

PHOENIX LIFE ASSURANCE LIMITED

Company Registration Number: 1419

STRATEGIC REPORT, DIRECTORS' REPORT AND
FINANCIAL STATEMENTS
for the year ended 31 December 2013

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Strategic report

The Directors present the Strategic Report, their Report and Financial Statements of Phoenix Life Assurance Limited ("the Company") for the year ended 31 December 2013.

The Company is incorporated in the United Kingdom. Its registration number is 1419 and its registered office is 1, Wythall Green Way, Wythall, Birmingham B47 6WG.

The financial statements of the Company for the year ended 31 December 2013 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS') and applied in accordance with the Companies Act 2006.

Business review

Principal activities

The principal activity of the Company is the transaction of life assurance and pension business which is largely in run off.

All business is written in the UK.

Strategy

The strategy of the Phoenix Group, of which the Company is a member, is to manage closed life funds in an efficient and secure manner, protecting and enhancing policyholders' interests whilst maximising value for shareholders.

Corporate activity

On 27 June 2012, the Company entered into a business transfer agreement ("BTA") with Guardian Financial Services Limited ("Guardian"). The transfer was initially effected under a reinsurance agreement effective from 1 July 2012. In accordance with the BTA, 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 transfer in 2013, the Company released net liabilities of £92m and paid £22m consideration to Guardian in connection with the on-going servicing of the transferred policies. Accordingly, the Company recognised a gain on transfer of £70m in the Statement of Comprehensive Income as detailed in note 2.

On 5 March 2013, National Provident Life Limited ("NPLL"), a subsidiary company, repaid £13m of the 9.25% £65m subordinated unsecured loan notes.

On 25 March 2013, NP Life Holdings Limited ("NPLH"), a subsidiary company, repaid a loan of £80m and accrued interest of £5m.

On 31 July 2013, the Company cancelled the reinsurance of some annuity liabilities reinsured from the NPF to Opal Reassurance Limited ("Opal Re"), a fellow group company. In order to effect this the Company received premiums of £18m.

On 2 October 2013 the Company made an interest bearing loan of £20m to Pearl Group Holdings (No. 2) Limited ("PGH2"), the Company's immediate parent.

On 1 November 2013, loans of £211m, £212m and £55m to PGH2, the Company's immediate parent, were replaced by two interest bearing loans of £423m and £55m.

On 13 December 2013, loans of £61m and £24m to PGH2, the Company's immediate parent, were replaced by adding £85m to the interest bearing loan of £423m issued on 1 November 2013.

At 31 December 2013, the outstanding balance on loans to PGH2, the Company's immediate parent, was £586m (2012: £554m). At 31 December 2013, the total outstanding balance on loans from Phoenix Life Holdings Limited ("PLHL") was £250m (2012: £250m).

The Company has reversed an impairment of £40m (2012: reversal of impairment of £37m) in the carrying value of its subsidiary NPLH reflecting the results of the subsidiary for the year ended 31 December 2013.

Business transacted

The Company maintains four long-term funds, together with its shareholder fund ("SHF"). The life funds comprise three with-profits ("WP") funds of which the Pearl WP fund operates on a 90:10 basis and the SERP and LL WP funds operate on a 100:0 basis; and a non-profit fund ("NPF"). In terms of policyholder liabilities, the Pearl WP fund is the largest with gross policyholder liabilities of £6,619m (2012: £6,946m) at the period end.

The Company writes a wide range of life and pensions business, predominantly on individual risks. Business written in the NPF includes unit-linked life and pensions and conventional life and pensions.

The Pearl WP fund and LL WP fund transact conventional and unitised with-profits business, the LL WP fund also transacts some unit-linked business and the SERP fund transacts only conventional with-profits business. The NPF fund transacts term assurance and permanent health insurance ("PHI") business as well as immediate and deferred annuities, together with some unit-linked business.

The Company has reinsured certain blocks of immediate and deferred annuities to a fellow subsidiary, Opal Re.

Reinsurance arrangements are in place with companies not in the Phoenix Group to cover some permanent health, critical illness and term assurance risks and annuities.

Policy administration is outsourced to Pearl Group Services Limited ("PGS"), a fellow group company. PGS has, in turn, outsourced all administration to Diligenta Limited. Under the agreements with PGS, the majority of costs are levied on a per policy basis thereby mitigating the Company's expense risk. Asset management is outsourced to Ignis Investment Services Limited, a fellow Group entity and Henderson Global Investors.

Investment administration and custody services are outsourced to HSBC Bank plc and State Street Bank and Trust Company.

Certain actuarial services are outsourced to Towers Watson Limited.

The gross premium income of the Company for the year was £366m (2012: £(261)m). The negative premiums in 2012 were as a result of the cancellation of certain inward reinsurance agreements with fellow group companies in transactions connected with the reinsurance agreement entered into with Guardian. Further information is disclosed in note 3.

The total value of assets was £17,253m compared with £21,559m a year earlier.

The gross liabilities under insurance and investment contracts at 31 December 2013 were £11,243m (2012: £11,898m).

There are agreements in place for the Company's SHF and NPF to provide financial support to the Company's WP funds. At 31 December 2013, the SHF provided support of £713m (2012: £908m) to the SERP fund, on which an impairment of £621m (2012: £772m) has been recognised. Support was also provided to the LL WP fund of £51m (2012: £144m) from the SHF with an impairment recognised of £nil (2012: £65m) and from the NPF of £102m (2012: £102m) which has been fully impaired.

Principal risks and uncertainties

The Company is exposed to a number of financial risks arising from its underlying assets and liabilities, in particular from movements in financial markets, the change in interest rates, the widening of credit spreads and the risk of corporate defaults and insurance risk.

The principal owners' risk exposures during the year relate to the NPF, SERP and LL WP funds and reflect the wide range of products. Life assurance, PHI and critical illness contracts are affected by mortality and morbidity risks whilst pension business is adversely affected by improving annuitant longevity. Persistency and expense inflation risks apply to most products. The owners are also exposed to the risks of meeting policyholder guarantees in the SERP and LL WP funds. The funds also carry investment risk on holdings of fixed and variable rate income securities backing surplus assets in the fund and from investment performance associated with products carrying fund based charges. A proportion of the business in the NPF is unit-linked with the investment performance risk being carried by policyholders, although owner profit is affected by fund based charges. Risk exposures will reflect the wide range of business managed, with market risks and improving annuitant mortality being the principal risk exposures. De-risking strategies are in place such as investment strategies matching fixed interest securities with liabilities and the purchase of interest rate swaptions to mitigate risks of guaranteed annuity options.

The Company does not have a significant exposure to peripheral Eurozone debt. Management systems are in place to monitor credit exposures across counterparties, geographies and business lines.

The Company mitigates insurance risk through the use of internal risk measurement models, experience analyses, sensitivity analysis and stress testing. Mortality and morbidity risks are, in certain circumstances, mitigated by the use of reinsurance, although this exposes the Company to counterparty risk regarding the failure of the reinsurance party. Where significant, this counterparty is mitigated by the Company holding collateral pledged by the reinsurer.

In addition, the Company faces operational risks. The policy administration arrangements, which as noted above have been outsourced to Diligenta, are considered secure even in extreme stresses, specifically given the letter of credit and guarantee provided by Diligenta's parent undertaking Tata Consultancy Services.

As a result of the various transactions mentioned above, the Company is exposed to counterparty risk with reinsurers, and from the loans to PGH2.

The Pearl WP fund is relatively strong financially and the risks, such as annuitant longevity and meeting policyholder guarantees, are unlikely to have a material adverse impact on the owners. The SERP fund and LL WP fund are relatively weak and, as a result, the owner is exposed to insurance risk and to market and credit risk associated with its investments because the margin between the value of assets and the realistic value of policyholder liabilities is small. Further de-risking strategies are in place such as investment strategies matching fixed and variable rate income securities with liabilities, to mitigate risks associated with guarantees, the purchase of interest rate swaptions to mitigate risks of guaranteed annuity options, and selective reinsurance arrangements to mitigate mortality, morbidity and longevity risk.

Further information on financial risks is provided in the notes to the financial statements.

Key Performance Indicators ("KPIs")

The Company's performance is measured and monitored by the Board with particular regard paid to the following KPIs:

Customers

The Directors review various metrics in respect of Treating Customers Fairly ("TCF"), customer communication and complaints on a monthly basis. TCF is monitored through various TCF committees. All agreed service standards for the Company were met during the year.

There is also a With-Profits Committee comprising independent and executive members to opine on issues of fairness to policyholders including ensuring policyholder monies are managed in accordance with the Company's Principles and Practices of Financial Management ("PPFM").

Capital resources

The aim of the Company is to maintain an appropriate margin of regulatory capital over capital resource requirements, both on a Pillar 1 and a Pillar 2 basis. As at 31 December 2013, the Company's free assets on a Pillar 1 basis were £595m (2012: £606m).

Profits after taxation and distributable reserves

For the year ended 31 December 2013 the Company reported a profit after taxation of £123m (2012: profit £189m). As at 31 December 2013, the Company had distributable reserves amounting to £369m (2012: £335m).

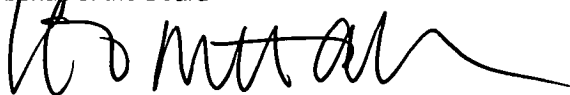
Cash flows

Policyholder and shareholder fund cash flows are monitored closely by the business to ensure that all liabilities can be met as they fall due.

Investment performance

The performance of the Company's invested assets is reviewed against pre-defined benchmarks by the Board, the Investment Management Committee and the Asset-Liability Management Committee ("ALCO").

On behalf of the Board



L Nuttall

For and on behalf of Pearl Group Secretariat Services Limited
Company Secretary

18 March 2014

Directors' report

Results and dividends

The results of the Company for the year are shown in the statement of comprehensive income on page 17. The profit before owners' tax was £147m (2012: profit £181m).

Dividends totalling £231m were paid during the year (2012: £150m).

Corporate governance

The Company, as part of a group wide framework, has established a governance framework for monitoring and overseeing strategy, conduct of business standards and operations of the business that includes:

- a clearly stated corporate organisational structure, matters reserved for the Board and written terms of reference for its committees, with appropriate delegated authorities;
- a Board Audit Committee, the members of which are non-executive Directors, which oversees internal control and financial reporting matters;
- a risk management function providing a second line of defence, independent of operations and with responsibility for monitoring and reporting of risk; and
- an internal audit function which provides independent, objective assurance over the complete control framework reporting to the Chairman of the Board Audit Committee and with direct access to all executive members, in particular the Chief Executive Officer.

The Board currently has 5 non-executive members and 4 executive members.

Future developments

The Company's long-term business is in gradual run-off. The Company will continue to explore future business opportunities which help to secure future benefits for both policyholders and owners.

Going concern

The Strategic Report and Directors' Report summarise the Company's activities, its financial performance and financial position together with any factors likely to affect its future development. In addition, it discusses the principal risks and uncertainties it faces. Notes 35 and 36 to the financial statements summarise the Company's capital and risk management objectives and policies together with its financial risks.

The Board has followed the United Kingdom Financial Reporting Council's "*Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009*" when performing their going concern assessment. As part of its comprehensive assessment of whether the Company is a going concern, the Board has undertaken a review of the valuation and liquidity of its investments as at the period end. The Board has also reviewed solvency and cash flow projections under normal and stressed conditions.

As a result of this review, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Directors

The names of those individuals who served as Directors of the Company during the year or who held office as at the date of signature of this report are as follows:

A B Davidson	
J P Evans	(Chairman)
M J Merrick	
A Moss	
J C Park	Resigned on 19 June 2013
D L Richardson	Resigned 31 January 2013
A W Snow	Appointed on 8 August 2013
M D Ross	
W R Treen	
S C True	Appointed on 2 September 2013
M N Urmston	

Secretary

Pearl Group Secretariat Services Limited acted as Secretary throughout the year.

Disclosure of indemnity

Qualifying third party indemnity arrangements (as defined in sections 234 of the Companies Act 2006) were in force for the benefit of the Directors of the Company during the year and remain in place at the date of approval of this report.

Disclosure of information to auditor

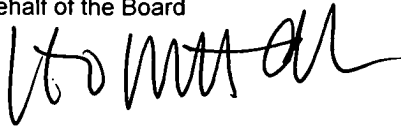
So far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditor are unaware, and each of the Directors has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information (as defined) and to establish that the Company's auditor are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418(2) of the Companies Act 2006.

Re-appointment of auditor

In accordance with section 487 of the Companies Act 2006, the Company's auditor, Ernst & Young LLP, will be deemed to have been re-appointed at the end of the period of 28 days following circulation of copies of these financial statements as no notice has been received from members pursuant to section 488 of the Companies Act 2006 prior to the end of the accounting reference period to which these financial statements relate.

On behalf of the Board



L Nuttall

For and on behalf of Pearl Group Secretariat Services Limited
Company Secretary

18 March 2014

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the Company financial statements ("the financial statements") in accordance with applicable United Kingdom law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under the law the Directors have elected to prepare those statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they present fairly the financial performance, financial position and cash flows of the Company for the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the Directors to:

- select suitable accounting policies in accordance with IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance;
- state that the Company has complied with applicable IFRSs, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report to the members of Phoenix Life Assurance Limited

We have audited the financial statements of Phoenix Life Assurance Limited for the year ended 31 December 2013 which comprise the accounting policies, the statement of comprehensive income, the statement of financial position, the statement of cash flows, the statement of changes in equity and the related notes 1 to 41. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRS") as adopted by the European Union.

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

Respective responsibilities of Directors and auditor

As explained more fully in the Statement of Directors' responsibilities set out on page 7, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Strategic report, Directors' report and financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

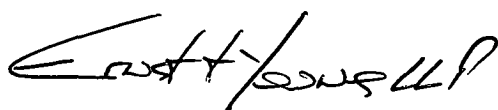
Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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



Benjamin Gregory (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

20 March 2014

Accounting policies

(a) Basis of preparation

The financial statements have been prepared on a historical cost basis except for investment property and those financial assets and financial liabilities that have been measured at fair value.

The financial statements are separate financial statements and the exemption in section 401 of the Companies Act 2006 has been used not to present consolidated financial statements.

Statement of compliance

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") as they apply to the financial statements of the Company for the year ended 31 December 2013, and applied in accordance with the Companies Act 2006.

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

The Company presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement more than twelve months after the period end is presented in the notes.

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

(b) Critical accounting estimates and judgements

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

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Company's business that typically require such estimates are insurance and investment contract liabilities, determination of the fair value of financial assets and liabilities, impairment tests for investments in subsidiaries and income taxes.

Insurance and investment contract liabilities

Insurance and investment contract liability accounting is discussed in more detail in accounting policies (e) and (f) with further detail of the key assumptions made in determining insurance contract liabilities included in note 36.

Fair value of financial assets and liabilities

The fair values of financial assets and liabilities are classified and accounted for as set out in accounting policies (o) and (g) respectively. Where possible, financial assets and liabilities are valued on the basis of listed market prices by reference to quoted market bid prices for assets and offer prices for liabilities, without any deduction for transaction costs. These are categorised as Level 1 financial instruments and do not involve estimates. If prices are not readily determinable, fair value is determined using valuation techniques including pricing models, discounted cash flow techniques or broker quotes. Financial instruments valued where valuation techniques are based on observable market data at the period end are categorised as Level 2 financial instruments. Financial instruments valued where valuation techniques are based on non-observable inputs are categorised as Level 3 financial instruments. Level 2 and Level 3 financial instruments therefore involve the use of estimates and note 31 provides further disclosures on fair value hierarchy and assumptions used to determine fair values.

