Interim Results for Partnership Assurance Group plc (‘Partnership’)

For the half year ended 30 June 2014

14 August 2014

ANNUITY MARKET DISRUPTION CONTINUES TO CREATE UNCERTAINTY BUT OPPORTUNITIES IDENTIFIED TO BUILD STRONGER AND MORE DIVERSIFIED BUSINESS

Financial highlights

- New business premiums[1] of £409 million (HY13: £631 million), including:
  - £334 million of individual annuities (HY13: £590 million), with sales of £135 million in Q2 reflecting the impact of the Budget
  - £37 million of underwritten Defined Benefit (‘DB’) bulk annuity sales (HY13: £11 million), follows a strong start to the year building on Partnership’s market-leading capability in the underwritten DB market
  - Care annuities and Protection sales continue to be unaffected by the Budget proposals at £36 million and £2 million, respectively (HY13: £28 million and £2 million, respectively)
- Total operating profits of £33 million (HY13: £59 million) comprising:
  - £18 million of new business operating profits (HY13: £38 million), representing a new business margin of 4.4% (HY13: 6.0%). Reduction since prior year reflects impact of the Budget on individual annuity sales and the associated lower contribution to overheads
  - £7 million of in-force operating profits (HY13: £18 million, including £11 million of non-recurring assumption changes)
  - Return on surplus assets of £9 million (HY13: £3 million), representing a yield of 4.6% on a larger pool of surplus assets relative to comparable period
- IFRS profit before tax £15 million (HY13: £9 million) after £9m of negative investment variances and £10 million of other non-recurring expenditure
- MCEV per share increased to 136p at 30 June 2014 (31 December 2013: 130p)
- Assets under management increased by £380 million to £4.43 billion at 30 June 2014 (31 December 2013: £4.05 billion)
- Estimated economic capital surplus remains robust at £170 million (31 December 2013: £173 million) with coverage of 153% at 30 June 2014 (31 December 2013: 159%)
- Interim dividend of 0.5p per share

Operational highlights

- Underlying operating expenses decreased to £42 million from £43 million in the second half of 2013, with actions taken since the Budget more than offsetting the full impact of Plc costs and inflation, demonstrating the flexibility of the cost base
- The cost management proposals announced in June together with the actions taken immediately post Budget are expected to generate annualised cost savings of £21 million against the anticipated 2015 cost base, resulting in total underlying operating expenses of approximately £80 million in 2015
- Ability to leverage Intellectual Property (‘IP’) and innovate rapidly demonstrated through launch of Enhanced Choice Annuity within 8 weeks of the Budget, combining customer desire for flexibility with a guaranteed income for life. Continuing to explore further opportunities to deploy IP across new products
- DB proposition strengthened and extended to offer trustees a greater range of de-risking options. Very encouraging pipeline growth of over 50% in the second quarter, but sales remain lumpy and timing of completion of deals more likely to be weighted towards Q4 2014 or Q1 2015 than Q3 2014. Pipeline spread across 12 different Employee Benefit Consultants

('EBCs') reflecting both the increasing recognition of medical underwriting in defined benefit de-risking and the stronger and broader relationships with EBCs

- Significant opportunity identified in US. Partnership's IP evaluated and results indicate validity of dataset. Currently exploring the most appropriate market entry strategy
- Investment management agreement signed with Rothschild to invest £150 million in commercial mortgages, further diversifying the investment portfolio. Partnership will benefit from Rothschild's extensive experience of managing this asset class and Rothschild will co-invest alongside Partnership

Current trading

- Significant disruption to Partnership's core market continues as advisors and customers digest the implications of the proposed changes in pensions announced at the Budget and await confirmation of new regulations
- Quotes of individual annuities below 50% of levels seen in comparable period last year with conversion levels also down, leading to current sales being below 50% of Q1 2014 levels. However, it is unclear whether sales will stabilise at this level given the ongoing uncertainty surrounding guidance and regulations
- Risk selection and pricing discipline continue to be prioritised over market share growth
- Partnership welcomes the Government's response to its consultation on "Freedom and choice in pensions", in particular the recognition of the need for impartial guidance and the acknowledgement that annuities will remain the right product for many. Partnership will continue to work with the Government as the detail underpinning the reforms is further developed

Steve Groves, Chief Executive Officer, commented:

"We continue to see significant disruption in the individual annuity market as a result of the Budget, however, despite this uncertainty, we are continuing to focus on a long term strategy, based around our core competencies, which is intended to deliver a stronger and more diversified business over time. This includes extending our defined benefit de-risking proposition, developing new products to meet the expected ongoing customer need for longevity insurance and progressing opportunities to leverage our unique dataset internationally.

We have taken decisive action to manage our cost base in light of the disruption and will continue to maintain pricing discipline and only write business that is economically attractive.

