	Half year ended 30 June 2013 £m	Year ended 31 December 2013 £m
Net worth	**748**	603	802
PVFP	**2,119**	2,397	2,301
TVFOG	**(27)**	(41)	(39)
COC	**(7)**	(16)	(5)
Total VIF	**2,085**	2,340	2,257
	2,833	2,943	3,059

The net worth of covered business of £748 million at 30 June 2014 (30 June 2013: £603 million; 31 December 2013: £802 million) consists of £379 million of free surplus in excess of required capital (30 June 2013: £406 million; 31 December 2013: £529 million).

3. ANALYSIS OF COVERED BUSINESS MCEV EARNINGS (AFTER TAX)

	Half year ended 30 June 2014		
	Net worth £m	**VIF £m**	**Total Life MCEV £m**
Life MCEV at 1 January 2014	**802**	**2,257**	**3,059**
New business value	**4**	**3**	**7**
Expected existing business contribution (reference rate)[1]	**15**	**44**	**59**
Expected existing business contribution (in excess of reference rate)[2]	**(4)**	**17**	**13**
Transfer from VIF to net worth	**84**	**(84)**	**–**
Experience variances	**29**	**7**	**36**
Assumption changes	**13**	**(30)**	**(17)**
Other operating variances	**53**	**(9)**	**44**
Life MCEV operating earnings	**194**	**(52)**	**142**
Economic variances	**16**	**(38)**	**(22)**
Other non-operating variances	**(37)**	**(67)**	**(104)**
Total Life MCEV earnings	**173**	**(157)**	**16**
Capital and dividend flows	**(227)**	**(15)**	**(242)**
Life MCEV at 30 June 2014	**748**	**2,085**	**2,833**

1 Expected existing business contribution (reference rate) represents the expected return on the opening MCEV at the long-term risk-free rate of 3.55% (30 June 2013: 2.42%).

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.

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES CONTINUED

3. ANALYSIS OF COVERED BUSINESS MCEV EARNINGS (AFTER TAX) CONTINUED

	Half year ended 30 June 2013		
	Net worth £m	VIF £m	Total Life MCEV £m
Life MCEV at 1 January 2013	886	2,377	3,263
New business value	7	3	10
Expected existing business contribution (reference rate)	14	27	41
Expected existing business contribution (in excess of reference rate)	1	20	21
Transfer from VIF to net worth	83	(83)	–
Experience variances	(6)	32	26
Assumption changes	15	5	20
Other operating variances	9	–	9
Life MCEV operating earnings	123	4	127
Economic variances	8	(31)	(23)
Other non-operating variances	(7)	5	(2)
Total Life MCEV earnings	124	(22)	102
Capital and dividend flows	(407)	(15)	(422)
Life MCEV at 30 June 2013	603	2,340	2,943

	Year ended 31 December 2013		
	Net worth £m	VIF £m	Total Life MCEV £m
Life MCEV at 1 January 2013	886	2,377	3,263
New business value	13	5	18
Expected existing business contribution (reference rate)	27	56	83
Expected existing business contribution (in excess of reference rate)	2	40	42
Transfer from VIF to net worth	188	(188)	–
Experience variances	37	42	79
Assumption changes	–	3	3
Other operating variances	9	74	83
Life MCEV operating earnings	276	32	308
Economic variances	60	46	106
Other non-operating variances	144	(171)	(27)
Total Life MCEV earnings	480	(93)	387
Capital and dividend flows	(564)	(27)	(591)
Life MCEV at 31 December 2013	802	2,257	3,059

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 %**
Half year ended 30 June 2014	**83**	**7**	**8%**
Half year ended 30 June 2013	160	10	6%
Year ended 31 December 2013	286	18	6%

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.