Impairment of investment in subsidiaries

Investments in subsidiaries are subject to impairment reviews as detailed in accounting policy (n). Impairments are measured at the difference between the carrying value of a particular asset and its recoverable amount. The recoverable amount is the higher of value in use or fair value less costs of disposal of the subsidiary estimated using applicable valuation techniques. The policy is discussed in more detail in accounting policy (n).

Income taxes

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The UK taxation regime applies separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets.

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

(c) Foreign currency transactions

Assets and liabilities denominated in foreign currencies are translated into sterling at the closing rate at the period end. Income and expenses denominated in foreign currencies are translated at the prevailing rate at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised within fair value gains and losses as income or an expense in the statement of comprehensive income.

(d) Classification of contracts

Contracts under which the Company accepts significant insurance risk are classified as insurance contracts.

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

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

(e) Insurance contracts and investment contracts with DPF

Under current IFRS requirements, insurance contracts and investment contracts with DPF are measured using accounting policies consistent with those previously adopted under United Kingdom Generally Accepted Accounting Principles ("UK GAAP"). Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Insurance liabilities

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

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

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

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

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

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

The with-profits bonus reserve for an individual contract is determined by either a retrospective calculation of 'accumulated asset share' approach or by way of a prospective 'bonus reserve valuation' method.

The cost of future policy related liabilities is determined using a market consistent approach, mainly based on a stochastic model calibrated to market conditions at the end of the reporting period. Non market related assumptions (for example, persistency, mortality and expenses) are based on experience adjusted to take into account of future trends.

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

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

The principal assumptions are given in note 36.

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

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

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

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

The principal assumptions used to calculate the PVFP are the same as those used in calculating the insurance contract liabilities given in note 36.

Embedded derivatives

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

Liability adequacy

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

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

Unallocated surplus

The unallocated surplus comprises the excess of the assets over the policyholder liabilities of the with-profits business. For the Company's with-profits funds, the amount included in the statement of financial position line item 'Unallocated surplus' represents amounts which have yet to be allocated to owners since the unallocated surplus attributable to policyholders has been included within liabilities under insurance contracts. The with-profits funds are closed to new business and as permitted by IFRS 4, the whole of the unallocated surplus has been classified as a liability (either within insurance contract liabilities or unallocated surplus).

If the realistic value of liabilities to policyholders exceeds the value of the assets in the with-profits fund ("WPF"), the unallocated surplus is valued at £nil and the amount of deficit reduces the fair value of the liability of the WPF to repay the capital support from the NPF or SHF as detailed in note 35.

(f) Investment contracts without DPF

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

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

Investment income attributable to, and the movements in the fair value of, investment contracts without DPF are included in the 'Change in investment contract liabilities' as income or an expense in the statement of comprehensive income.

(g) Financial liabilities

On initial recognition, financial liabilities are recognised when due and measured at the fair value of the consideration received less directly attributable transaction costs (with the exception of liabilities at fair value through profit or loss for which all transaction costs are expensed). Subsequent to initial recognition, financial liabilities (except for liabilities designated at fair value through profit or loss) are measured at amortised cost using the effective interest method.

Financial liabilities are designated upon initial recognition at fair value through profit or loss when doing so results in more meaningful information because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the Company's key management personnel.

(h) Borrowings

Interest-bearing borrowings are recognised initially at fair value less any attributable transaction costs. The difference between initial costs and the redemption value is amortised as income or expense in the statement of comprehensive income over the period of the borrowing using the effective interest method.

(i) Deposits from reinsurers

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

Deposits received from reinsurers are measured at fair value through profit and loss as designated upon initial recognition.

(j) Obligations for repayment of collateral received

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

(k) Income tax

Income tax comprises current and deferred tax. Income tax is recognised as income or an expense in the statement of comprehensive income except to the extent that it relates to items recognised as other comprehensive income, in which case it is recognised as other comprehensive income in that statement.

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

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

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

The tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on owners' returns. This allocation is calculated based on an assessment of the effective rate of tax that is applicable to owners for the year. Deferred tax assets and liabilities taxed at policyholder rates are not offset against deferred tax assets or liabilities taxed at shareholder rates due to restrictions in place in life tax legislation.

(l) Investment property

Investment property is stated at fair value. Fair value is the price that would be received to sell a property in an orderly transaction between market participants at the measurement date. Gains and losses arising from the change in fair value are recognised as income or an expense in the statement of comprehensive income.

(m) Investments in associates and joint ventures

Investments in associates and joint ventures that are held for investment purposes are accounted for under IAS 39 *Financial Instruments: Recognition and Measurement* as permitted by IAS 28 *Investments in Associates and Joint Ventures*. These are measured at fair value through profit or loss. There are no investments in associates and joint ventures which are of a strategic nature.

(n) Investment in subsidiaries

Investments in shares in subsidiaries held for strategic purposes are carried in the statement of financial position at cost less impairment. Investments in shares in subsidiaries held for investment purposes are carried at fair value.

At each reporting date, the Company assesses whether there are any indications of impairment or reversal of impairment. When such indications exist, an impairment test is carried out by comparing the carrying value of the investment against the estimate of the recoverable amount, which represents the higher of value in use or fair value less costs of disposal. For investments in life insurance companies, the value in use will be calculated with reference to the underlying embedded value and for other entities, IFRS net asset value. Impairments and reversal of impairments are recognised as income or an expense in the statement of comprehensive income in the period in which they occur.

(o) Financial assets

Purchases and sales of financial assets are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset.

Loans and deposits are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These investments are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investment. All transaction costs directly attributable to the acquisition are also included in the cost of the investment. Subsequent to initial recognition, these investments are carried at amortised cost, using the effective interest method.

Derivative financial instruments are classified as held for trading. They are recognised initially at fair value and subsequently are re-measured to fair value. Exchange-traded derivatives are valued at the published bid price, or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. The gain or loss on re-measurement to fair value is recognised as income or an expense in the statement of comprehensive income.

Equities, fixed and variable rate income securities and collective investment schemes are designated at fair value through profit or loss and accordingly are stated in the statement of financial position at fair value. They are designated at fair value through profit or loss because they are managed and evaluated on a fair value basis in accordance with the Company's stated risk management policies.

Impairment of financial assets

The Company assesses at each period end whether a financial asset or group of financial assets held at amortised cost is impaired. The Company first assesses whether objective evidence of impairment exists for financial assets. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in the collective assessment of impairment.

Fair value estimation

The fair value of financial instruments traded in active markets such as publicly traded securities and derivatives are based on quoted market prices at the period end. The quoted market price used for financial assets is the current bid price on the trade date. The fair value of investments that are not traded in an active market is determined using valuation techniques such as broker quotes, pricing models or discounted cash flow techniques. Where pricing models are used, inputs are based on market related data at the period end. Where discounted cash flow techniques are used, estimated future cash flows are based on contractual cash flows using current market conditions and market calibrated discount rates and interest rate assumptions for similar instruments.

For units in unit trusts and shares in open-ended investment companies, fair value is determined by reference to published bid-values. The fair value of receivables and floating rate and overnight deposits with credit institutions is their carrying value. The fair value of fixed interest-bearing deposits is estimated using discounted cash flow techniques.

Stock lending

Financial assets that are lent under the Company's stock lending programme do not qualify for derecognition from the statement of financial position as the Company retains substantially all the risks and rewards of the transferred assets.

Collateral

The Company receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, derivative contracts and reinsurance arrangements in order to reduce the credit risk of these transactions. The amount and type of collateral required where the Company receives collateral depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, where the Company has contractual rights to receive the cash flows generated, is recognised as an asset in the statement of financial position with a corresponding liability for its repayment. Non-cash collateral received is not recognised in the statement of financial position, unless the counterparty defaults on its obligations under the relevant agreement.

Cash and non-cash collateral pledged where the Company retains the contractual rights to receive the cash flows generated is not derecognised from the statement of financial position, unless the Company defaults on its obligations under the relevant agreement. Cash and non-cash collateral pledged, where the counterparty has contractual rights to receive the cash flows generated, is derecognised from the statement of financial position and a corresponding receivable is recognised for its return.

(p) Reinsurance

The Company cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Reinsurers' share of insurance contract liabilities are dependent on expected claims and benefits arising under the related reinsured policies.

Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Company may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer. The impairment charge is recorded as an expense in the statement of comprehensive income. The reinsurers' share of investment contract liabilities is measured on a basis that is consistent with the valuation of the liability to policyholders to which the reinsurance applies.

Gains or losses on purchasing reinsurance are recognised as income or an expense in the statement of comprehensive income at the date of purchase and are not amortised. They are the difference between the premiums ceded to reinsurers and the related change in the reinsurers' share of insurance contract liabilities.

(q) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and short-term deposits with an original maturity term of three months or less at the date of placement. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are deducted from cash and cash equivalents for the purpose of the statement of cash flows.

(r) Leases

Where a significant element of the risks and rewards of title to the asset is retained by the lessor, such leases are classified as operating leases. The assets held for use in such leases are included in investment property. Rental income from such leases is recognised as income in the statement of comprehensive income on a straight line basis over the period of the lease.

(s) Provisions and contingent liabilities

A provision is recognised when the Company has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where the Company has a present legal or constructive obligation but it is not probable that there will be an outflow of resources to settle the obligation or the amount cannot be reliably estimated, this is disclosed as a contingent liability.

A provision is recognised for onerous contracts in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs reflect the least net cost of exiting the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

(t) Dividends

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Company's owners. Interim dividends are deducted from equity when they are paid.

Dividends for the year that are approved after the reporting period are dealt with as an event after the reporting period.

(u) Income recognition

Gross premiums

In respect of insurance contracts and investment contracts with DPF, premiums are accounted for on a receivable basis and exclude any taxes or duties based on premiums. Funds at retirement under individual pension contracts converted to annuities with the Company are, for accounting purposes, included in both claims incurred and premiums within gross premiums written.

Gross premiums include amounts payable as refunds of premiums in cases where the Company cancels arrangements for the reinsurance of risk from another insurer.

Reinsurance premiums

Outward reinsurance premiums are accounted for on a payable basis.

Reinsurance premiums include amounts receivable as refunds of premiums in cases where the Company cancels arrangements for the reinsurance of risk to another insurer.

Fee and commission income

Fee and commission income relates to the following:

- investment contract income – investment contract policyholders are charged for policy administration services, investment management services, surrenders and other contract fees. These fees are recognised as revenue over the period in which the related services are performed. If the fees are for services provided in future periods, then they are deferred and recognised over those periods. 'Front end' fees are charged on some non-participating investment contracts. Where the non-participating investment contract is measured at fair value, such fees which relate to the provision of investment management services are deferred and recognised as the services are provided; and
- other fees, which are recognised as the services are provided.

Net investment income

Net investment income comprises interest, dividends, rents receivable, fair value gains and losses on financial assets and investment property and impairment reversals and losses on loans and deposits and investments in subsidiaries.

Interest income is recognised as income in the statement of comprehensive income as it accrues using the effective interest method. Dividend income is recognised as income in the statement of comprehensive income on the date the right to receive payments is established, which in the case of listed securities is the ex-dividend date.

Rental income from investment property is recognised as income in the statement of comprehensive income on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

Fair value gains and losses on financial assets designated at fair value through profit or loss are recognised as income or an expense in the statement of comprehensive income. Realised gains and losses are the difference between the net sale proceeds and the original cost. Unrealised gains and losses are the difference between the valuation at the period end and their valuation at the previous period end or purchase price, if acquired during the year.

Other operating income

Other operating income comprises the general business result and other non-investment income which is recognised on an accruals basis.

(v) Benefits, claims and expenses recognition

Gross benefits and claims

Claims on insurance contracts and investment contracts with DPF reflect the cost of all claims arising during the period, including policyholder bonuses allocated in anticipation of a bonus declaration. Claims payable on maturity are recognised when the claim becomes due for payment and claims payable on death are recognised on notification. Surrenders are accounted for at the earlier of the payment date or when the policy ceases to be included within insurance contract liabilities. Where claims are payable and the contract remains in force, the claim instalment is accounted for when due for payment. Claims payable include the costs of settlement.

Reinsurance claims

Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

Finance costs

Interest payable is recognised as an expense in the statement of comprehensive income as it accrues and is calculated by using the effective interest method.

(w) Transfers of business

Where the Company participates in a transfer of insurance business scheme under Part VII of the Financial Services and Markets Act 2000 and the ultimate shareholders remain the same, the transaction constitutes business combinations involving entities or businesses under common control. IFRS does not prescribe the treatment of such transfers. Accordingly, on initial recognition, the transferred assets and liabilities are measured at the carrying value in the transferring company and the resulting gain or loss is recognised as income or an expense in the statement of comprehensive income.

(x) Share capital and capital contributions

Ordinary share capital

The Company has issued "A" and "B" ordinary shares which are classified as equity. Details of the relating entitlements are disclosed within note 13.

Capital contributions

Capital contributions received by the Company and which contain no agreement for their repayment are recognised directly in the statement of changes in equity as a distributable reserve.

(y) Events after the reporting period

The financial statements are adjusted to reflect significant events that have a material effect on the financial results and that have occurred between the period end and the date when the financial statements are authorised for issue, provided they give evidence of conditions that existed at the period end. Events that are indicative of conditions that arise after the period end that do not result in an adjustment to the financial statements are disclosed.

(z) Non-current assets and liabilities held for sale

Non-current assets are classified separately as held for sale in the balance sheet when their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is met only when the sale is highly probable, the asset is available for immediate sale in its present condition, and management is committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Liabilities directly associated with the assets classified as held for sale and expected to be included as part of the sale transaction are correspondingly also classified separately. Property, plant and equipment and intangible assets once classified as held for sale are not subject to depreciation or amortisation. The net assets and liabilities of a disposal group classified as held for sale are measured at the lower of their carrying amount and fair value less cost to sell.