Significant uncertainty remains regarding the long term impact of the Budget proposals, but I believe our strategy will help ensure Partnership is well-positioned for the evolving retirement market."

Chris Gibson-Smith, Chairman, commented:

"Partnership is adapting to the new environment by targeting opportunities identified to deliver growth and diversify the business, founded on our unique Intellectual Property. While a good start has been made, much has still to be accomplished and many uncertainties remain. Under these circumstances the Board believes it important to retain financial flexibility but at the same time recognises the importance to shareholders of regular dividend payments. It has therefore declared an interim dividend of 0.5p per share. The Board will next review dividend payments at the time of the full year results in early 2015."

Notes:

(1) New business premiums are Single Premium Equivalent (SPE) sales completed in the period. These are recorded when funds have been received from the policyholder. Quarterly and half year SPE totals are subject to rounding.

Enquiries

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Further information

A copy of this announcement is available on Partnership's website www.partnership-group.com

A presentation for analysts and investors will take place at 9am (UK time) today at Bank of America Merrill Lynch, 2, King Edward St, London, EC1A 1HQ.

Access to the webcast and a copy of the presentation will also be available via our website.

A replay of the presentation will be made available on the website.

Participants may also dial in as follows:
+44 (0)20 3059 8125
Please quote "Partnership" to access the call.

Financial calendar

20 August 2014	Interim dividend ex-dividend date
22 August 2014	Interim dividend record date
30 October 2014	Interim dividend payment date
12 November 2014	2014 Q3 interim management statement
3 March 2015	2014 full year results

Forward looking statements

This announcement in relation to Partnership Assurance Group Plc and its subsidiaries (the 'Group') contains, and we may make other statements (verbal or otherwise) containing, forward-looking statements about the Group's current plans, goals and expectations relating to future financial conditions, performance, results, strategy and/or objectives.

Statements containing the words: 'believes', 'intends', 'expects', 'plans', 'seeks', 'targets', 'continues' and 'anticipates' or other words of similar meaning are forward-looking (although their absence does not mean that a statement is not forward-looking). Forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control. For example, certain insurance risk disclosures are dependent on the Group's choices about assumptions and models, which by their nature are estimates. As such, actual future gains and losses could differ materially from those that we have estimated.

Other factors which could cause actual results to differ materially from those estimated by forward-looking statements include but are not limited to: domestic and global economic and business conditions; asset prices; market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of governmental and/or regulatory authorities, including, for example, new government initiatives related to the provision of retirement benefits or the costs of social care and the effect of the European Union's "Solvency II" requirements on the Group's capital maintenance requirements; the impact of inflation and deflation; market competition; changes in assumptions in pricing and reserving for insurance business (particularly with regard to mortality and morbidity trends, gender pricing and lapse rates); risks associated with arrangements with third parties, including joint ventures and distribution partners; inability of reinsurers to meet obligations or unavailability of reinsurance coverage; the impact of changes in capital, solvency or accounting standards, and tax and other legislation and regulations in the jurisdictions in which the Group operates.

As a result, the Group's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set out in the forward-looking statements within this announcement. The Group undertakes no obligation to update any of the forward-looking statements contained within this announcement or any other forward-looking statements it may make. Nothing in this announcement should be construed as a profit forecast.

Performance review

Total new business premiums were £409m for the half year ended 30 June 2014, a decrease of 35% on the same period last year.

SPE	**Half year ended 30 June 2014 £m**	Half year ended 30 June 2013 £m	Year ended 31 December 2013 £m
Individual retirement annuities	**334**	590	1,076
Defined benefit buy-in/ buy-out annuities	**37**	11	84
Individual care annuities	**36**	28	66
Individual protection annuities	**2**	2	3
Total new business premiums	**409**	631	1,229

Individual retirement annuities

Retirement annuities sold to individuals form the majority of our business. New business premiums for retirement annuities decreased by 43% to £334m (HY 2013: £590m).

The sales result in the first half of the year reflects the pre-Budget performance and subsequently lower post-Budget sales. The March 2014 Budget announcements on changes to the Pension Taxation regime have made a significant impact on sales since that date. Despite the uncertainty that the announcement has caused, the majority of people with annuities in our pipeline decided to continue with their purchase after discussion with their advisers. However, the announcement has resulted in lower quote volumes and this has resulted in lower completions in the second quarter of the year, with sales now running at below 50% of pre-budget levels as a result.

In May, we launched a new flexible product the Enhanced Choice Annuity, in response to the requirement for increased flexibility for customers. The product has the benefit of immediate access to a guaranteed income for life and a tax-free lump sum, but also offers the choice of 'cashing in' the annuity should there be a better option available in 12 months' time.