Present value of future profits (PVFP)	Years 1–5 £m	6–10 £m	11–15 £m	16–20 £m	20+ £m	Total
30 June 2014	**826**	**531**	**359**	**228**	**175**	**2,119**
30 June 2013	1,086	577	341	213	180	2,397
31 December 2013	997	576	344	212	172	2,301

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:

	30 June 2014		30 June 2013		31 December 2013	
Term	**Gilt yield +10bps**	**Swap yield**	Gilt yield +10bps	Swap yield	Gilt yield +10bps	Swap yield
1 year	**0.74%**	**0.82%**	0.33%	0.59%	0.51%	0.61%
5 years	**2.09%**	**2.21%**	1.50%	1.57%	2.08%	2.16%
10 years	**2.97%**	**2.86%**	2.75%	2.65%	3.32%	3.11%
15 years	**3.40%**	**3.19%**	3.40%	3.17%	3.79%	3.48%
20 years	**3.62%**	**3.34%**	3.71%	3.42%	3.92%	3.60%

Had the Group used the swap rate curve as set out in the CFO Forum principles, the MCEV would have been £118 million lower (30 June 2013: £168 million lower; 31 December 2013: £160 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:

	30 June 2014	30 June 2013	31 December 2013
Additional yield over risk-free rates	**0.35%**	0.51%	0.36%

INFLATION

For purposes of the MCEV calculation, the rate of increase in the UK Retail Price Index ('RPI') as at 30 June 2014 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 (30 June 2013: RPI plus 100 basis points; 31 December 2013: RPI plus 100 basis points).

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES CONTINUED

6. ASSUMPTIONS CONTINUED

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 30 June 2014. 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.

Interest rate volatility	Option term (years)					
	5	**10**	**15**	**20**	**25**	**30**
30 June 2014 Swap term (years)						
5	**23.3%**	**19.3%**	**17.0%**	**16.7%**	**16.3%**	**16.1%**
10	**20.7%**	**18.3%**	**16.7%**	**16.1%**	**15.6%**	**15.3%**
20	**18.2%**	**16.8%**	**15.2%**	**14.2%**	**13.5%**	**12.9%**
30	**17.1%**	**15.8%**	**14.1%**	**12.8%**	**11.8%**	**11.1%**

Interest rate volatility	Option term (years)					
	5	10	15	20	25	30
30 June 2013 Swap term (years)						
5	24.0%	18.6%	17.0%	16.5%	16.8%	16.3%
10	21.3%	17.8%	16.3%	15.9%	15.8%	15.4%
20	19.4%	17.0%	15.4%	14.6%	14.5%	14.0%
30	18.7%	16.4%	14.7%	13.8%	13.4%	12.7%

Interest rate volatility	Option term (years)					
	5	10	15	20	25	30
31 December 2013 Swap term (years)						
5	23.1%	17.3%	16.5%	16.3%	16.2%	15.9%
10	19.9%	16.3%	15.4%	15.1%	14.9%	14.7%
20	18.1%	15.5%	14.2%	13.5%	13.2%	12.7%
30	17.0%	14.9%	13.4%	12.4%	11.8%	11.2%

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.

Equity implied volatility (ATM)	Term (years)					
	5	10	15	20	25	30
30 June 2014	**20.5%**	**20.4%**	**20.8%**	**21.3%**	**21.8%**	**22.3%**
30 June 2013	21.7%	25.0%	25.7%	26.4%	27.2%	28.0%
31 December 2013	18.9%	22.1%	22.4%	22.9%	23.3%	23.7%

Best estimate levels of volatility are assumed for directly held property. The model implied volatility for 30 June 2014 is 15% (2013: 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.

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 our 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:

	Half year ended 30 June 2014	Half year ended 30 June 2013	Year ended 31 December 2013
Equities	**3.0%**	3.0%	3.0%
Property	**2.0%**	2.0%	2.0%
Gilts	**0.0%**	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 30 June 2014 includes Perpetual Reset Capital Securities with a principal outstanding of £425 million (2013: £425 million) and subordinated debt with a face value of £200 million (2013: £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 without adjustment for internal holdings in the Perpetual Reset Capital Securities and the Pearl facility.