PHOENIX LIFE ASSURANCE LIMITED

Statement of comprehensive income
for the year ended 31 December 2013

	Notes	2013 £m	2012 £m
Gross premiums written	3	366	(261)
Less: premiums ceded to reinsurers	4	21	(91)
Net premiums written		387	(352)
Fees and commissions	5	3	3
Net investment income	6	298	886
Total revenue, net of reinsurance payable		688	537
Gains on transfer of business	2	74	146
Net income		762	683
Policyholder claims		(1,067)	(1,129)
Less: reinsurance recoveries		190	204
Change in insurance contract liabilities		769	816
Change in reinsurers' share of insurance contract liabilities		(324)	(156)
Transfer to unallocated surplus	17	(26)	(17)
Net policyholder claims and benefits incurred		(458)	(282)
Change in investment contract liabilities		(50)	(20)
Change in reinsurers' share of investment contract liabilities		1	-
Acquisition costs		-	(1)
Amortisation of acquired in-force business		-	(8)
Administrative expenses	7	(71)	(105)
Other operating expenses	10	(31)	(56)
Total operating expenses		(609)	(472)
Profit before finance costs and tax		153	211
Finance costs	11	(8)	(15)
Profit for the year before tax		145	196
Tax attributable to policyholders' returns	12	2	(15)
Profit before tax attributable to owners		147	181
Tax charge	12	(22)	(7)
Less: tax attributable to policyholders' returns		(2)	15
Tax attributable to owners		(24)	8
Profit for the year attributable to owners		123	189
Other comprehensive income		-	-
Total comprehensive income for the year attributable to owners		123	189

PHOENIX LIFE ASSURANCE LIMITED

Statement of financial position – equity and liabilities
as at 31 December 2013

	Notes	As at 31 December 2013 £m	As at 31 December 2012 £m
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	13	342	342
Share premium		41	41
Capital contribution reserve	14	197	197
Retained earnings		478	586
Total equity		1,058	1,166
Liabilities			
Insurance contract liabilities			
Liabilities under insurance contracts	16	10,893	11,574
Unallocated surplus	17	330	304
		11,223	11,878
Financial liabilities			
Investment contracts	31	350	324
Borrowings	18	250	250
Deposits received from reinsurers	19	1,776	1,936
Derivatives	20	606	999
Obligations for repayment of collateral received	21	1,821	3,526
	31	4,803	7,035
Provisions	22	4	14
Deferred tax	23	24	-
Payables related to direct insurance contracts	24	73	80
Current tax	23	3	19
Accruals and deferred income	25	3	12
Other payables	26	62	90
Liabilities classified as held for sale	27	-	1,265
Total liabilities		16,195	20,393
Total equity and liabilities		17,253	21,559

PHOENIX LIFE ASSURANCE LIMITED

Statement of financial position – assets
as at 31 December 2013

	Notes	As at 31 December 2013 £m	As at 31 December 2012 £m
ASSETS			
Investment in subsidiaries	28	294	253
Investment property	29	10	31
Financial assets			
Loans and deposits	30	732	798
Derivatives	20	547	1,283
Equities		556	700
Fixed and variable rate income securities		6,735	8,955
Collective investment schemes		6,261	5,982
Reinsurers' share of investment contract liabilities		12	12
	31	14,843	17,730
Deferred tax assets	23	-	7
Insurance assets			
Reinsurers' share of insurance contract liabilities	16	1,592	1,841
Reinsurance receivables		1	1
Insurance contract receivables		2	1
		1,595	1,843
Prepayments and accrued income		85	99
Other receivables	32	368	39
Cash and cash equivalents	33	58	397
Assets classified as held for sale	27	-	1,160
Total assets		17,253	21,559

On behalf of the Board



A Moss
Director

18 March 2014

PHOENIX LIFE ASSURANCE LIMITED

Statement of cash flows
for the year ended 31 December 2013

	Notes	As at 31 December 2013 £m	As at 31 December 2012 £m
Cash flows from operating activities			
Cash (absorbed)/generated by operations	34	(168)	189
Taxation paid		(2)	(32)
Net cash flows from operating activities		<u>(170)</u>	<u>157</u>
Cash flows from investing activities			
Part VII transfers – London Life scheme	2	-	16
Part VII transfers – GI scheme	2	-	(1)
Part VII transfers – Guardian scheme	2	(22)	-
Interest received from Group entities		13	13
Capital contribution paid to subsidiary	28	-	(100)
Loan repayments by subsidiaries	30	98	-
Loan issued to parent company	30	(20)	-
Net cash flows from investing activities		<u>69</u>	<u>(72)</u>
Cash flows from financing activities			
Ordinary share dividends paid	15	(231)	(150)
Proceeds of capital contribution	14	-	216
Return of capital contribution	14	-	(100)
Interest paid on subordinated liabilities		(7)	(1)
Net cash flows from financing activities		<u>(238)</u>	<u>(35)</u>
Net (decrease)/increase in cash and cash equivalents		(339)	50
Cash and cash equivalents at the beginning of the year		397	347
Cash and cash equivalents at the end of the year	33	<u>58</u>	<u>397</u>
Supplementary disclosures on cash flows from operating activities			
Interest received		315	653
Dividends received		115	48

PHOENIX LIFE ASSURANCE LIMITED

Statement of changes in equity
for the year ended 31 December 2013

	Share capital (note 13)	Share premium	Capital contribution reserve (note 14)	Retained earnings	Total
	£m	£m	£m	£m	£m
At 1 January 2013	342	41	197	586	1,166
Profit for the year	-	-	-	123	123
Other comprehensive income for the year	-	-	-	-	-
Total comprehensive income for the year	-	-	-	123	123
Dividends paid on ordinary shares (note 15)	-	-	-	(231)	(231)
At 31 December 2013	342	41	197	478	1,058

Of the above, £369m (2012: £335m) is considered distributable.

	Share capital (note 13)	Share premium	Capital contribution reserve (note 14)	Retained earnings	Total
	£m	£m	£m	£m	£m
At 1 January 2012	342	41	81	547	1,011
Profit for the year	-	-	-	189	189
Other comprehensive income for the year	-	-	-	-	-
Total comprehensive income for the year	-	-	-	189	189
Capital contribution received	-	-	216	-	216
Return of capital contribution	-	-	(100)	-	(100)
Dividends paid on ordinary shares (note 15)	-	-	-	(150)	(150)
At 31 December 2012	342	41	197	586	1,166

Notes to the financial statements

1. Financial information

The financial statements for the year ended 31 December 2013, set out on pages 9 to 58, were authorised by the Board of Directors for issue on 18 March 2014.

In preparing the financial statements the Company has adopted the following standards, interpretations and amendments which have been issued by the International Accounting Standards Board ("IASB") and have been adopted for use by the EU. None of these have a material effect on the results of the Company.

- IFRS 13 *Fair Value Measurement* (2013) defines fair value and sets out in a single IFRS a framework for measuring fair value. As a result of adopting this standard for financial instruments that are recognised at fair value on a recurring basis, the Company will now determine 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.
- Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7 *Financial Instruments: Disclosures*) (2013). The amendment requires an entity to disclose information about rights to set-off financial instruments and related arrangement. The new disclosure requirements are intended to help users of financial statements better assess the effect or potential effect of offsetting arrangements on an entity's financial position.
- Annual improvements to IFRS 2009-2011 cycle (2013). This makes a number of minor improvements to existing standards and interpretations.

The IASB has issued the following standards, interpretations and amendments which, subject to adoption for use by the EU, apply from the dates shown. The Company has decided not to early adopt any of these standards, interpretations or amendments where this is permitted. The impact on the Company of adopting them is subject to evaluation:

- IFRS 9 *Financial Instruments*. This is the first two parts of a replacement standard for IAS 39 *Financial Instruments: Recognition and Measurement* and deals with the classification and measurement of financial assets and financial liabilities, including some hybrid contracts, and general hedge accounting. The mandatory effective date of 2015 has been removed and will be revisited upon completion of all phases of IFRS 9.
- IFRS 12 *Disclosure of Interests in Other Entities* (2013) combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities.
- IAS 27 *Separate Financial Statements* (Revised). IAS 27 now only deals with the requirements for separate financial statements, which have been carried over largely unamended from IAS 27 *Consolidated and Separate Financial Statements*. Requirements for consolidated financial statements are now contained in IFRS 10 *Consolidated Financial Statements*.
- Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32) (2014). The amendments address inconsistencies in current practice when applying the offsetting criteria in IAS 32.
- Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12) (2013).
- Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36 *Impairment of Assets*) (2014). Modifications to the disclosures required by IAS 36 have been made as a result of the requirements of IFRS 13.
- Annual improvements to IFRS 2010-2012 cycle (2014). This makes a number of minor improvements to existing standards and interpretations.
- Annual improvements to IFRS 2011-2013 cycle (2014).

In addition, the following standards, interpretations and amendments have been issued but are not currently relevant to the Company:

- IFRS 10 *Consolidated Financial Statements* (2013) provides a single consolidation model that identifies control as the basis for consolidation for all types of entities.
- IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* (2013).
- IFRS 11 *Joint Arrangements* (2013) establishes principles for financial reporting by parties to a joint arrangement.
- IAS 19 *Employee Benefits* (Amendment) (2013). The IASB has issued numerous amendments to IAS 19. These range from fundamental changes like removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording.

- IAS 28 *Investments in Associates and Joint Ventures* (Revised). This standard supersedes IAS 28 *Investments in Associates* and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.
- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1) (2013). The amendment requires companies to group together items within other comprehensive income that may be reclassified to the profit or loss section of the income statement.
- Investment Entities (Amendment to IFRS 10) (2013).
- Government Loans (Amendments to IFRS 1 *First time Adoption of International Financial Reporting Standards*) (2013).
- Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39 *Financial Instruments: Recognition and Measurement*) (2014). These amendments include an exception to the requirement for the discontinuation of hedge accounting in IAS 39.
- IFRIC 21 *Leases* (2014).

2. Transfers of business

On 31 March 2012, the general insurance business of the Company transferred to BA(GI) Limited for £nil consideration in accordance with a scheme under Part VII of the Financial Services and Markets Act 2000 ("The GI Scheme") approved by the High Court on 22 March 2012.

On 27 June 2012, the Company entered into a BTA with Guardian. The transfer was originally effected under a reinsurance agreement effective from 1 July 2012. In accordance with the BTA, 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.

On 24 September 2012 and with effect from 1 July 2012, all of the long term business and the majority of the shareholders' funds of London Life Limited ("LLL") were transferred to the Company for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 ("The LL Scheme") approved by the High Court on 24 September 2012.

On 24 October 2013, following the deauthorisation of LLL to carry out long term business, the remaining shareholders' funds of LLL were transferred to the Company for £nil consideration.

The carrying value of liabilities and assets transferred are set out below:

	2013 LLL Scheme £m	2013 Guardian Scheme £m	2013 Total £m
Liabilities			
Liabilities under insurance contracts	-	1,177	1,177
Assets			
Financial assets			
Collective investment schemes	4	-	4
Reinsurers share of insurance contract liabilities	-	(1,085)	(1,085)
Net assets transferred in	4	-	4
Net liabilities transferred out	-	92	92
Consideration	-	(22)	(22)
Gain on transfer of business	4	70	74

The liabilities under insurance contracts and reinsurers share of insurance contract liabilities were presented as liabilities and assets classified as held for sale at 31 December 2012.

The carrying value of assets and liabilities transferred by the GI and LLL schemes and the (loss)/gain arising in 2012 are set out below:

PHOENIX LIFE ASSURANCE LIMITED

	2012 GI Scheme £m	2012 LLL Scheme £m	2012 Total £m
Liabilities			
Insurance contract liabilities			
Liabilities under insurance contracts	-	1,432	1,432
Investment contracts with DPF	-	115	115
General insurance contract liabilities	(46)	-	(46)
Financial liabilities			
Investment contracts	-	316	316
Unallocated surplus	-	6	6
Derivatives	-	196	196
Obligations for repayment of capital received	-	315	315
Deposits received from reinsurers	-	586	586
Payables related to direct insurance contracts	-	8	8
Deferred tax liabilities	-	2	2
Current tax	-	35	35
Accruals and deferred income	-	3	3
Other payables	-	12	12
	<u>(46)</u>	<u>3,026</u>	<u>2,980</u>
	2012 GI Scheme £m	2012 LLL Scheme £m	2012 Total £m
Assets			
Intangible assets			
Acquired in-force business	-	8	8
Financial assets			
Loans and deposits	-	63	63
Derivatives	-	264	264
Equities	-	12	12
Fixed and variable rate income securities	(53)	1,449	1,396
Collective investment schemes	-	710	710
Reinsurers' share of investment contract liabilities	-	12	12
Deferred tax assets	-	6	6
Insurance assets			
Reinsurers' share of insurance contract liabilities	(8)	629	621
Insurance contract receivables	-	1	1
Tax recoverable	-	2	2
Prepayments and accrued income	-	14	14
Other receivables	(1)	3	2
Cash and cash equivalents	(1)	16	15
	<u>(63)</u>	<u>3,189</u>	<u>3,126</u>
Net assets transferred	<u>(17)</u>	<u>163</u>	<u>146</u>
Consideration	-	-	-
(Loss)/Gain on transfer of business	<u>(17)</u>	<u>163</u>	<u>146</u>

3. Gross premiums written

Gross premiums written comprise:

	2013 £m	2012 £m
Gross premiums written under on-going arrangements	366	424
Reinsurance cancellation premium paid to National Provident Life Limited	-	(596)
Reinsurance cancellation premium paid to Phoenix Life Limited	-	(89)
	<u>366</u>	<u>(261)</u>

Until 30 June 2012, the Company reinsured certain annuity in-payment liabilities from fellow group companies, National Provident Life Limited ("NPLL") and Phoenix Life Limited ("PLL"). Certain blocks of these reinsurance agreements were cancelled on 1 July 2012, as a result of which the Company paid premiums of £596m to NPLL

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and £89m to PLL. The cancellation of these reinsurance arrangements is connected to the business transfer arrangement ("BTA") with Guardian Financial Services ("Guardian") outlined in note 4.

4. Premiums ceded to reinsurers

With effect from 31 July 2013, the Company cancelled the reinsurance of some annuity liabilities reinsured from the NPF to Opal Re, a fellow group company. In order to effect this the Company received premiums of £18m with no impact on profit before or after tax.

On 27 June 2012, the Company entered into a BTA with Guardian. The transfer was initially effected under a reinsurance agreement effective from 1 July 2012. In accordance with the BTA, 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.

The Company paid a reinsurance premium of £1,158m to Guardian in 2012. Under the terms of the agreement, in order to mitigate the risk of counterparty default, Guardian held assets in a collateral account over which the Company had a fixed charge as disclosed in note 31.

In connected transactions, with effect from 1 July 2012, the Company cancelled the reinsurance of pension annuity in-payment liabilities reinsured from the NPF to Opal Re. In order to effect this the Company received premiums of £1,070m.

As a result of the above reinsurance transactions, the Company recognised a loss before tax of £39m within comprehensive income in 2012.

Premiums ceded to reinsurers comprise:

	2013 £m	2012 £m
Reinsurance premium ceded to Guardian	-	(1,158)
Reinsurance cancellation premium received from Opal Re	18	1,070
Reinsurance premiums ceded under on-going reinsurance arrangements	3	(3)
	<u>21</u>	<u>(91)</u>

5. Fees and commissions

	2013 £m	2012 £m
Other fees	<u>3</u>	<u>3</u>

6. Net investment income

	2013 £m	2012 £m
Investment income		
Interest income on loans and deposits	19	23
Interest income on financial assets designated at fair value through profit or loss on initial recognition	296	630
Dividend income	115	48
Rental income	2	5
	<u>432</u>	<u>706</u>

Fair value (losses)/gains

Financial assets at fair value through profit or loss		
Held for trading – derivatives	(188)	(138)
Designated upon initial recognition	16	406
Investment in subsidiary (note 28)	1	(1)
Investment property (note 29)	(3)	(4)
	<u>(174)</u>	<u>263</u>

Other gains/(losses)

Reversal of impairment on investments in subsidiaries (note 28)	40	37
Write-off of loan to group company	-	(120)
	<u>40</u>	<u>(83)</u>

Net investment income	<u>298</u>	<u>886</u>
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Interest income on loans and deposits includes interest receivable of £19m (2012: £22m) on loans to Group entities.

Dividend income includes dividends from subsidiaries of £nil (2012: £nil).

7. Administrative expenses

	2013	2012
	£m	£m
Outsourcing expenses	51	61
Investment management expenses and transaction costs	20	44
	<u>71</u>	<u>105</u>

The Company has no employees. Administrative services are provided by Pearl Group Services Limited, a fellow group company.

8. Directors' remuneration

	2013	2012
	£000	£000
Remuneration (executive and non-executive Directors' remuneration excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	<u>656</u>	<u>437</u>
Other long-term benefits	<u>398</u>	<u>240</u>
Contributions to money purchase pension schemes	<u>35</u>	<u>19</u>

	2013	2012
	Number	Number
Number of Directors accruing retirement benefits under:		
- a money purchase pension scheme	4	3
Number of directors who had exercised share options during the year	4	-

	2013	2012
	£000	£000
Highest paid Director's remuneration:	<u>257</u>	<u>184</u>

The Executive Directors are employed by either Pearl Group Management Services Limited or Pearl Group Services Limited. The Non-Executive Directors are not employed but provide services via a letter of appointment.