There remains significant uncertainty over the near-term level of annuity sales as research indicates that people are currently deferring their retirement or their at-retirement decumulation decisions. This level of deferral may increase as we approach April 2015 and the changes to the Pensions Tax rules are implemented.

In the longer term, it is likely that the increased flexibility will lead to fewer people buying an annuity. However, consumer research indicates that a guaranteed income for life continues to be an attractive retirement option. It is also clear that longevity risk cannot be managed on an individual basis.

Post April 2015, we see the potential for our addressable share of the market increasing as more retirees are encouraged to shop-around through the impartial guidance process. We are pleased to note that the guidance process will be impartial and we will continue to work with government, regulatory and industry stakeholders as the new regime is developed.

The long-term structural drivers behind the growth of the defined contribution pension market remain intact. The new regulations create the opportunity to develop new products where our unrivaled intellectual property and nimble product development capability mean we are well positioned for success in the future.

Defined benefit buy-in/ buy-out annuities

Defined benefit bulk annuity ('DB') sales are unaffected by the Budget and have grown to £37m, representing more than a threefold increase over the equivalent period last year.

We have continued to invest in the development of our defined benefit de-risking proposition with investments into our support infrastructure and our sales capability over the first half of the year to ensure that we are best-placed to succeed in this nascent and potentially material market.

The core market for our proposition is smaller pension schemes, with fund sizes up to £100m. In 2013, this segment represented around £180 billion of funds out of a total market size of around £1.8

trillion[1]. A total of 208 de-risking deals were completed in 2013 in our core market totalling £3.2bn. Of these only 3% were medically underwritten.

Our focus is on increasing the proportion of deals that are medically underwritten. We have extended and strengthened our distribution network and Employee Benefits Consultant (EBC) relationships in the first half of 2014 and are encouraged by the acceptance of medically underwritten transactions amongst EBCs, Scheme Trustees and sponsoring companies.

As a consequence, our pipeline of potential DB deals continues to grow and is up by more than 50% in the second quarter of 2014.

The timing and size of future DB deals will be difficult to accurately predict and sales are likely to be lumpy but the growing pipeline, our market-leading experience and track record in medical underwriting leaves us very confident in the opportunity for significant growth.

Individual care annuities

Sales of care annuities are unaffected by the Budget and increased by 29% to £36m (HY 2013: £28m).

The sale of annuities for funding long-term care represents a good performance and is in line with our expectations. After subdued trading in 2013, which reflected the outcome of the RDR on advisers selling care annuities and uncertainty surrounding Government Care policy, advisers do appear to be returning to the market.

Quote activity showed modest growth quarter on quarter in 2014 but is stabilising after the disruption of the last few quarters. However, the conversion from quote to policy for Individual Needs Annuities (INAs) can be lengthy and unpredictable and the impact on sales can take longer to be seen.

Individual protection

Protection sales were unaffected by the Budget and remained flat at £2m (HY 2013: £2m). Partnership regards protection as an opportunity to leverage our proprietary Intellectual Property (IP) to be able to provide protection cover for people that other insurers cannot quote for.

Whilst a small component of our business in 2014, there are significant opportunities to grow in the future.

Operating profit before tax

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
New business operating profit	**17,803**	38,162	85,678
In-force operating profit	**6,840**	17,966	34,278
Long-term expected return on surplus assets	**8,746**	3,136	11,435
Operating profit	**33,389**	59,264	131,391

Total operating profit

Total operating profit is considered by the Board to be the core measure of underlying performance for the Group.
Total operating profit in the half year to 30 June 2014 was £33.4m (HY 2013: £59.3m), a decrease of 44%.

The decrease in operating profit reflects a lower contribution from new business and lower contribution from the in-force business, partially offset by a higher expected return on surplus assets.

The component parts of the total operating profit and the movements in each are set out below:

[1] Source: PDF purple book 2013

New business operating profit

New business operating profit indicates the level of profit generated on the business sold in the year. We have delivered new business operating profits of £17.8m (HY 2013: £38.2m), achieving a new business margin of 4.4% (HY 2013: 6.0%).

New business operating profit decreased due largely to lower volumes of annuity sales following the Budget announcement and also due to a very strong comparative performance in H1 2013. The overall impact of reduced volumes on new business operating profit has been mitigated to an extent by our maintenance of pricing discipline and by the expense actions that we took immediately after the Budget announcement to contain expenses.

We anticipate that the new business margin (net of expenses) will decrease further in the second half of the year as individual annuity volumes settle at a lower post-budget level, offset to a degree by the impact of the expense reduction measures beginning to take effect.

In-force operating profit

In-force operating profit shows the profits earned in the management of the in-force business and demonstrates the robustness of the key operating assumptions made at point-of-sale.