	Half year ended 30 June 2014		Half year ended 30 June 2013		Year ended 31 December 2013	
	Face value (including accrued interest) £m	**Market value £m**	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	**430**	**420**	430	344	444	377
Phoenix Life Limited subordinated debt	**204**	**214**	204	187	211	205

Unlisted debt has been included at face value.

	Half year ended 30 June 2014 Face value £m	Half year ended 30 June 2013 Face value £m	Year ended 31 December 2013 Face value £m
Unlisted debt			
Pearl and Impala facilities	**1,528**	1,773	1,612
Royal London PIK notes and facility	**124**	119	121

MCEV INTERIM FINANCIAL STATEMENTS AND NOTES CONTINUED

7. SENSITIVITY TO ASSUMPTIONS

The table below summarises the key sensitivities of the MCEV of covered business at 30 June 2014:

	30 June 2014 Life MCEV £m	31 December 2013 Life MCEV £m
(1) Base	2,833	3,059
(2) 1% decrease in risk-free rates	27	11
(3) 1% increase in risk-free rates	(26)	7
(4) 10% decrease in equity market values	(51)	(41)
(5) 10% increase in equity market values	39	47
(6) 10% decrease in property market values	(39)	(46)
(7) 10% increase in property market values	38	45
(8) 100bps increase in credit spreads[1]	(159)	(143)
(9) 100bps decrease in credit spreads[1]	149	148
(10) 25% increase in equity/property implied volatilities	(11)	(7)
(11) 25% increase in swaption implied volatilities	(8)	6
(12) 25% decrease in lapse rates and paid-up rates	(21)	(25)
(13) 5% decrease in annuitant mortality	(127)	(122)
(14) 5% decrease in non-annuitant mortality	17	28
(15) Required capital equal to the minimum regulatory capital[2]	2	1

1 25bps 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.

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SHAREHOLDER INFORMATION

ANNUAL GENERAL MEETING

Our Annual General Meeting was held on 30 April 2014.

The voting results for our 2014 AGM are available on our website at www.thephoenixgroup.com.

SHAREHOLDER SERVICES

Our registrar, Computershare, maintains the Company's register of members. Shareholders may request a hard copy of this Interim 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:

Computershare Investor Services (Cayman) Limited
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 email address	info@computershare.co.je

SHARE PRICE

You can access the current share price of Phoenix Group Holdings at www.thephoenixgroup.com.

GROUP FINANCIAL CALENDAR FOR 2014

Announcement of unaudited six months' interim results	21 August 2014
Announcement of third quarter interim management statement	23 October 2014

2014 INTERIM DIVIDEND

Ex-dividend date	3 September 2014
Record date	5 September 2014
Interim 2014 dividend payment date	2 October 2014

2014 ANNUAL RESULTS

Our financial results for the year ended 31 December 2014 will be announced on 18 March 2015.

FORWARD-LOOKING STATEMENTS

The Interim Report 2014 contains, and we may make other statements (verbal or otherwise) containing forward-looking statements and other financial and/or statistical data about the Group's current plans, goals and expectations relating to future financial conditions, performance, results, strategy and/or objectives.

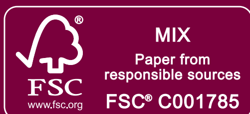
Statements containing the words: 'believes', 'intends', 'will', 'expects', 'plans', 'aims', 'seeks', 'targets', 'continues' and 'anticipates' or other words of similar meaning are forward-looking. Such forward-looking statements and other financial and/or statistical data involve risk and uncertainty 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 ultimate transition to the European Union's 'Solvency II' Directive 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
- 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 and other financial and/or statistical data within the Interim Report 2014.

The Group undertakes no obligation to update any of the forward-looking statements or data contained within the Interim Report 2014 or any other forward-looking statements or data it may make or publish.

The Interim Report 2014 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 Interim Report 2014 is, or should be construed as a profit forecast or estimate.



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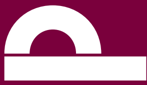
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