For the purposes of this note an apportionment of the total remuneration paid to the Directors of the Company by the Phoenix Group has been made based on an estimate of the services rendered to the Company.

9. Auditor's remuneration

The remuneration of the auditor of the Company, including their associates was £340,000 (2012: £367,000). No services were provided to associated pension schemes.

Fees paid to Ernst & Young LLP for non-audit services to the Company and its associates are not disclosed in these financial statements as the consolidated financial statements of the ultimate parent, Phoenix Group Holdings, disclose such fees on a consolidated basis.

	2013	2012
	£000	£000
Audit of the Company's financial statements	236	254
Audit related assurance services	104	113
	<u>340</u>	<u>367</u>

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10. Other operating expenses

	2013 £m	2012 £m
Movement in deposits received from reinsurers	<u>31</u>	<u>56</u>

11. Finance costs

	2013 £m	2012 £m
Interest expense		
On borrowings at amortised cost	<u>8</u>	<u>15</u>
Attributable to:		
- policyholders	3	9
- owners	<u>5</u>	<u>6</u>
	<u>8</u>	<u>15</u>

12. Tax charge

Current year tax charge/(credit)

	2013 £m	2012 £m
Current tax:		
UK Corporation tax	(25)	26
Adjustment in respect of prior years	<u>34</u>	<u>(16)</u>
Total Current tax	<u>9</u>	<u>10</u>
Deferred tax:		
Impact of New Life Tax Regime (note 23)	-	(39)
Origination and reversal of temporary differences	3	21
Change in the rate of UK corporation tax	3	3
Write down of deferred tax assets	<u>(37)</u>	<u>(2)</u>
Total Deferred tax	<u>(31)</u>	<u>(17)</u>
Total tax charge	<u>(22)</u>	<u>(7)</u>
Attributable to:		
- policyholders	2	(15)
- owners'	<u>(24)</u>	<u>8</u>
	<u>(22)</u>	<u>(7)</u>

The Company, as a proxy for policyholders in the UK, is required to pay taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK life assurance policyholder earnings is included in income tax expense. The tax credit/(charge) attributable to policyholder earnings was £2m (2012: £(15)m).

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Reconciliation of tax (charge)/credit

	2013 £m	2012 £m
Profit before tax	145	196
Policyholder tax credit/(charge)	2	(15)
Profit before the tax attributable to owners	<u>147</u>	<u>181</u>
Tax at standard UK rate of 23.25% (2012: 24.5%)	(34)	(44)
Adjustment to owners' tax charge in respect of prior years	(4)	(16)
Profits taxed at rates other than 23.25%	5	-
Deferred tax rate change	3	3
Movement in unprovided deferred tax – capital losses	(3)	-
Impact of new life tax regime (note 23)	-	(12)
Non-taxable accounting gain on Part VII transfer	-	68
Non-taxable reversal of impairment of valuation of subsidiary	9	9
Owners' tax credit	<u>(24)</u>	<u>8</u>
Policyholder tax credit/(charge)	2	(15)
Total tax charge for the year	<u>(22)</u>	<u>(7)</u>

13. Share capital

	2013 £m	2012 £m
Issued and fully paid		
42,169,489 (2012: 42,169,489) "A" ordinary shares of 5p each	2	2
340,001,000 (2012: 340,001,000) "B" ordinary shares of £1 each	<u>340</u>	<u>340</u>
	<u>342</u>	<u>342</u>

The Company's Articles of Association contain a restriction on the number of shares that may be allotted.

The holders of the "A" ordinary shares have no voting rights.

The holders of the "B" shares are entitled to:

- a dividend equivalent to 99.999% of the profits of the Company which it may determine to distribute in respect of any financial year with the balance going to the holders of the "A" ordinary shares.
- on a return of capital, repayment in full of the capital paid up on the "B" ordinary shares and a further sum equal to 99.999% of the assets available for distribution to members with the balance of assets then going to the holders of the "A" ordinary shares.

At a General Meeting, on a show of hands every holder of the "B" ordinary shares has one vote and on a poll, holders of the "B" ordinary shares have one vote for every share held.

14. Capital contribution reserve

	2013 £m	2012 £m
At 1 January	197	81
Contribution received	-	216
Contribution repaid	-	(100)
At 31 December	<u>197</u>	<u>197</u>

In July 2012, the Company received a capital contribution of £216m from its immediate parent, PGH2.

In October 2012, the Company repaid £100m to its immediate parent, PGH2, in the form of cash.

The capital contribution has been treated as capital as there is no agreement for repayment. The reserve is considered distributable.

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15. Dividends on ordinary shares

	2013 £m	2012 £m
Interim dividend for 2013 at 44.12p per share (2012: 44.12p per share)	150	150
Second interim dividend for 2013 at 23.71p per share (2012: nil per share)	81	-
	<u>231</u>	<u>150</u>

16. Liabilities under insurance contracts

	Gross Liabilities 2013 £m	Re- insurers' share 2013 £m	Gross Liabilities 2012 £m	Re- insurers' share 2012 £m
Life assurance business:				
Insurance contracts	7,815	1,592	8,369	1,841
Investment contracts with DPF	<u>3,078</u>	<u>-</u>	<u>3,205</u>	<u>-</u>
	<u>10,893</u>	<u>1,592</u>	<u>11,574</u>	<u>1,841</u>
Amounts due for settlement after 12 months	<u>10,140</u>	<u>1,592</u>	<u>10,776</u>	<u>1,841</u>

	Gross Liabilities 2013 £m	Re- insurers' share 2013 £m	Gross liabilities 2012 £m	Re- insurers' share 2012 £m
At 1 January	12,839	3,001	12,108	2,526
Premiums	366	(21)	(261)	91
Claims	(1,067)	(190)	(1,129)	(204)
Part VII transfer scheme (note 2)	(1,177)	(1,085)	1,547	630
Other changes in liabilities	<u>(68)</u>	<u>(113)</u>	<u>574</u>	<u>(42)</u>
	10,893	1,592	12,839	3,001
Classified as held for sale (note 2)	<u>-</u>	<u>-</u>	<u>(1,265)</u>	<u>(1,160)</u>
At 31 December	<u>10,893</u>	<u>1,592</u>	<u>11,574</u>	<u>1,841</u>

As permitted by IFRS 7, the Company has not disclosed fair values for investment contracts with DPF as fair value ranges for the DPF cannot be reliably estimated. There is no active market for these instruments which will be settled with policyholders in the normal course of business.

Other changes in liabilities principally comprise changes in economic and non-economic assumptions and experience.

17. Unallocated surplus

	2013 £m	2012 £m
At 1 January	304	281
Part VII Scheme (note 2)	-	6
Transfer from statement of comprehensive income	<u>26</u>	<u>17</u>
At 31 December	<u>330</u>	<u>304</u>

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18. Borrowings

	2013 £m	2012 £m
Carrying value		
Subordinated loan from fellow group company, Phoenix Life Holdings Limited ("PLHL")	<u>250</u>	<u>250</u>
Amounts due for settlement after 12 months	<u>250</u>	<u>250</u>
	2013 £m	2012 £m
Fair value		
Subordinated loan from fellow group company, PLHL	<u>250</u>	<u>250</u>

The Company's shareholder fund received a subordinated loan facility of £250m from PLHL on 2 September 2009. This has been fully utilised and bears interest equal to the actual investment income earned on the £250m assets transferred. The interest is accrued and paid to PLHL on an annual basis. The maturity date of the loan is 2 September 2019. Repayment of any part of the loan earlier than the maturity date is conditional on the Company giving the Prudential Regulation Authority ("PRA") not less than six months' notice in writing of the proposed early repayment and receiving written confirmation that the PRA does not object to such a repayment.

19. Deposits received from reinsurers

	2013 £m	2012 £m
Carrying value:		
At 31 December	<u>1,776</u>	<u>1,936</u>
Amount due for settlement after 12 months	<u>1,776</u>	<u>1,936</u>
	2013 £m	2012 £m
Fair value:		
At 31 December	<u>1,776</u>	<u>1,936</u>

With effect from 1 January 2007, the Company reassured certain pension annuities in payment to a fellow group Company, Opal Reassurance Limited ("Opal"). Under the terms of this reinsurance arrangement the Company holds assets in a collateral account over which Opal has a fixed charge.

Further information on the Company's collateral arrangements is provided in note 31.

20. Derivatives

The Company purchases derivative financial instruments in connection with the management of its insurance contract liabilities based on the principles of reduction of risk and efficient portfolio management.

The fair values of derivative financial instruments are as follows:

	2013 Assets £m	2013 Liabilities £m	2012 Assets £m	2012 Liabilities £m
Forward currency	37	11	12	3
Credit default options	-	4	6	4
Interest rate swaps	343	550	1,013	975
Swaptions	137	-	236	-
Inflation swaps	17	4	12	-
Stock index futures	2	3	-	-
Total return bond swaps	-	26	2	16
Fixed interest futures	11	8	2	1
	<u>547</u>	<u>606</u>	<u>1,283</u>	<u>999</u>

The amount recoverable after one year is £456m (2012: £1,224m). The amount payable after one year is £555m (2012: £971m).

The Company pledges and receives collateral in respect of its derivative positions. Further information is provided in note 31.

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21. Obligations for repayment of collateral received

	2013 £m	2012 £m
Carrying value:		
At 31 December		
Stock lending collateral	1,609	2,947
Derivative collateral	212	579
	<u>1,821</u>	<u>3,526</u>
Amount due for settlement after 12 months	<u>177</u>	<u>553</u>
Fair value:		
At 31 December	<u>1,821</u>	<u>3,526</u>

Further information on the Company's collateral arrangements is provided in note 31.

22. Provisions

	Complaints and litigation costs £m	Leasehold properties £m	Total £m
At 1 January 2013	1	13	14
Released in the year	-	(9)	(9)
Utilised during the year	-	(1)	(1)
At 31 December 2013	<u>1</u>	<u>3</u>	<u>4</u>

The leasehold properties provision has been made for amounts in respect of the excess of lease rentals and other payments on properties that are currently vacant or expected to become vacant, over the amounts to be recovered from subletting these properties. The discount rate used is 1.74% (2012: 2.6%) and it is expected that the provision will be utilised over the next 4 years (2012: 5 years).

23. Tax assets and liabilities

	2013 £m	2012 £m
Current Tax		
Current tax payables	<u>(3)</u>	<u>(19)</u>
Deferred tax		
The balances at 31 December comprise:		
Deferred tax assets	5	44
Deferred tax liabilities	<u>(29)</u>	<u>(37)</u>
Net deferred tax (liabilities)/assets	<u>(24)</u>	<u>7</u>

Movement in deferred tax assets and liabilities

Year ended 31 December 2013

	1 January £m	Recognised in the statement of comprehensive income £m	Other movements £m	31 December £m
Trading losses	42	(39)	-	3
Accelerated capital allowances	2	-	-	2
IFRS transitional adjustments	(37)	8	-	(29)
	<u>7</u>	<u>(31)</u>	<u>-</u>	<u>(24)</u>

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Year ended 31 December 2012

	1 January	Recognised in the statement of comprehensive income	Other movements*	31 December
	£m	£m	£m	£m
Trading losses	28	14	-	42
Expenses and deferred acquisition costs carried forward	-	(5)	5	-
Provisions and other temporary differences	(10)	10	-	-
Accelerated capital allowances	1	1	-	2
IFRS transitional adjustments	-	(37)	-	(37)
	<u>19</u>	<u>(17)</u>	<u>5</u>	<u>7</u>

* Other movements in 2012 are deferred tax assets transferred from London Life Limited under the Part VII transfer (per note 2).

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

The Finance Act 2012 introduced new rules for the taxation of insurance companies, with effect from 1 January 2013. The deferred tax on the non-profit surplus has reversed and is replaced with IFRS transitional adjustments. The deferred tax on the transitional adjustments will be amortised over a 10 year period on a straight line basis commencing in 2013 and ending in 2022 as the IFRS tax transitional adjustment is brought into account in the current tax computations

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

	2013 £m	2012 £m
Deferred tax assets have not been recognised in respect of:		
Capital losses*	38	33

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

24. Payables related to direct insurance contracts

	2013 £m	2012 £m
Payables related to direct insurance contracts	<u>73</u>	<u>80</u>
Amount due for settlement after 12 months	<u>-</u>	<u>-</u>

25. Accruals and deferred income

	2013 £m	2012 £m
Accruals	<u>3</u>	<u>12</u>
Amount due for settlement after 12 months	<u>-</u>	<u>-</u>

26. Other payables

	2013 £m	2012 £m
Investment broker balances	16	33
Other payables	<u>46</u>	<u>57</u>
	<u>62</u>	<u>90</u>
Amount due for settlement after 12 months	<u>-</u>	<u>-</u>

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27. Liabilities and assets classified as held for sale

	2013 £m	2012 £m
Liabilities classified as held for sale:		
Liabilities under insurance contracts	-	1,265
Assets classified as held for sale:		
Reinsurers' share of insurance contract liabilities	-	1,160

As detailed in note 2, the Company completed a transfer of business previously reinsured in full to Guardian using a scheme under Part VII of the Financial Services and Markets Act 2000 during 2013.

28. Investment in subsidiaries

	Investments in subsidiaries at cost £m	Investments in subsidiaries at fair value £m	Total £m
Cost or valuation			
At 1 January 2013	874	11	885
Additions	-	-	-
Fair value movements	-	1	1
At 31 December 2013	874	12	886
Impairment			
At 1 January 2013	632	-	632
Impairment reversal (note 6)	(40)	-	(40)
At 31 December 2013	592	-	592
Carrying amount			
At 31 December 2013	282	12	294

The Company's investment in NPLH (and its wholly owned subsidiary, NPLL) has been impaired for a number of years. During 2013, as a result of the improved profitability of NPLL, the repayment of loan notes in 2013 by both NPLL and NPLH (described in note 30), and the Part VII transfer to Guardian (similar to that described in note 2), the Company recognised a reversal of impairment of £40m (2012: £37m) in net investment income (note 6).

	Investments in subsidiaries at cost £m	Investments in subsidiaries at fair value £m	Total £m
Cost or valuation			
At 1 January 2012	774	12	786
Additions	100	-	100
Fair value movements	-	(1)	(1)
At 31 December 2012	874	11	885
Impairment			
At 1 January 2012	669	-	669
Impairment reversal (note 6)	(37)	-	(37)
At 31 December 2012	632	-	632
Carrying amount			
At 31 December 2012	242	11	253

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The subsidiaries of the Company are as follows:

	Measurement basis	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Alcobendas Entrust Limited	Fair value	UK	Ordinary shares of £1
Axial Fundamental Strategies	Cost	USA	100% interest
Bellevale Properties Limited	Cost	British Virgin Islands	Ordinary shares of \$1
London Life Trustees Limited	Cost	UK	Ordinary shares of £1
National Provident Life Limited (Insurance company) *	Cost	UK	Ordinary shares of £1
NP Life Holdings Limited (Insurance holding company)	Cost	UK	Ordinary shares of £1
Pearl (Barwell 2) limited	Cost	UK	Ordinary shares of £1
Pearl (Chiswick House) Limited	Cost	UK	Ordinary shares of £1
Pearl (Moor House 1) Limited	Cost	UK	Ordinary shares of £1
Pearl (Moor House 2) Limited	Cost	UK	Ordinary shares of £1
Pearl (Printworks) Limited	Cost	UK	Ordinary shares of £1
Pearl (Stockley Park) Limited	Cost	UK	Ordinary shares of £1
Pearl (WP) Investments LLC	Fair value	USA	100% interest
Pearl Customer Care Limited	Cost	UK	Ordinary shares of £1
Pearl Life Trustees Limited	Cost	UK	Ordinary shares of £1
The London Life Association Limited	Cost	UK	Ordinary shares of 50p

* is held via a subsidiary company

29. Investment property

	2013 £m	2012 £m
At 1 January	31	42
Disposals	(18)	(7)
Fair value losses	(3)	(4)
At 31 December	<u>10</u>	<u>31</u>
Unrealised losses in the period on assets held at end of year	<u>(2)</u>	

The property portfolio consists of a mix of commercial sectors, spread geographically throughout the UK

Commercial investment property is measured at fair value by independent property valuers having appropriate recognised professional qualifications and recent experiences in the location and category of the property being valued. The valuations are carried out in accordance with the Royal Institute of Chartered Surveyors' ("RICS") guidelines with expected income and capitalisation rate as the key non-observable inputs.