Profits emerging from the in-force book in the half year to 30 June 2014 were £6.8m (HY 2013: £18.0m). The first half of 2013 benefitted from the release of expense reserves arising from the economies of scale realised on in-force business following the transfer of the administration of a significant block of in-force annuities onto our in-house administration platform. This release of reserves was not expected to recur.

The level of in-force operating profits are in line with our expectations and reflect the increased size of the business, offset by other factors, including the impact of lower release of default margins because of lower spreads on corporate bonds.

Long-term expected return on surplus assets

Long-term expected return on surplus assets measures the impact of our investment strategy for surplus assets and contributes towards our objective of maximising risk-adjusted returns.

We recorded an increase in expected return on surplus assets to £8.7m (HY 2013: £3.1m), reflecting the growth in surplus assets in the period and the allocation of surplus assets out of cash and into higher-yielding assets. In the period we have invested part of the surplus funds into equity release assets which were not required to back insurance liabilities. These assets are available to back future annuity business.

The long-term expected return is derived from applying an average expected yield appropriate to the category of surplus assets held, and is adjusted for the best-estimate expected level of defaults on those investments. The risk-adjusted annual yields applied to surplus assets during the period were:

	Half year ended 30 June 2014	Half year ended 30 June 2013	Year ended 31 December 2013
Cash	**0.5%**	0.5%	0.5%
Gilts	**3.0%**	3.0%	3.0%
Corporate bonds	**4.5%**	4.5%	4.5%
Commodity Trade Finance loans	**10.0%**	n/a	10.0%
Equity Release mortgages	**6.0%**	n/a	n/a

IFRS profit before tax

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
New business operating profit	**17,803**	38,162	85,678
In-force operating profit	**6,840**	17,966	34,278
Long-term expected return on surplus assets	**8,746**	3,136	11,435
Operating profit	**33,389**	59,264	131,391
Investment variances	**(9,043)**	3,158	8,643
Non-recurring expenditure	**(9,656)**	(28,517)	(30,769)
Other	**321**	(664)	(1,201)
Interest on borrowings	**-**	(24,679)	(25,403)
Profit from continuing operations before tax	**15,011**	8,562	82,661

IFRS profit before tax indicates the (pre-tax) level of profit contributing to regulatory capital and potentially available for distribution to shareholders.

IFRS profit before tax amounted to £15.0m compared to £8.6m for 2013. The increase is primarily due to the positive impact of lower one-off costs following the IPO in June 2013 and reduced interest costs partially offset by lower operating profits.

The growth in profit before tax includes £9.0m of negative investment variances against long-term assumptions and the impact of non-recurring expenses in this period, which included a total of £1.2m related to expected restructuring costs and £6.0m due to impairment of distribution assets following the budget announcement.

Earnings per share

Basic earnings per share was 3 pence (2013: 1 pence). The increase in earnings per share reflects the increase in profit for the period, partially offset by the 37% increase in the basic weighted average number of shares. The incresase in weighted average number of shares follows the issue of shares in connection to the IPO in 2013. Diluted earnings per share was equivalent to basic earnings per share as the dilutive impact of instruments potentially giving rise to additional ordinary shares does not have a material impact.

Investment variances

The negative investment variance in the period is primarily due to the impact of falling risk-free rates partialy offset by a positive variance arising from tightening credit spreads.

Non-recurring expenditure

Non-recurring expenditure of £9.7m for the period (HY 2013: £28.5m) includes £1.2m of restructuring costs and £6.0m related to the impairment of prepayment assets relating to sales IT infrastructure, following the Budget announcement. Other non-recurring expenditure includes costs relating to regulatory projects (including Solvency II) and re-engineering of financial processes, development of new products and sales channels.

Other items

Other items of £0.3m (HY 2013: £0.7m loss) relate to interest on cash holdings at the holding company, sundry income and costs arising in the distribution subsidiaries of the Group and holding company expenses.

Interest on borrowings

The company was debt free in the first half of 2014 and interest costs were £nil (HY 2013: £24.7m).

During 2013 the outstanding loan notes were converted into equity as part of the IPO and related group restructuring and the bank loan was repaid from the proceeds of the IPO.

Dividends

Dividends will be recognised in the Consolidated Statement of Changes in Equity when paid. As set out in note 5, an interim dividend of 0.5 pence per share, at an expected total cost of £2m has been declared for payment in October 2014 and will be reflected in the Statement of Changes in Equity in the second half of the year.

MCEV

	Half year ended 30 June 2014			Half year ended 30 June 2013	Year ended 31 December 2013
	Covered business	**Non covered business**	**Total Group MCEV**	Total Group MCEV	Total Group MCEV
	£000's	**£000's**	**£000's**	£000's	£000's
Opening Group MCEV	**463,494**	**56,139**	**519,633**	9,890	9,890
Opening adjustments	**-**	**-**	**-**	-	-
Adjusted opening Group MCEV	**463,494**	**56,139**	**519,633**	9,890	9,890
Operating MCEV earnings	**41,862**	**-**	**41,862**	54,028	107,236
Non-operating MCEV earnings	**(4,822)**	**(363)**	**(5,185)**	(55,643)	(54,225)
Total MCEV earnings	**37,040**	**(363)**	**36,677**	(1,615)	53,011
Other movements in IFRS net equity	**-**	**239**	**239**	455,519	456,732
2013 final Dividend	**-**	**(12,000)**	**(12,000)**	-	-
Closing Group MCEV	**500,534**	**44,015**	**544,549**	463,794	519,633

Total market consistent embedded value (MCEV) as at 30 June 2014 was £545m, which compares to MCEV at 31 December 2013 of £520m. This represents £1.36 per share (31 December 2013: £1.30 per share).

MCEV movements in the period

The key driver of MCEV earnings was the value of new business written over the period, together with the impact of a lower allowance for frictional cost of capital.

During the period the approach for calculating the frictional cost of capital has been reassessed to more accurately reflect the assets backing required capital. This resulted in a one off increase in MCEV of approximately £10m.

The principal change in the value of the non-covered business is due to the payment of the 2013 final dividend of £12m.

Further details of MCEV and its movements in the period are set out in MCEV Supplementary Information which follows IFRS Financial Information.

Assets under management

Partnership assets by credit rating[2]:

	Half year ended 30 June 2014	Year ended 31 December 2013
	£m	£m
AAA	***637***	*611*
AA	***248***	*261*
A	***1,233***	*1,193*
BBB	***1,248***	*1,057*
Total Fixed Interest Securities	**3,366**	3,122
Commodity Trade Finance loans	**2**	12
Equity Release mortgages	**937**	840
Cash	**127**	78
Assets under management	**4,432**	**4,052**

Our investment strategy is to invest in assets that produce superior risk-adjusted yield and are efficient from an economic capital perspective.

Assets under management have increased to £4.4bn (31 December 2013: £4.1bn), including accrued interest, excluding £283m (31 December 2013: £272m) of assets that the Group manages on behalf of reinsurers under certain reinsurance arrangements.

Our investment portfolio (excluding equity release investments) is of high overall quality with in excess of 61% invested in bonds rated A or better and near 100% rated BBB or better.

During the first half of the year, the proportion of the assets invested in BBB rated bonds increased due to out-performance relative to our more highly rated bonds and due to normal investment trading activity.

During the first half of 2014 we have continued to source newly originated equity release loans and, whilst we continue to seek out attractive bulk purchases, we have not completed any in the year to date. Newly originated loans in 2014 totalled £80m (HY 2013: £58m). The level of equity release mortgage assets as a proportion of total assets under management at 30 June 2014 remained at 21% (31 December 2013: 21%).

We are actively investigating other alternative assets that can provide superior risk-adjusted returns for the benefit of shareholders or to match insurance liabilities.

We have signed an Investment management agreement with Rothschild to invest £150 million in commercial mortgages, further diversifying the investment portfolio. Partnership will benefit from Rothschild's extensive experience of managing this asset class and Rothschild will co-invest alongside Partnership.

[2] Median rating of Standard and Poor's, Moody's and Fitch, where available.

Capital management

Economic capital (EC) is the principal risk-based capital measure used by the Board. Economic capital is based on the Board's view of the available capital and required capital calibrated to a 1 in 200 stress. The coverage ratio expresses the available capital as a percentage of the required capital.

The level of excess economic capital at 30 June 2014 was £170m (2013: £173m), giving a capital coverage ratio of 153% (31 December 2013: 159%), well in excess of our targeted minimum of 125% (under normal economic circumstances).

The stress and scenario tests we perform, which reflect the key risks borne by the Group, continue to show a robust capital position, demonstrating the close matching of assets and liabilities, efficient use of reinsurance, and monitoring of risk levels against our Board tolerances.

EC surplus increased by £9m arising from the combination of new business written during the period and movements in the in-force position before allowing for the £12m dividend paid in the period.

The Group's Economic Capital and IGD capital ratios as at 30 June 2014 are strong. The Economic Capital and IGD capital positions as at 30 June 2014 are calculated at the Partnership Assurance Group plc level.

	Economic capital		IGD	
	Half year ended 30 June 2014 £m	Year ended 31 December 2013 £m	**Half year ended 30 June 2014 £m**	Year ended 31 December 2013 £m
Total Capital Available	**492**	467	**470**	469
Capital Required	**322**	294	**207**	193
Excess Surplus	**170**	173	**263**	276
Coverage (%)	**153%**	159%	**227%**	243%

Stress and scenario testing

The Group undertakes stress and scenario tests to ensure the robustness of the Economic Capital solvency position, having regard to the material financial and non-financial risks to which the Group is exposed. The most material risks to the level of capital adequacy on an economic basis arise from the Group's investment in assets with credit risk exposure, residential property risk exposure, and longevity risk. Other risks are either not material or are appropriately hedged to leave minimal exposure for the Group.