The fair value measurement of the investment properties has been categorised as a level 3 fair value based on the inputs to the valuation techniques used. The following table shows the valuation techniques used in measuring the fair value of investment property and the significant non-observable inputs used:

Description	Valuation techniques	Significant non-observable inputs	Range (weighted average)
Commercial Investment Property	RICS valuation	Expected Income per square foot	£3.35 - £235 (£28.77)
		Capitalisation rate	3.59% - 13.13% (6.15%)

The estimated fair value of the commercial properties would increase (decrease) if:

- The expected income were to be higher (lower)
- The capitalisation rate were to be lower (higher)

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30. Loans and deposits

	2013 £m	2012 £m
Loans to Group entities at amortised cost:		
Loans to PGH2	586	554
Loans to subsidiary companies	103	198
Loans to fellow subsidiaries	27	29
	<u>716</u>	<u>781</u>
Other loans and deposits	16	17
At 31 December	<u>732</u>	<u>798</u>

There are three loans to PGH2, each of which are repayable on 13 December 2018 and earn interest at a rate of LIBOR + 350 bps. On 2 October 2013 the Company made an interest-bearing loan of £20m to PGH2, the Company's immediate parent. On 1 November 2013, loans of £211m, £212m and £55m to PGH2 were replaced by two interest-bearing loans of £423m and £55m. On 13 December 2013, loans of £61m and £24m to PGH2 were replaced by adding £85m to the interest bearing loan of £423m issued on 1 November 2013.

There are two loans to a subsidiary company National Provident Life Limited ("NPLL"). One of these loans is repayable on 30 June 2016 and earns interest at a fixed rate of 9.25%, and the other is repayable on 2 September 2019 and interest is calculated based on monthly returns. On 5 March 2013 NPLL repaid £13m of the 9.25% £65m subordinated unsecured notes. On 25 March 2013 NP Life Holdings Limited ("NPLH"), a subsidiary company, repaid a loan of £85m.

There are four loans to fellow group companies PGH (LCA) Limited and PGH (LCB) Limited. Each of these has one loan that is repayable on 30 June 2016 and earns interest at a rate of LIBOR + 125bps and one loan that is repayable on 02 September 2024 and earns interest at a rate of LIBOR + 100bps.

There has been no other movement on loans to Group companies during the year other than interest capitalised on the loans to PGH2 of £12m (2012: £12m).

Included in other loans and deposits are a £6m (2012: £6m) loan and policy loans of £10m (2012: £11m).

31. Financial instruments

Where disclosures in the IFRS financial statements for the first time in accordance with IFRS 13, comparatives are not required and have not been provided, except where previously disclosed on a voluntary basis in prior periods.

The table below sets out a comparison of the carrying amounts and fair values of financial instruments as at 31 December 2013:

	<u>Carrying value</u>		
	Total	Amounts due for settlement after 12 months	Fair value
	£m	£m	£m
Financial assets at 31 December 2013			
Loans and deposits at amortised cost	732	704	724
Financial assets at fair value through profit or loss			
Held for trading - derivatives	547	456	547
Designated upon initial recognition			
Equities	556	-	556
Fixed and variable rate income securities	6,735	6,594	6,735
Collective investment schemes	6,261	-	6,261
Reinsurers share of investment contracts	12	-	12
	<u>14,843</u>	<u>7,754</u>	<u>14,835</u>

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	<u>Carrying value</u>		
		Amounts due for settlement after 12 months	Fair value
	Total £m	£m	£m
Financial liabilities at 31 December 2013			
Financial liabilities at fair value through profit or loss			
Held for trading - derivatives	606	555	606
Designated upon initial recognition			
Investment contracts	350	-	350
Deposits received from reinsurers	1,776	1,776	1,776
Financial liabilities measured at amortised cost			
Borrowings	250	250	250
Obligations for repayment of collateral received	1,821	-	-
	<u>4,803</u>	<u>2,581</u>	<u>2,982</u>

Obligations for repayment of collateral received have no expected settlement date. As the obligations relate to the repayment of collateral received in the form of cash, the liability is stated at the value of the consideration received and therefore no fair value has been disclosed.

	<u>Carrying value £m</u>	<u>Fair value £m</u>
Financial assets at 31 December 2012		
Loans and deposits at amortised cost	798	798
Financial assets at fair value through profit or loss		
Held for trading - derivatives	1,283	1,283
Designated upon initial recognition		
Equities	700	700
Fixed and variable rate income securities	8,955	8,955
Collective investment schemes	5,982	5,982
Reinsurers share of investment contracts	12	12
	<u>17,730</u>	<u>17,730</u>

Amount recoverable after 12 months 10,350

	<u>Carrying value £m</u>	<u>Fair value £m</u>
Financial liabilities at 31 December 2012		
Financial liabilities at fair value through profit or loss		
Held for trading - derivatives	999	999
Designated upon initial recognition		
Investment contracts	324	324
Deposits received from reinsurers	1,936	1,936
Financial liabilities measured at amortised cost		
Borrowings	250	250
Obligations for repayment of collateral received	3,526	3,526
	<u>7,035</u>	<u>7,035</u>
Amount due for settlement after 12 months	<u>4,035</u>	

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 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.

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Level 2 financial instruments. The fair values of 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 Company's financial instruments determined by valuation techniques using non market observable 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, 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 market observable 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.

Fair value hierarchy of financial instruments

The tables below separately identify financial instruments carried at fair value from those measured on another basis but for which fair value is disclosed.

At 31 December 2013	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Investment in subsidiaries measured at fair value	<u>-</u>	<u>-</u>	<u>12</u>	<u>12</u>
Total financial assets measured at fair value				
Derivatives	<u>14</u>	<u>533</u>	<u>-</u>	<u>547</u>
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	5	-	551	556
Fixed and variable rate income securities	5,344	1,334	57	6,735
Collective investment schemes	5,620	70	571	6,261
Reinsurers' share of investment contract liabilities	<u>-</u>	<u>12</u>	<u>-</u>	<u>12</u>
Total financial assets measured at fair value	<u>10,969</u>	<u>1,416</u>	<u>1,179</u>	<u>13,564</u>
Financial assets for which fair values are disclosed				
Loans and deposits at amortised cost	-	16	708	724
Total financial assets	<u>10,983</u>	<u>1,965</u>	<u>1,887</u>	<u>14,835</u>

Fair value hierarchy information for non-financial assets measured at fair value is included in note 29 for investment properties

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	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities measured at fair value				
Derivatives	11	592	3	606
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	-	350	-	350
Deposits received from reinsurers	-	1,776	-	1,776
Total financial liabilities measured at fair value	11	2,718	3	2,732
Financial liabilities for which fair values are disclosed				
Borrowings at amortised cost	-	-	250	250
Total financial liabilities	11	2,718	253	2,982
At 31 December 2012	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Investment in subsidiaries measured at fair value	-	-	11	11
Financial assets measured at fair value				
Derivatives	-	1,283	-	1,283
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	4	-	696	700
Fixed and variable rate income securities	7,286	1,522	147	8,955
Collective investment schemes	5,264	98	620	5,982
Reinsurers' share of investment contract liabilities	-	12	-	12
	12,554	1,632	1,463	15,649
Total financial assets measured at fair value	12,554	2,915	1,463	16,932
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities measured at fair value				
Derivatives	-	995	4	999
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	-	324	-	324
Deposits received from reinsurers	-	1,936	-	1,936
Total financial liabilities measured at fair value	-	3,255	4	3,259

Level 3 financial instrument sensitivities

Level 3 investments in equities and fixed and variable rate income securities are valued using broker quotes. Although such valuations are sensitive to estimates, it is not possible to calculate the impact of a change in one or more of the assumptions to reasonably possible alternative assumptions.

Collective investment schemes categorised as level 3 assets are valued using net asset statements provided by independent third parties. Although such valuations are sensitive to estimates, it is not possible to calculate the impact of a change in one or more assumptions to reasonably possible alternative assumptions.

Borrowings measured at fair value and categorised as Level 3 financial liabilities comprise the subordinated loan from PLHL, measured using an internally developed model.

Significant transfers of financial instruments between level 1 and level 2

At 31 December 2013	From level 1 to level 2 £m	From level 2 to level 1 £m
Financial assets at fair value		
Derivatives	-	2
Financial assets designated at fair value through profit or loss upon initial recognition		
Fixed and variable rate income securities	350	145
Financial liabilities at fair value		
Derivatives	-	2

Consistent with 2012, all the Company's Level 1 and Level 2 assets have been valued using standard market pricing sources.

The application of the Company'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 1 to level 2 in the period.

At 31 December 2012	From level 1 to level 2 £m	From level 2 to level 1 £m
Financial assets at fair value		
Financial assets designated at fair value through profit or loss upon initial recognition		
Fixed and variable rate income securities	210	432

With confidence in markets increasing and the resulting increase in liquidity there was a narrowing of spreads, which resulted in a number of Level 2 bonds at year end 2011 meeting the Level 1 requirements in 2012.

Movement in level 3 financial instruments measured at fair value	At 1 January 2013 £m	Total gains/ (losses) in statement of comprehensive income £m	Purchases £m	Sales £m	Transfers to level 1 and level 2 £m	At 31 December 2013 £m	Unrealised gains/ (losses) in the period on assets held at end of year £m
Investment in subsidiaries	11	1	-	-	-	12	-
Financial assets designated at fair value through profit or loss upon initial recognition							
Equities	696	(53)	35	(127)	-	551	(34)
Fixed and variable rate income securities	147	40	-	(125)	(5)	57	10
Collective investment schemes	620	(46)	-	(3)	-	571	17
	1,474	(58)	35	(255)	(5)	1,191	(7)

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	At 1 January 2013 £m	Total losses in statement of comprehensive income £m	Purchases £m	Sales £m	Transfers (to)/from level 1 and level 2 £m	At 31 December 2013 £m	Unrealised losses on liabilities held at end of year £m
Financial liabilities designated at fair value through profit or loss upon initial recognition							
Derivatives	4	(4)	3	-	-	3	(8)

	At 1 January 2012 £m	Total gains/ (losses) in statement of comprehensive income £m	Purchases and sales £m	Transfers (to)/from level 1 and level 2 £m	At 31 December 2012 £m	Unrealised gains/ (losses) on assets held at end of year £m
Investment in subsidiaries	12	(1)	-	-	11	-
Derivatives	19	2	(21)	-	-	-
Financial assets designated at fair value through profit or loss upon initial recognition						
Equities	678	16	2	-	696	3
Fixed and variable rate income securities	127	(53)	-	73	147	(54)
Collective investment schemes	673	(30)	9	(32)	620	(32)
	1,509	(66)	(10)	41	1,474	(83)

	At 1 January 2012 £m	Total gains in statement of comprehensive income £m	Purchases and sales £m	Transfers to level 1 and level 2 £m	At 31 December 2012 £m	Unrealised gains on liabilities held at end of year £m
Financial liabilities designated at fair value through profit or loss upon initial recognition						
Derivatives	-	4	-	-	4	-

Gains and losses on Level 3 financial instruments are included as income or an expense in net investment income in the statement of comprehensive income. There were no gains or losses recognised in other comprehensive income.

During 2013, updates to the Company's observations with regard to the liquidity of certain fixed and variable rate income securities resulted in transfers into Level 3 from Levels 1 and 2.

Offsetting financial assets and financial liabilities

The Company has no financial assets and financial liabilities that have been offset in the statement of financial position as at 31 December 2013 (2012: none).

The table below contains disclosures related to financial assets and financial liabilities recognised in the statement of financial position that are subject to enforceable master netting arrangements or similar agreements. Such agreements do not meet the criteria for offsetting in the statement of financial position as the Company has no current legally enforceable right to offset recognised financial instruments. Furthermore, certain related assets received as collateral under the netting arrangements will not be recognised in the statement of consolidated financial position as the Company does not have permission to sell or re-pledge, except in the case of default. Details of the Company's collateral arrangements in respect of these recognised assets and liabilities are provided below.

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At 31 December 2013

Financial assets

	Gross and net amounts of recognised financial assets £m	Related amounts not offset			Net amount £m
		Financial instruments received as collateral £m	Cash received as collateral £m	Derivative liabilities £m	
OTC Derivatives	533	-	212	329	(8)
Exchange traded derivatives	14	-	3	11	-
Stock lending	1,556	-	1,609	-	(53)
Total	2,103	-	1,824	340	(61)

Financial liabilities

	Gross and net amounts of recognised financial liabilities £m	Related amounts not offset			Net amount £m
		Financial instruments pledged as collateral £m	Cash pledged as collateral £m	Derivative assets £m	
OTC Derivatives	595	26	237	329	3
Exchange traded derivatives	11	-	-	11	-
Total	606	26	237	340	3

At 31 December 2012

Financial assets

	Gross and net amounts of recognised financial assets £m	Related amounts not offset			Net amount £m
		Financial instruments received as collateral £m	Cash received as collateral £m	Derivative liabilities £m	
OTC Derivatives	1,281	39	579	627	36
Exchange traded derivatives	2	-	-	-	2
Stock lending	2,847	-	2,947	-	(100)
Total	4,130	39	3,526	627	(62)

Financial liabilities

	Gross and net amounts of recognised financial liabilities £m	Related amounts not offset			Net amount £m
		Financial instruments pledged as collateral £m	Cash pledged as collateral £m	Derivative assets £m	
OTC Derivatives	997	36	322	627	12
Exchange traded derivatives	2	-	-	-	2
Total	999	36	322	627	14

Derivative and reinsurance collateral arrangements

Assets accepted

It is the Company's practice to obtain collateral to mitigate the counterparty risk related to over-the-counter ("OTC") derivatives and certain reinsurance transactions, usually in the form of cash or marketable financial instruments.

Where the Company receives collateral in the form of marketable financial instruments which it is not permitted to sell or re-pledge except in the case of default, it is not recognised in the statement of financial position. The fair value of financial assets accepted as collateral for OTC derivatives and reinsurance transactions but not recognised in the statement of financial position amounts to £nil and £nil respectively (2012: £39m and £1,206m).

Where the Company receives collateral on OTC derivatives and reinsurance transactions in the form of cash it is recognised in the statement of financial position along with a corresponding liability to repay the amount of the collateral received, disclosed as 'Obligations for the repayment of collateral received' and 'Deposits received from reinsurers' respectively. The amounts recognised as financial assets and financial liabilities from cash collateral received at December 2013 are set out below.

	<u>OTC derivatives</u>		<u>Reinsurance</u>	
	2013	2012	2013	2012
	£m	£m	£m	£m
Financial assets	212	579	1,592	2,988
Financial liabilities	212	579	1,776	1,936

The maximum exposure to credit risk in respect of OTC derivative assets is £533m (2012: £1,281m) of which credit risk of £541m (2012: £1,248m) is mitigated by use of collateral arrangements (which are settled net after taking account of any OTC derivative liabilities owed to the counterparty).