The impact of the stress and scenario tests for the most material balance sheet risks are set out below:

	Economic Capital Ratio Sensitivities	
	Half year ended 30 June 2014	Year ended 31 December 2013
Basic coverage ratio	**153%**	159%
Credit spread widening + 100 bps	**147%**	157%
Credit spread widening + 200 bps	**139%**	153%
Euro zone crisis*	**134%**	151%
"Lehman"crisis*	**131%**	145%
Longevity - 5% deterioration	**142%**	152%
Property - 10% price fall	**140%**	151%

The increased sensitivity to stress events compared to the 31 December 2013 position reflects both the growth in the balance sheet over the period and a refinement in the approach to allowing for tax in stressed conditions.

*'Euro zone crisis and "Lehman" crisis scenarios have been modelled by applying the credit spreads of 7 October 2011 and 5 December 2008 respectively.

Solvency II

The EU consultative process on the new Solvency II regime remains on track and there is increasing confidence that the capital regime will come in to force on 1 Jan 2016 as planned. Partnership's Solvency II programme is on track in preparing to meet the demands of the new legislation. Whilst there remains uncertainty as to how some aspects will be introduced into the UK regulatory framework, our current assessments indicate the Group remains well-placed to transition to the new regime.

Risk Management and Internal Control

The Group has a risk management framework in place comprising formal committees, a suite of formal policies, a common risk assessment process and risk review functions. The Group's risk management framework remains as set out on pages 28 and 29 of the 2013 Annual Report and Accounts.

The Board is ultimately responsible for maintaining the Group's risk management framework and system of internal control, and monitoring their effectiveness. However, such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives. As such they can provide only reasonable, and not absolute, assurance against material misstatement or loss.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Group remain consistent with those set out on pages 30 to 35 of the 2013 Annual Report and Accounts. The following table summarises the changes to the principal risks since the start of 2014.

Risk	Strategic objective	Description	How we manage the risk	Description of risk change
Underwriting, pricing and reserving risk	Leveraging Partnership's proprietary IP	Underwriting and pricing risk is the risk that insurance contracts will be written that are not within the Board's risk appetite, or that the premium charged for that business is not adequate to cover the risks borne by the Group. The accurate pricing of non-standard annuities is dependent on the Group's assessment of the impact on prospective customers' longevity of various medical and lifestyle factors and an estimate of future investment yields and credit default. The actual timing of deaths and investment income experience may be inconsistent with the assumptions and pricing models used in underwriting and setting prices for its products. Reserving risk is the risk that the reserves have been calculated incorrectly, or the assumptions used in the calculations are inappropriate.	As the Group's insurance business is targeted at people with conditions affecting their life expectancy, or people seeking to fund domiciliary or residential care, the underwriting risk is managed through the use of highly trained, and qualified underwriting staff, together with detailed underwriting manuals designed to cover a large array of medical conditions. Partnership has developed its own proprietary underwriting manuals for retirement annuity business and those seeking Care funding, based on industry standard mortality tables modified to take account of experience data recorded by Partnership. The assumptions used in the reserving for future policyholder payments are set based on available market and experience data, on the advice of Partnership's Actuarial Function Holder. The assumptions are approved by the Board. The reserves are calculated using recognised actuarial methods with due regard to the actuarial principles set out in the PRA's sourcebooks, including appropriate levels of prudential margin against future adverse experience.	No change in first half of 2014.

Risk	Strategic objective	Description	How we manage the risk	Description of risk change
Specific insurance risk	Maximising risk adjusted returns	Insurance risk on the Group's annuity contracts arises through longevity risk and through the risk that operating factors, such as administration expenses, are worse than expected. Insurance risk on the Group's protection policies arises through higher than expected mortality levels.	The Group's longevity and mortality experience is monitored on a regular basis and compared to the underlying assumptions used to reserve for future insurance payments. The exposure to longevity and mortality risk is reduced through the use of re-insurance. Expense risk is managed through regular assessment and quarterly reforecasting of expenses incurred against budgets.	No change in first half of 2014.
Concentration risk	Maximising risk adjusted returns	The Group writes annuity contracts for the provision of retirement income or care fees, and protection insurance contracts, primarily for individuals in the UK with one or more medical conditions that is likely to reduce their overall life expectancy. The Group's insurance risk is therefore concentrated on longevity and mortality risk.	The Group manages this risk through the use of external reinsurance arrangements.	Increased risk. The Group reduced the level of longevity risk it transfers to reinsurers during the first half of 2014.