Credit risk on exchange traded derivative assets of £14m (2012: £2m) is mitigated through regular margining and the protection offered by the exchange.

The maximum exposure to credit risk in respect of reinsurance assets, including assets classified as held for sale, is £1,592m (2012: £2,988m) and £1,592m (2012: £2,988m) of this is mitigated by use of collateral arrangements.

Assets pledged

The Company pledges collateral in respect of its OTC derivative liabilities.

Where the Company pledges collateral in the form of cash or marketable financial instruments and retains all the risks and rewards of the transferred assets, it continues to be recognised in the statement of financial position. Cash collateral pledged where the counterparty retains the risks and rewards is derecognised from the statement of financial position and a corresponding receivable is recognised for its return. The value of assets pledged at 31 December 2013 in respect of OTC derivative liabilities amounted to £263m (2012: £357m).

Stock lending collateral arrangements

The Company lends listed financial assets held in its investment portfolio to other institutions. The Company conducts its stock lending programme only with well-established, reputable institutions in accordance with established market conventions.

The financial assets do not qualify for derecognition as the Company retains all the risks and rewards of the transferred assets except for the voting rights. The carrying value of listed financial assets lent at 31 December 2013 that have not been derecognised amounted to fixed and variable income securities of £1,556m (2012: £2,847m).

It is the Company's practice to obtain collateral in stock lending transactions, usually in the form of cash or marketable financial instruments.

Where the Company receives collateral in the form of marketable financial instruments which it is not permitted to sell or re-pledge except in the case of default, such collateral is not recognised in the statement of financial position. The fair value of financial assets accepted as collateral amounts to £nil (2012: £nil).

Where the Company receives collateral in the form of cash, it is recognised in the statement of financial position along with a corresponding liability to repay the amount of the collateral received, disclosed as 'Obligations for the repayment of collateral received'. The amount recognised as a financial asset and a financial liability at 31 December 2013 is £1,609m (2012: £2,966m) and £1,609m (2012: £2,947m) respectively.

The maximum exposure to credit risk in respect of stock lending transactions is £1,556m (2012: £2,847m) of which credit risk of £1,556m (2012: £2,847m) is mitigated through the use of collateral arrangements.

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32. Other receivables

	2013 £m	2012 £m
Investment broker balances	106	23
Collateral pledged	237	-
Other receivables	25	16
	<u>368</u>	<u>39</u>
Amount recoverable after 12 months	<u>-</u>	<u>-</u>

Collateral pledged of £322m was included within "cash and cash equivalents" in the prior period.

The carrying value of other receivables approximates to their fair values.

33. Cash and cash equivalents

	2013 £m	2012 £m
Bank and cash balances	21	37
Short-term deposits (including demand and time deposits)	37	360
	<u>58</u>	<u>397</u>

The carrying amounts approximate to fair value at the period end.

34. Cash flows

Cash flows from operating activities

	2013 £m	2012 £m
Profit for the year before tax	145	196
Non-cash movements in profit for the year before tax		
Fair value losses/(gains) on:		
Investment property	3	4
Financial assets	(175)	96
Impairment of subsidiaries held at fair value	(1)	1
Change in unallocated surplus	26	17
Change in deposits received from reinsurers	(160)	(590)
Interest expense on borrowings	8	5
Interest income on loans	(12)	(12)
Changes in operating assets and liabilities		
Change in investment assets	2,072	(70)
Reversal of impairment of subsidiaries held at cost	(39)	(37)
Change in net derivative assets/(liabilities)	531	423
Change in reinsurance assets	249	693
Change in insurance contract and investment contract liabilities	(655)	(210)
Change in other assets	934	(1,094)
Change in other liabilities	(3,094)	767
Cash (absorbed)/generated by operations	<u>(168)</u>	<u>189</u>

35. Capital management

Capital Management Framework

The Company's Capital Management Framework is designed to achieve the following objectives:

- provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary excess capital;
- ensure sufficient liquidity to meet obligations to policyholders and other creditors; and
- meet the dividend expectations of owners.

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

The capital policy is set by the Board and monitored each month at both the executive and Board level. The policies ensure sufficient liquidity to meet creditor and dividend obligations through the combination of cash buffers and cash flows. Volatility in the latter is monitored at the executive and Board level through stress and scenario testing. Where cash flow volatility is judged to be in excess of the Board's risk appetite, de-risking activities are undertaken.

The capital policy is set by the Board and monitored on a daily basis. These policies ensure there is sufficient capital to meet regulatory capital requirements under a range of stress conditions. The capital policy is managed according to the risk profile and financial strength of the Company.

Regulatory capital requirements

The Company must retain sufficient capital at all times to meet the regulatory capital requirements mandated by the Prudential Regulation Authority ("PRA"). In addition to EU-directive-based "Pillar 1" and Group capital requirements, the PRA has also stipulated a "Pillar 2" of risk-based capital requirements that have been implemented in the UK. The Company's actual capital requirement is based on whichever of the Pillar 1 or Pillar 2 requirement turns out to be more onerous. The Company generally holds an amount of capital that is greater than the minimum required amount to allow for adverse events in the future that may use capital and might otherwise cause the Company to fail the minimum level of regulatory capital test.

Pillar 1

With the exception of with-profits businesses, the regulatory capital requirement under Pillar 1 is the total amount held in respect of investment, expense and insurance risks (the "long-term insurance capital requirement" ("LTICR")) and any additional amounts required to cover the more onerous of two specified stress tests (the "resilience capital requirement" ("RCR")). The regulatory capital requirement is then deducted from the available capital resources to give the excess capital on a regulatory basis.

A further test is required under Pillar 1 in respect of with-profits funds which may result in an additional capital requirement referred to as the "with-profits insurance capital component" ("WPICC").

The table below sets out the Company's capital resources position at 31 December 2013 as reported in the annual returns to the PRA and compares this with the total equity attributable to owners of the Company as reported in the statement of financial position.

	2013 £m	2012 £m
Total equity attributable to owners	1,058	1,166
Differences in the valuation of assets and liabilities	1,030	770
Unallocated surplus	330	304
Core tier one capital in related undertakings	17	20
Deductions in related undertakings	(116)	(78)
Other tier two instruments	250	250
Inadmissible assets other than intangibles and own shares	(1)	(8)
Asset values in excess of Pillar 1 counterparty limits	(434)	(371)
Capital resources on a Pillar 1 Regulatory reporting basis	<u>2,134</u>	<u>2,053</u>

The Company has complied with externally imposed capital requirements during the year. At 31 December 2013, the amount of capital that the Company was required to hold was £1,539m (2012: £1,447m) and the excess capital over that required was £595m (2012: £606m).

Pillar 2

The Pillar 2 capital requirements are based on a self-assessment methodology, the Individual Capital Assessment ("ICA"). This methodology determines the capital requirement to ensure that the Company's realistic liabilities can be met in one year's time with a 99.5% confidence level, or in other words to be able to withstand a one in 200 year event. The PRA reviews the Company's ICA and may impose additional capital requirements if necessary in the form of Individual Capital Guidance ("ICG").

Group Capital Adequacy

In addition to the requirement to maintain individual capital resources in excess of its individual capital resources requirement, the Company is required to ensure that its capital resources are sufficient to maintain group capital resources in excess of the group capital resources requirement at all times. This is calculated at the level of the Company's highest EEA insurance parent undertaking, Phoenix Life Holdings Limited ('PLHL').

The group capital resources requirement is an aggregate of the individual capital resources requirements of each of the regulated entities within the Phoenix Group. Group capital resources are based on an aggregation of the capital resources of each of the regulated entities, net of the Phoenix Group's investment in them, and net of surplus assets held in the long-term funds of the regulated entities, but without making any deduction for counterparty exposures in excess of defined limits.

There are different forms and quality of capital that may be admitted to the calculation of group capital resources and there are also restrictions which limit lower quality capital to prescribed levels. Lower quality capital which exceeds these levels must be excluded from group capital resources, with a corresponding effect on the excess of group capital resources over group capital resources requirements.

Internal capital support to With-Profits funds

As noted in the Strategic Report, there are arrangements for the Company's SHF and NPF to provide capital support to the Company's WP funds. At 31 December 2013, the SHF provided support of £713m (2012: £908m) to the SERP fund, on which an impairment of £621m (2012: £772m) has been recognised. Support was also provided to the LL WP fund of £51m (2012: £144m) from the SHF with an impairment recognised of £nil (2012: £65m) and from the NPF of £102m (2012: £102m) which has been fully impaired.

36. Risk management

The Company is exposed to a number of risks in its business including those arising from underlying assets and liabilities. The Company complies with the Group approach to risk management which is described in the Phoenix Group Holdings annual report and accounts.

Risk and capital management objectives and policies

The risk management objectives and policies of the Company are based on the requirement to protect the Company's regulatory capital position, thereby safeguarding policyholders' guaranteed benefits whilst also ensuring the Company can meet various cash flow requirements. Subject to this, the Company seeks to use available capital to achieve increased investment returns, balancing risk and reward, to generate additional value for policyholders and owners.

In pursuing these objectives, the Company deploys financial assets and incurs insurance contract liabilities and financial liabilities. Financial assets principally comprise investments in equity securities, fixed and variable income securities, property, collective investment schemes, derivatives, reinsurance, trade and other receivables and banking deposits. Financial liabilities comprise derivative liabilities, borrowings for financial purposes, and other payables.

Financial Risk and the Asset and Liability Management framework

The use of financial instruments naturally exposes the Company to the risks associated with them, chiefly market risk, credit risk and financial soundness risk.

Responsibility for agreeing the financial risk profile rests with the Board, given advice from investment managers, internal committees and the actuarial function. In setting the risk profile, the Board will receive advice from the appointed investment managers, the with-profit actuary and the actuarial function holder as to the potential implications of that risk profile with regard to the probability of both realistic insolvency and of failing to meet the regulatory minimum capital requirement. The actuarial function holder will also advise the extent to which the investment risk taken is consistent with the Company's commitment to treat customers fairly.

Derivatives are used in a number of the Company's funds, within policy guidelines agreed by the Board and overseen by the Investment Committee supported by the management oversight committee. Derivatives are primarily used for efficient portfolio management or for risk hedging purposes.

More details on the Company's exposure to financial risk are provided below.

The Company is also exposed to insurance risk. Life assurance risk arises through exposure to mortality, longevity and to variances between assumed and actual experience in factors such as persistency levels and management and administrative expenses. More details on the Company's exposure to insurance risk are provided below.

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The Company's overall exposure to investment risk is monitored by appropriate committees which agree policies for managing each type of risk on an on-going basis, essentially within the Asset and Liability Management ("ALM") framework that has been developed to achieve investment returns in excess of amounts due in respect of insurance contracts. The effectiveness of the Company's ALM relies on close matching of assets and liabilities arising from insurance contracts, taking into account the types of benefits payable to policyholders under each type of contract. Separate portfolios of assets are maintained for with-profits business, which includes all of the Company's participating business, non-linked non-participating business and unit-linked business held within the with-profits fund.

Financial risk analysis

Transactions in financial instruments may result in the Company assuming financial risks. This includes credit risk, market risk and liquidity risk. Each of these is described below, together with a summary of how the Company manages them.

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. These obligations can relate to both recognised and unrecognised assets and liabilities.

There are two principal sources of credit risk for the Company:

- Credit risk which results from direct investment activities, including investments in fixed and variable rate income securities, equities, derivatives, collective investment schemes, hedge funds and the placing of cash deposits; and
- Credit risk which results indirectly from activities undertaken in the normal course of business. Such activities include premium payments, outsourcing contracts, reinsurance, and the lending of securities.

The amount disclosed in the statement of financial position in respect of all financial assets, together with rights secured under unrecognised collateral arrangements represents the Company's maximum exposure to credit risk.

Credit risk is managed by the monitoring of aggregate Company exposures to individual counterparties and by appropriate credit risk diversification. The Company manages the level of credit risk it accepts through comprehensive credit risk tolerances. In certain cases, protection against exposure to particular credit risk types may be achieved through use of derivatives. The credit risk borne by the owners on with-profits policies is dependent on the extent to which the underlying insurance fund is relying on owners' support.

Quality of credit risk

An indication of the Company's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The following table provides information regarding the aggregate credit exposure with external credit ratings:

At 31 December 2013

	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Non rated £m	Unit Linked £m	Total £m
Loans and deposits	-	-	-	-	-	-	732	-	732
Derivatives	-	-	433	5	-	-	109	-	547
Fixed and variable rate income securities	991	3,411	829	731	48	15	710	-	6,735
Reinsurers' share of investment contract liabilities	-	-	-	-	-	-	-	12	12
Reinsurers' share of insurance contract liabilities	-	3	1	-	-	-	1,588	-	1,592
Cash and cash equivalents	-	33	23	2	-	-	-	-	58

At 31 December 2012

	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Non rated £m	Unit Linked £m	Total £m
Loans and deposits	-	-	-	-	-	-	798	-	798
Derivatives	-	-	1,251	-	-	-	32	-	1,283
Fixed and variable rate income securities	5,547	503	1,088	728	121	98	870	-	8,955
Reinsurers' share of investment contract liabilities	-	-	-	-	-	-	-	12	12
Reinsurers' share of insurance contract liabilities	-	4	1	-	-	-	1,836	-	1,841
Cash and cash equivalents	-	-	396	-	-	-	-	1	397

Non-equity based derivatives are included in the credit risk table above and are subject to appropriate collateral arrangements.

Credit ratings have not been disclosed in the above tables for holdings in collective investment schemes. The credit quality of the underlying debt securities within these vehicles is managed by the safeguards built into the investment mandates for these vehicles.

It is also the Company's policy to maintain accurate and consistent internal risk ratings across its asset portfolio. This enables management to focus on the applicable risks and to compare credit exposures across all lines of business, geographical regions and products. The rating system is supported by a variety of financial analytics combined with market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories of assets and are derived in accordance with the Company's rating policy. The attributable risk ratings are assessed and updated regularly and significant exposures and breaches are reported to the Board and to the Investment Committee.

A further indicator of the quality of the Company's financial assets is the extent to which they are neither past due nor impaired. The Company had no material assets which were impaired or past due (2012: £nil).

Concentration of credit risk

Concentration of credit risk might exist where the Company has significant exposure to an individual counterparty or a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions. The Company counterparty risk is monitored by the counterparty limits contained within the investment guidelines and investment management agreements, overlaid by regulatory requirements and the monitoring of aggregate counterparty exposure across the Company. Counterparty risk in respect of OTC (over the counter) derivative counterparties is monitored using a Value-at-Risk (VaR) exposure metric.

The Company is also exposed to concentration risk outsourced service providers. This is due to the nature of the outsourced service market. The Company operates a policy to manage outsource service counterparty exposures and the impact from default is reviewed regularly by executive committees and measured through the ICA stress and scenario testing.

Reinsurance

The Company is exposed to credit risk as a result of insurance risk transfer contracts with reinsurers. This also gives rise to concentration of risk with individual reinsurers, due to the nature of the reinsurance market and the restricted range of reinsurers that have acceptable credit ratings. The Company manages its exposure to reinsurance credit risk through the operation of a reinsurance policy and regular monitoring of exposures at the Reinsurance Management Committee. The Company's largest reinsurance counterparty is Opal, a fellow group company, the reinsurance asset recoverable at 31 December 2013 was £1,582m (2012: £1,829m).

Collateral

The credit risk of the Company is mitigated, in certain circumstances, by entering into collateral agreements. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and the valuation parameters. Collateral is mainly obtained in respect of stock lending, certain reinsurance arrangements and to provide security against the maturity proceeds of derivative financial instruments. Management monitors the market value of the collateral received, requests additional collateral when needed and performs an impairment valuation when impairment indicators exist and the asset is not fully secured. Further details are given in note 31 above.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises interest risk, currency risk and other price risk.