Risk	Strategic objective	Description	How we manage the risk	Description of risk change
Interest rate risk	Maximising risk adjusted returns	Interest rate risk arises from open positions in fixed and variable rate stock issued by government and corporate bodies that are exposed to general and specific market movements. The Group is exposed to the market movements in interest rates to the extent that the asset value movement is different to the accompanying movement in the value of its insurance liabilities. The difference between asset and liability movements can arise from both a change in the absolute level of interest rates, and from a change in the 'spread' (that is the level of interest rates applying to an asset in excess of the risk-free interest rate).	The Group manages its interest rate risk within an asset liability management (ALM) framework that has been developed to achieve investment returns in excess of its obligations under insurance contracts. The principal technique of the ALM framework is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to policyholders.	No change in first half of 2014.
Market credit risk	Maximising risk adjusted returns	Market credit risk is the risk that the Group invests in assets that may default. If an asset fails to repay either interest or capital, or that payment is significantly delayed, the Group may make losses and be unable to meet liabilities as they fall due.	The Group's Investment Management Guidelines set out maximum exposure to bonds issued by a single, or related group of, counterparty(/ies) and to credit ratings. The allowance made for issuer default in the Group's valuation is regularly monitored and kept up to date.	No change in first half of 2014.
Property risk	Maximising risk adjusted returns	Property risk arises from the provision of a protected equity guarantee on the mortgages underlying the equity release assets purchased. The Group is exposed to the risk that property values do not rise sufficiently, or that the property is not maintained properly, to recover the full value of the loan made plus accrued interest.	The Group ensures that the purchase prices of loan assets reflect a prudent assessment of future property price growth. Careful attention is paid to the "loan to value ratio" in order to limit the risk exposure to the Group. The Group seeks to avoid excess concentration of property holdings in any geographical area.	Increased risk. As part of the Group's strategy to investigate alternative assets steps have been taken during the first half of the year to extend our available asset classes to include commercial mortgages. We expect to make our first investment in the asset class during the second half of 2014.

Risk	Strategic objective	Description	How we manage the risk	Description of risk change
Liquidity risk	Maximising risk adjusted returns	Liquidity risk arises where cash flows from investments and from new premiums prove insufficient to meet our obligations to policyholders and other third parties as they fall due.	The Group's ALM framework ensures that cash flows are sufficient to meet both long- and short-term liabilities. The Group maintains a minimum level of cash and highly liquid assets such that, in the extreme scenario of new business cash flows being insufficient to meet current obligations, those obligations can continue to be met.	No change in first half of 2014.
Counterparty credit risk	Maximising risk adjusted returns	Credit risk arises if another party fails to honour its obligations to the Group including failure to honour these obligations in a timely manner. The Group's primary credit risk exposure arises from the inability of the reinsurers to meet their claim payment obligations.	The Group has arrangements with its reinsurers whereby most reinsurance premiums are either deposited back to the Group or held by a third party in a trust arrangement. In addition, the Group's reinsurance policy is to seek to choose companies with a minimum 'A' credit rating.	No change in first half of 2014.
Distribution risk	Improving access for customers	Distribution risk arises from adverse changes in customer need for the Group's products, the Group's competitive landscape or its relationships with intermediaries.	The Group derives competitive advantage from its proprietary underwriting intellectual property which it considers to be unique in the non-standard annuity and Care market. It is the Group's strategy to continue to innovate and introduce new products and propositions that meet customer needs and leverage this intellectual property to protect its competitive position. The Group maintains a multi-channel distribution strategy in order to diversify and reduce concentration risk and has secured long-term agreements with its key distribution partners.	Increased risk. The March 2014 Budget announcement on changes to the Pensions Taxation regime has introduced an uncertainty of customer need in the lead up to April 2015 and resulted in a decrease in the non-standard annuity market in the first half of 2014. Defined benefit bulk annuity sales and individual care annuities, along with the accelerated launch of the Enhanced Choice Annuity, demonstrate the Group's ability to innovate and leverage its intellectual property.

Risk	Strategic objective	Description	How we manage the risk	Description of risk change
Operational risk	Maximising risk adjusted returns	Operational risk arises from inadequate or failed internal processes, people and systems or from external events.	The Group maintains a suite of risk management tools to help manage its operational risks including facilitated risk and control self-assessments, risk event management and loss reporting. Underlying and informing the operation of these tools is a framework of formal policies and controls which govern the management and oversight of the risks faced by the Group. These include business continuity and disaster recovery arrangements. Operational risk is overseen by the Executive Operational Risk Committee.	No change. Any potential impacts arising from the Group's current cost reduction proposals are being carefully managed and closely monitored to ensure operational risk is kept within agreed risk appetites.