The Company is mainly exposed to market risk as a result of:

- the mismatch between liability profiles and the related asset investment portfolios;
- the investment of surplus assets including owners' reserves yet to be distributed, surplus assets within the long-term funds and assets held to meet regulatory capital and solvency requirements; and
- the income flow of management charges from the invested assets of the Company.

The Company manages the levels of market risk that it accepts through the operation of an Investment Management policy and an approach to investment management that determines:

- the constituents of market risk for the Company;
- the basis used to fair value financial assets and liabilities;
- the asset allocation and portfolio limit structure;
- diversification from benchmarks by type of instrument and geographical area;
- the net exposure limits by each counterparty or group of counterparties, geographical and industry segments;
- control over hedging activities;
- reporting of market risk exposures and activities; and
- monitoring of compliance with market risk policy and review of market risk policy for pertinence to the changing environment.

All operations comply with regulatory requirements relating to the taking of market risk.

Interest risk

Interest risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates due to the effect such movements have on the value of interest-bearing assets and on the value of future guarantees provided under certain contracts of insurance.

Interest risk is managed by matching assets and liabilities where practicable and by entering into derivative arrangements for hedging purposes where appropriate. This is particularly the case for the non-profit funds. For with-profits business, some element of investment mismatching is permitted where it is consistent with the principles of treating customers fairly. The with-profits funds of the Company provide capital to allow such mismatching to be effected. In practice, the Company maintains an appropriate mix of fixed and variable rate income securities according to the underlying insurance contracts and will review this at regular intervals to ensure that overall exposure is kept within the risk profile agreed for each particular fund. This also requires the maturity profile of these assets to be managed in line with the liabilities to policyholders.

The sensitivity analysis for interest risk indicates how changes in the fair value or future cash flows of a financial instrument arising from changes in market interest rates at the reporting date result in a change in profit after tax and in equity. It takes into account the effect of such changes in market interest rates on all assets and liabilities that contribute to the Company's reported profit after tax and to equity.

With-profits business and non-participating business within the with-profits funds are exposed to interest risk as guaranteed liabilities are valued relative to market interest rates and investments include fixed and variable rate interest securities and derivatives. For with-profits business the profit or loss arising from mismatches between such assets and liabilities is largely offset by increased or reduced discretionary policyholder benefits. The contribution of these funds to the Company result is determined primarily by either the owners' share of the declared annual bonus or by the owners' interest in any change in value in the capital advanced to the Company's with-profits funds.

In the non-profit funds, policy liabilities are duration matched with primarily fixed and variable rate income securities, with the result that sensitivity to changes in interest rates is very low.

An increase of 1% in interest rates, with all other variables held constant, would result in an increase in profit after tax in respect of a full financial year and in equity of £4m (2012: £8m decrease). A decrease of 1% in interest rates, with all other variables held constant, would result in a reduction in profit after tax in respect of a full financial year and a decrease in equity of £9m (2012: £9m increase in profit).

Equity, property and inflation risk

The Company has exposure to financial assets and liabilities whose values will fluctuate as a result of changes in market prices other than from interest rate and currency fluctuations. This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Company limits its exposure to any one counterparty in its investment portfolios and to any one foreign market.

The portfolio of marketable equity securities and property investments which is carried in the statement of financial position at fair value has exposure to price risk. The Company's objective in holding these assets is to earn higher long-term returns by investing in a diverse portfolio of high quality equities and properties. Portfolio characteristics are analysed regularly and price risks are actively managed in line with investment mandates. The Company's holdings are diversified across industries, and concentrations in any one company or industry are limited.

Equity and property price risk is primarily borne in respect of assets held in with-profits funds. For with-profits fund policyholders' future bonuses will be impacted by the investment returns achieved and hence the price risk. In addition some equity investments are held in respect of owners' funds. The Company as a whole is exposed to price risk fluctuations impacting the income flow of management charges from the invested assets of all funds.

Equity and property price risk is managed through the agreement and monitoring of financial risk profiles that are appropriate for maintaining adequate regulatory capital and treating customers fairly. This is largely achieved through asset class diversification.

The impact of non-government fixed and variable rate income securities and, *inter alia*, the change in market credit spreads during the year are fully reflected in the values shown in these financial statements. Similarly, the value of derivatives that the Company holds takes into account fully the changes in swap spreads.

The sensitivity analysis for equity and property price risk illustrates how a change in the fair value of equities and properties affects the Company result. It takes into account the effect of such changes in equity and property prices on all assets and liabilities that contribute to the Company's reported profit after tax and to equity.

A 10% increase in equity/property prices, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year and in equity of £3m (2012: increase £5m). A 10% decrease in equity/property prices, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and in equity of £3m (2012: decrease £5m).

There is also an exposure to spread changes affecting the prices of corporate bonds and derivatives. This exposure applies to the with-profits fund, non-profit funds (where risks and rewards fall wholly to owners) and in owners' funds.

A 100 basis point widening of credit spreads, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year and in equity of £24m (2012: £10m). A 100 basis point narrowing of credit spreads, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and in equity of £29m (2012: £9m).

Currency risk

The Company's principal transactions are carried out in sterling and therefore its exchange risk is limited principally to foreign operations.

The Company's financial assets are primarily denominated in the same currencies as its insurance liabilities. Thus the main foreign exchange risk arises from recognised assets and liabilities denominated in currencies other than those in which insurance liabilities are expected to be settled and, indirectly, from the earnings of UK companies arising abroad.

The with-profits funds have an exposure to overseas assets which is not driven by liability considerations. The purpose of this exposure is to reduce overall risk whilst maximising returns by diversification. This exposure is limited and managed through investment mandates which are subject to the oversight of the Investment Committees. Fluctuations in exchange rates from holdings in overseas assets are hedged against currency risks.

Sensitivity of profit after tax and in equity to fluctuations in currency exchange rates is not considered significant at 31 December 2013 or 31 December 2012, since unhedged exposure to foreign currency was relatively low.

Financial soundness risk

Financial soundness risk is a broad risk category encompassing financial control and reporting risk, capital management risk, liquidity and funding risk, and tax risk.

Financial control and reporting risk is defined as the failure of the Company to appropriately record, report or disclose financial information through its annual statutory and regulatory reporting.

Capital management risk is defined as the failure of the Company to maintain sufficient capital to provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary capital. The Company has exposure to capital management risk through the regulatory capital requirements mandated by the PRA.

Liquidity and funding risk is defined as the failure of the Company to maintain adequate levels of financial resources to enable it to meet its obligations as they fall due. The Company has exposure to liquidity risk as a result of its inability to meet its short term cash flow requirements, and to meet its obligations to policy liabilities and the operating requirements of its subsidiaries.

Tax risk is defined as the risk of financial or reputational loss arising from a lack of liquidity, funding or capital due to an unforeseen tax cost, or by the inappropriate reporting and disclosure of information in relation to taxation. The Company has exposure to tax risk through the annual statutory and regulatory reporting and through the processing of policyholder tax requirements. Tax risk is managed by maintaining an appropriately-staffed tax team who have the qualifications and experience to make judgements on tax issues, augmented by advice from external specialists where required. The Company has a formal tax risk policy, which sets out its risk appetite in relation to specific aspects of tax risk, and which details the controls the Company has in place to manage those risks. These controls are subject to a regular review process.

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The Board has defined a number of governance objectives and principles and the liquidity risk framework is designed to ensure that:

- liquidity risk is managed in a manner consistent with the Board's strategic objectives, risk appetite and Principles and Practices of Financial Management ("PPFM");
- cash flows are appropriately managed and the reputation of the Company and the Phoenix Group are safeguarded; and
- appropriate information on liquidity risk is available to those making decisions.

The Company's policy is to maintain sufficient liquid assets of suitable credit quality at all times and, where appropriate, to have access to borrowings so as to be able to meet all foreseeable current liabilities as they fall due in a cost-effective manner. Forecasts are prepared regularly to predict required liquidity levels over both the short and medium term allowing management to respond appropriately to changes in circumstances.

Some of the Company's commercial property investments are held through a unit trust. This unit trust has the power to restrict and/or suspend withdrawals, which would, in turn, affect liquidity. To date, the unit trust has continued to process both investments and realisations in a normal manner and has not imposed any restrictions or delays.

The Company's investments in the Ignis Fundamental Solutions Fund ("IFSF") and the Ignis Strategic Solutions Fund ("ISSF") are managed by Ignis Asset Management Limited, a fellow group company. The fund managers of the underlying funds have the power to impose gates on redemptions which can restrict available liquidity within the funds.

The following table provides a maturity analysis showing the remaining contractual maturities of the Company's undiscounted financial liabilities and associated interest. The contractual maturities of liabilities under insurance contracts are included based on the estimated timing of the amounts recognised in the statement of financial position in accordance with the requirements of IFRS 4:

At 31 December 2013

	1 year or less or on demand £m	1-5 years £m	Greater than 5 years £m	No fixed term £m	Total £m
Liabilities under insurance contracts	753	2,459	5,228	2,453	10,893
Investment contracts	350	-	-	-	350
Borrowings	-	-	250	-	250
Deposits received from reinsurers	-	-	-	1,776	1,776
Derivatives	51	51	984	-	1,086
Obligations for repayment of collateral received	1,644	50	127	-	1,821
Payables related to direct insurance contracts	73	-	-	-	73
Accruals and deferred income	3	-	-	-	3
Other payables	62	-	-	-	62

At 31 December 2012

	1 year or less or on demand £m	1-5 years £m	Greater than 5 years £m	No fixed term £m	Total £m
Liabilities under insurance contracts	798	2,580	5,624	2,572	11,574
Investment contracts	324	-	-	-	324
Borrowings	-	-	250	-	250
Deposits received from reinsurers	-	-	-	1,936	1,936
Derivatives	27	90	1,615	-	1,732
Obligations for repayment of collateral received	2,973	135	418	-	3,526
Payables related to direct insurance contracts	80	-	-	-	80
Accruals and deferred income	12	-	-	-	12
Other payables	90	-	-	-	90

Investment contract policyholders have the option to terminate or transfer their contracts at any time and to receive the surrender or transfer value of their policies. Although these liabilities are payable on demand, and are therefore included in the contractual maturity analysis as due within one year, the Company does not expect all these amounts to be paid out within one year of the reporting date.

A significant proportion of the Company's financial assets are held in gilts, cash, supranationals and investment grade securities which the Company considers sufficient to meet the liabilities as they fall due.

Unit-linked contracts

For unit-linked contracts the Company matches all the liabilities with assets in the portfolio on which the unit prices are based. With the exception of reinsurance exposures on certain lines of unit-linked business there is therefore no interest, price, currency or credit risk for the Company on these contracts.

In extreme circumstances, the Company could be exposed to liquidity risk in its unit-linked funds. This could occur where a high volume of surrenders coincides with a tightening of liquidity in a unit-linked fund to the point where assets of that fund have to be sold to meet those withdrawals. Where the fund affected consists of property, it can take several months to complete a sale and this would impede the proper operation of the fund. In these situations, the Company considers its risk to be low since there are steps that can be taken first within the funds themselves both to ensure the fair treatment of all investors in those funds and to protect the Company's own risk exposure.

Insurance risk

Insurance risk refers to the risk that the frequency or severity of insured events may be worse than expected and includes expense risk. The Company's liabilities under insurance contracts are detailed in note 16 and include the following sources of insurance risk:

- Mortality – Higher than expected death claims on assurance products;
- Longevity – Lower than expected number of deaths experienced on annuity products or greater than expected improvements in life expectancy on immediate and deferred annuity products;
- Expenses – Policies cost more to administer than expected;
- Lapses – An adverse movement in either surrender rates or persistency rates on policies with guaranteed benefits leading to losses. This includes the risk of greater than expected policyholder option exercise rates giving rise to increased claims costs

Objectives and policies for mitigating insurance risk

The Company uses several methods to assess and monitor insurance risk exposures both for individual types of risks insured and overall risks. These methods include internal risk measurement models, experience analyses, external data comparisons, sensitivity analyses, scenario analyses and stress testing. In addition to this, mortality, longevity and morbidity risks are in certain circumstances mitigated by the use of reinsurance.

The profitability of the run-off of the Company's closed long-term insurance business depends to a significant extent on the values of claims paid in the future relative to the assets accumulated to the date of claim. Typically, over the lifetime of a contract, premiums and investment returns exceed claim costs in the early years and it is necessary to set aside these amounts to meet future obligations. The amount of such future obligations is assessed on actuarial principles by reference to assumptions about the development of financial and insurance risks.

It is therefore necessary for the Board to make decisions, based on actuarial advice, which ensure an appropriate accumulation of assets relative to liabilities. These decisions include investment policy, bonus policy and, where discretion exists, the level of payments on early termination.

Sensitivities

Insurance liabilities are sensitive to changes in risk variables, such as prevailing market interest rates, currency rates and equity prices, since these variations alter the value of the financial assets held to meet obligations arising from insurance contracts and changes in investment conditions also have an impact on the value of insurance liabilities themselves. Additionally, insurance liabilities are sensitive to the assumptions which have been applied in their calculation. Sometimes allowance must also be made for the effect on future assumptions of management or policyholder actions in certain economic scenarios. The most significant non-economic sensitivities arise from mortality, longevity and lapse risk.

A decrease of 5% in assurance mortality, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year and an increase in equity of £1m (2012: £2m). An increase of 5% in assurance mortality, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year and a decrease in equity of £1m (2012: £2m).

A decrease of 5% in annuitant longevity, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year and an increase in equity of £24m (2012: £23m). An increase of 5% in annuitant longevity, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year and a decrease in equity of £24m (2012: £23m).

A decrease of 25% in lapse rates, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year and an increase in equity of £5m (2012: £nil). An increase of 25% in lapse rates, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year and a decrease in equity of £5m (2012: £nil).

Assumptions

Valuation of participating insurance and investment contracts

For participating business, which is with-profits business (insurance and investment contracts), the insurance contract liability is stated at the amount of the realistic value of the liabilities, adjusted to exclude the owners' share of future bonuses and the associated tax liability. This is a market consistent valuation, which involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns.

Valuation of non-participating insurance contracts

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

Process used to determine assumptions

For participating business the assumptions about future demographic trends are intended to be "best estimates". They are determined after considering the Company's 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 year a number of changes were made to assumptions to reflect changes in expected experience or to harmonise the approach across the Phoenix Group. The impact of material changes during the year were as follows:

	Increase/ (decrease) in insurance liabilities 2013 £m	Increase/ (decrease) in insurance liabilities 2012 £m
Change in longevity assumptions	(8)	5
Change in persistency assumptions	2	4
Change in expenses assumptions	(6)	(2)

Valuation interest rate

For participating business the liabilities are determined stochastically using an appropriate number of risk neutral scenarios produced by an economic scenario generator calibrated to market conditions and gilt yields as at the valuation date.

For non-participating business, assets are firstly hypothecated to classes of business being valued. The valuation interest rates for each block of business are based on the expected returns of the hypothecated assets. The yield is then adjusted to make allowance for credit risk, liquidity risk, reinvestment risk and investment management expenses.

Valuation interest rates for the non-participating business are typically:

	2013	2012
Product:		
Life non-profit non-linked	2.51%	2.24%
Pension non-profit non-linked	3.43%	2.83%
Life annuities	3.23%	2.55%
Term assurance	2.51%	2.24%
Pension annuities in payment	3.34%	2.95%
Deferred pension annuities	3.39%	2.80%
Index-linked annuities	3.50%	2.83%

Expense inflation

Expenses are assumed to increase at the rate of increase in the Retail Price Index ("RPI") or Retail Price Index excluding mortgage payments ("RPIX") plus typical fixed margins in accordance with the various Management Service Agreements ("MSAs") the Company has in place with outsourced service providers. For with-profits business the rate of RPI inflation is determined within each stochastic scenario. For other business it is based on the Bank of England inflation spot curve. For MSAs with contractual increases set by reference to national average earnings inflation, this is approximated as RPI inflation plus 1%. In instances in which inflation risk is not mitigated, a further margin for adverse deviations may then be added to the rate of expense inflation.

Mortality and longevity rates

Mortality rates are based on published tables, adjusted appropriately to take account of changes in the underlying population mortality since the table was published, company experience and forecast changes in future mortality. Where appropriate, a margin is added to assurance mortality rates to allow for adverse future deviations. Annuitant mortality rates are adjusted to make allowance for future improvements in pensioner longevity. The mortality assumptions were varying proportions of the following published tables:

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	Published Table 2013	Published Table 2012
Annuities in payment (UK – level)	109.2% RMV00	109.2% RMV00
	106.8% RFV00	106.8% RFV00
Annuities in payment (UK – index linked)	109.2% RMV00	109.2% RMV00
	106.8% RFV00	106.8% RFV00
Annuities in payment (Euro denominated)	-	-
	97% AM00	97% AM00
	97% AF00	97% AF00
Deferred Annuities (UK, in deferment)	109.2% RMV00	109.2% RMV00
	106.8% RFV00	106.8% RFV00
	AMC00	AMC00
Whole of life and endowments	AFC00	AFC00
	A67-70	
	AM80	
Term assurance	AF80	AM80
	A67-70	AF80

A sample of the assumed future annual longevity improvement rates is shown below:

Females	2014	2024	2034	2044	2054
Age 60	1.99%	2.30%	2.39%		
Age 70	2.83%	2.35%	2.43%	2.46%	
Age 80	3.33%	2.49%	2.15%	2.24%	2.22%
Males	2014	2024	2034	2044	2054
Age 60	2.31%	1.50%	2.47%		
Age 70	3.56%	2.06%	1.99%	2.45%	
Age 80	3.32%	2.65%	1.97%	2.12%	2.22%

Lapse rates

The assumed rates for surrender and voluntary premium discontinuance in the participating business depend primarily on the length of time a policy has been in force. Withdrawal rates used in the valuation of with-profits policies are based on observed experience and adjusted when it is considered that future policyholder behaviour will be influenced by different considerations than in the past. In particular, it is assumed that withdrawal rates for unitised with-profits contracts will be higher on policy anniversaries on which Market Value Adjustments do not apply.

Policyholder options and guarantees

Some of the Company's products give potentially valuable guarantees, or give options to change policy benefits which can be exercised at the policyholders' discretion. These products are described below.

Most with-profits contracts give a guaranteed minimum payment on a specified date or range of dates or on death if before that date or dates. For pension contracts, the specified date is the policyholder's chosen retirement date or a range of dates around that date. For endowment contracts, it is the maturity date of the contract. For with-profits bonds it is often a specified anniversary of commencement, in some cases with further dates thereafter. Annual bonuses when added to with-profits contracts usually increase the guaranteed amount.

There are guaranteed surrender values on a small number of older contracts.

Some pension contracts include guaranteed annuity options (see deferred annuities below for details). The total amount provided in the with-profits funds in respect of the future costs of guaranteed annuity options are £957m (2012: £1,229m).

Discretionary participating bonus rate

The regular bonus rates assumed in each scenario are determined in accordance with the Company's PPFM. Final bonuses are assumed at a level such that maturity payments will equal asset shares subject to smoothing rules set out in the PPFM.

With-profits deferred annuities participate in profits only up to the date of retirement. At retirement, a guaranteed cash option allows the policyholder to commute the annuity benefit into cash on guaranteed terms.

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In common with other life companies in the UK which have written pension transfer and opt-out business, the Company has set up provisions for the review and possible redress relating to personal pension policies. These provisions, which have been calculated from data derived from detailed file reviews of specific cases, are included in liabilities arising under insurance contracts. The total amount provided in the with-profits funds in respect of the review and possible redress relating to pension policies, including associated costs, are £240m (2012: £324m).

Managing product risk

The following sections give an assessment of the risks associated with the Company's main life assurance products and the ways in which the Company manages those risks.

The following tables provide a product analysis of the liabilities under insurance contracts and reinsurers' share of insurance contract liabilities within the statement of financial position.

	2013 Gross		2013 Reinsurance	
	Insurance contracts £m	Investment contracts with DPF £m	Insurance contracts £m	Investment contracts with DPF £m
With-profits funds:				
Pensions:				
Deferred annuities – with guarantees	2,463	91	-	-
Deferred annuities – without guarantees	4	-	-	-
Immediate annuities	132	-	-	-
Unitised with-profits	-	2,622	-	-
Total pensions	2,599	2,713	-	-
Life:				
Unitised with-profits	182	357	-	-
Life with-profits	1,014	-	7	-
Total life	1,196	357	7	-
Other	1,410	7	7	-
Non-profit funds:				
Deferred annuities – without guarantees	34	-	-	-
Immediate annuities	2,535	-	1,582	-
Protection	30	-	(4)	-
Other	12	-	-	-
	<u>7,816</u>	<u>3,077</u>	<u>1,592</u>	<u>-</u>
	2012 Gross		2012 Reinsurance	
	Insurance contracts £m	Investment contracts with DPF £m	Insurance contracts £m	Investment contracts with DPF £m
With-profits funds:				
Pensions:				
Deferred annuities – with guarantees	2,838	101	-	-
Deferred annuities – without guarantees	6	-	-	-
Immediate annuities	141	-	-	-
Unitised with-profits	-	2,691	-	-
Total pensions	2,985	2,792	-	-
Life:				
Unitised with-profits	183	406	-	-
Life with-profits	1,123	-	9	-
Total life	1,306	406	9	-
Other	1,421	7	-	-
Non-profit funds:				
Deferred annuities – without guarantees	40	-	-	-
Immediate annuities	2,563	-	1,835	-
Protection	39	-	(3)	-
Other	15	-	-	-
	<u>8,369</u>	<u>3,205</u>	<u>1,841</u>	<u>-</u>

With-profits fund (Unitised and Traditional)

The Company operates three with-profits funds in which the with-profits policyholders benefit from a discretionary annual bonus (guaranteed once added in most cases) and a discretionary final bonus. Non-profit business is also written in the with-profits funds and includes immediate annuities and deferred annuities with Guaranteed Annuity Rates ("GAR").

The investment strategy of each fund differs, but is broadly to invest in a mixture of fixed and variable rate income securities, equities and property and other asset classes in such proportions as is appropriate to the investment risk exposure of the fund and its capital resources.

The Company has significant discretion regarding investment policy, bonus policy and early termination values. The process for exercising discretion in the management of the with-profits fund is set out in the PPFM for each with-profits fund and is overseen by with-profits committees. Advice is also taken from the with-profits actuary. Compliance with the PPFM is reviewed annually and reported to the PRA and policyholders.

The bonuses are designed to distribute to policyholders a fair share of the return on the assets in the with-profits funds together with other elements of the experience of the fund. The owners of the Company are entitled to receive one-ninth of the cost of bonuses declared for one fund and £nil for the two funds.

Unitised and traditional with-profits policies are exposed to equivalent risks, the main difference being that unitised with-profits policies purchase notional units in a with-profits fund whereas traditional with-profits policies do not. Benefit payments for unitised policies are then dependent on unit prices at the time of a claim, although charges may be applied. A unitised with-profits fund price is typically guaranteed not to fall and increases in line with any discretionary bonus payments over the course of one year.

Deferred annuities

Deferred annuity policies are written to provide either a cash benefit at retirement, which the policyholder can use to buy an annuity on the terms then applicable, or an annuity payable from retirement. The policies contain an element of guarantee expressed in the form that the contract is written in i.e. to provide cash or an annuity. Deferred annuity policies written to provide a cash benefit may also contain an option to convert the cash benefit to an annuity benefit on guaranteed terms; these are known as Guaranteed Annuity Rates ("GAR") policies.

During the last decade, interest rates and inflation have fallen and life expectancy has increased more rapidly than originally anticipated. Deferred annuity policies which are written to provide annuity benefits are managed in a similar manner to immediate annuities and are exposed to the same risks.

The guaranteed terms on GAR policies are more favourable than the annuity rates currently available in the market available for cash benefits.

The option provisions on GAR policies are particularly sensitive to downward movements in interest rates, increasing life expectancy and the proportion of customers exercising their option. Adverse movements in these factors could lead to a requirement to increase reserves which could adversely impact profit and potentially require additional capital. In order to address the interest rate risk (but not the risk of increasing life expectancy or changing customer behaviour with regard to exercise of the option), the Company has purchased derivatives that provide protection against an increase in liabilities and have thus reduced the sensitivity of profit to movements in interest rates.

The Company seeks to manage this risk in accordance with both the terms of the issued policies and the interests of customers, and has obtained external advice supporting the manner in which it operates the long-term funds in this respect.

Immediate annuities

This type of annuity is purchased with a single premium at the outset, and is paid to the policyholder for the remainder of their lifetime. Payments may also continue for the benefit of a surviving spouse or partner after the annuitant's death. Annuities may be level, or escalate at a fixed rate, or may escalate in line with a price index and may be payable for a minimum period irrespective of whether the policyholder remains alive.

The main risks associated with this product are longevity and investment risks. Longevity risk arises where the annuities are paid for the lifetime of the policyholder, and is managed through the initial pricing of the annuity and through reinsurance (appropriately collateralised) or transfer of existing liabilities. Annuities may also be a partial 'natural hedge' against losses incurred in protection business in the event of increased mortality (and vice versa) although the extent to which this occurs will depend on the similarity of the demographic profile of each book of business.

The pricing assumption for mortality risk is based on both historic internal information and externally generated information on mortality experience, including allowances for future mortality improvements. Pricing will also include a contingency margin for adverse deviations in assumptions.

Investment risk depends on the extent to which the annuity payments under the contracts have been matched by suitable assets which is managed under the ALM framework. Asset/liability modelling is used to monitor this position on a regular basis.

Protection

These contracts are typically secured by the payment of a regular premium payable for a period of years providing benefits payable on certain events occurring within the period. The benefits may be a single lump sum or a series of payments and may be payable on death, serious illness or sickness.

The main risk associated with this product is the claims experience and this risk is managed through the initial pricing of the policy (based on actuarial principles), the use of reinsurance and a clear process for administering claims.

37. Operating leases

Operating lease rentals charged within administrative expenses amounted to £1m (2012: £1m).

The Company has commitments under non-cancellable operating leases on various closed properties as set out below:

	2013 £m	2012 £m
Not later than one year	2	1
Later than one year and no later than five years	<u>4</u>	<u>4</u>
	<u>6</u>	<u>5</u>

38. Commitments

	2013 £m	2012 £m
To subscribe to private equity funds and other unlisted assets	82	101
To purchase, construct or develop investment property	33	46

39. Contingent liability

The Company has committed to provide further capital to NPLL if it is required by NPLL to meet its capital policy, provided that in doing so the Company continues at all times to be able to meet its own capital policy.

40. Related party transactions

The Company enters into transactions with related parties in its normal course of business. These are at arm's length on normal commercial terms apart from transfers of long-term business.

Pearl Group Services Limited provides management services to the Company, in the form of staff and other services, under a management services agreement. The charge made to the Company for the year ended 31 December 2013 amounted to £56m (2012: £60m) and at the end of the year £1m (2012: £2m) remained outstanding.

Ignis Investment Services Limited, a fellow subsidiary and its subsidiaries provide investment management services to the Company in accordance with a number of investment management agreements. The charge made to the Company for the year ended 31 December 2013 amounted to £20m (2012: £22m) and at the end of the year £10m (2012: £9m) remained outstanding.

In the year ended 31 December 2013 the Company paid dividends to its immediate parent company of £231m (2012: £150m).

On 2 October 2013 the Company made an interest-bearing loan of £20m to PGH2, the Company's immediate parent.

On 1 November 2013, loans of £211m, £212m and £55m to PGH2 were replaced by two interest-bearing loans of £423m and £55m.

On 13 December 2013, loans of £61m and £24m to PGH2, the Company's immediate parent, were replaced by adding £85m to the interest-bearing loan of £423m issued on 1 November 2013.

The Company received interest on loans to its subsidiaries of £6m (2012: £7m), received interest on loans to its parent of £1m (2012: £2m), capitalised interest on loans to its parent of £12m (2012: £12m) and paid interest on loans from its parent of £4m (2012: £5m).

The Company paid capital contributions to its subsidiary NPLH of £nil (2012: £100m).

PHOENIX LIFE ASSURANCE LIMITED

In the year ended 31 December 2013 the Company received premiums of £18m (2012: £1,070m) from Opal Re on the cancellation of the reinsurance of annuity in-payment liabilities.

At 31 December 2013, the Company held 540,612 (2012: 540,612) ordinary shares in Phoenix Group Holdings, its ultimate parent company, which had a market value of £4m (2012: £3m).

With effect from 1 July 2012, all of the long-term business of and the majority of the shareholders' funds of London Life Limited were transferred to the company for £nil consideration in accordance with a scheme under Part VII of the Financial Services and Markets Act 2000 ("The LL Scheme") approved by the High Court on 24 September 2012. On 24 October 2013 the remaining £4m in the London Life shareholder fund was transferred to the Company for £nil consideration.

On 5 March 2013 NPLL repaid £13m of the 9.25% £65m subordinated unsecured loan notes.

On 25 March 2013 NPLH repaid a loan of £80m and accrued interest of £5m.

In November 2013, leveraged loans of £150m were transferred by the Company to PLL in exchange for cash and corporate bonds of equivalent value.

Reinsurance transactions

	2013 £m	2012 £m
Reinsurance accepted from fellow group companies:		
Premiums written under on-going arrangements	50	47
Reinsurance cancellation premium paid (note 3)	-	(685)
Claims	(34)	(63)
Reinsurance ceded to fellow group companies:		
Premiums ceded under on-going arrangements	-	3
Cancellation premium received (note 4)	(18)	(1,070)
Claims	-	(1)
Share of reinsurance assets	1,582	1,829

Amounts due to related parties

	2013 £m	2012 £m
Loans due to parent	250	250
Deposits received from reinsurers	1,776	1,936
Other amounts due to fellow subsidiaries	10	12
	<u>2,036</u>	<u>2,198</u>

Amounts due from related parties

	2013 £m	2012 £m
Loans due from parent	586	554
Loans due from subsidiary companies	109	204
Loans due from fellow subsidiaries	27	29
Other amounts due from subsidiaries	3	12
Other amounts due from fellow subsidiaries	3	-
	<u>728</u>	<u>799</u>

Key management compensation

The compensation payable to employees classified as key management, which comprises the Directors, is disclosed in note 8.

During the year to 31 December 2013, key management and other family members contributed £1,200 (2012: £1,200) to products sold by the Company. These related primarily to investment, life and pensions products.

Parent and ultimate parent entity

Information on the Company's parent and ultimate parent is given in note 41.

41. Other information

The Company's principal place of business is the United Kingdom. The Company's immediate parent is Pearl Group Holdings (No.2) Limited and its ultimate parent is Phoenix Group Holdings, a company incorporated in the Cayman Islands and resident in Jersey. A copy of the financial statements of Phoenix Group Holdings can be obtained from the Company Secretary, 1st Floor, 32 Commercial Street, St. Helier, Jersey, JE2 3RU.