Risk	Strategic objective	Description	How we manage the risk	Description of risk change
Regulatory, legal and political environment risk	Maximising risk adjusted returns	Regulatory, legal and political environment risk arises where changes in regulation or legislation may result in a detrimental effect on the Group's strategy and profitability.	The Group's strategic planning process sets a medium term strategy based on our understanding of the regulatory, legal and political risks inherent in the markets in which it operates. This is informed by active and constructive engagement with policymakers and regulators both directly and indirectly through trade associations. Our planning and response capability is supported by continued monitoring of the regulatory, legal and political landscape.	Increased risk. Whilst the Group's risk management framework had identified the risk of adverse political changes to the at-retirement landscape, the March 2014 Budget announcement on proposed changes to the Pensions Taxation regime was unforeseen by the Group and the wider industry. The Group is heavily engaged with policymakers, its regulators and trade bodies to positively contribute to the final form of the changes and what they will mean for customers; including the form that the guidance promised to those reaching retirement will take. As recently announced, the Prudential Regulatory Authority is assessing the likely impact of these changes on insurers in the annuities market and the Group is committed to supporting their assessment.

Directors' Responsibilities Statement

Each of the Directors of the Company confirms that to the best of their knowledge:

(a) the condensed set of financial statements has been prepared in accordance with IAS 34: *Interim financial reporting* as adopted by the European Union;

(b) the interim management report includes a fair review of the information required by Disclosure and Transparency Rule 4.2.7, namely important events that have occurred during the period and their impact on the condensed set of financial statements, as well as a description of the principal risks and uncertainties faced by the Company and the undertakings included in the condensed consolidated financial statements taken as a whole for the remaining six months of the financial year; and

(c) the interim management report includes a fair review of material related party transactions and any material changes in the related party transactions described in the last annual report as required by Disclosure and Transparency Rule 4.2.8.

By order of the Board

Steve Groves
Chief Executive Officer
London
13 August 2014

David Richardson
Chief Financial Officer

Note:

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

Independent review report to Partnership Assurance Group plc

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2014 which comprises the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity, the condensed consolidated statement of financial position, the condensed consolidated cash flow statement and the related notes 1 to 10. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to it in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2, the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Chartered Accountants and Statutory Auditor
13 August 2014
London
United Kingdom

IFRS FINANCIAL INFORMATION

Condensed consolidated statement of comprehensive income

For the half year ended 30 June 2014

	Note	**Half year ended 30 June 2014 £000's**	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Gross premiums written	3	**385,340**	585,965	1,159,562
Outward reinsurance premiums		**(230,974)**	(366,567)	(733,849)
Net premiums earned		**154,366**	219,398	425,713
Net investment income		**108,616**	31,606	137,762
Share of results of joint ventures & associates accounted for using the equity method		**(166)**	(10)	(162)
Other income		**275**	122	219
Total income		**263,091**	251,116	563,532
Gross claims paid		**(191,080)**	(163,103)	(341,124)
Reinsurers' share of claims paid		**125,660**	107,413	225,277
		(65,420)	(55,690)	(115,847)
Change in insurance liabilities:				
Gross amount		**(305,833)**	(282,365)	(624,290)
Reinsurers' share		**185,179**	202,879	428,197
		(120,654)	(79,486)	(196,093)
Acquisition costs		**(3,480)**	(7,810)	(13,036)
Investment expenses and charges		**(6,995)**	(5,908)	(13,270)
Interest on external borrowings		**-**	(24,680)	(25,403)
Other operating expenses	3	**(51,531)**	(68,980)	(117,223)
		(62,006)	(107,378)	(168,931)
Total claims and expenses		**(248,080)**	(242,554)	(480,872)
Profit from continuing operations before tax		**15,011**	8,562	82,661
Income tax charge from continuing operations	4	**(3,950)**	(5,214)	(23,240)
Profit for the period		**11,061**	3,348	59,421
Profit/ (loss) attributable to:				
- Owners of the Parent		**11,059**	3,361	59,465
- Non-controlling interest		**2**	(13)	(44)
Basic earnings per ordinary share	6	**£0.03**	£0.01	£0.17
Diluted earnings per ordinary share	6	**£0.03**	£0.01	£0.17

Condensed consolidated statement of changes in equity

For the half year ended 30 June 2014

	Attributable to Owners of the Parent								
	Share Capital	Share Premium	Capital Redemption Reserve	Merger Reserve	Shares held by Employee Benefit Trust	Retained profit	Total	Non-controlling interest	Total
	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's
At 1 January 2013	36	182	3,297	-	(33)	78,901	82,383	(22)	82,361
PAGH shares exchanged for ordinary shares	28,250	(182)	(3,297)	(24,521)	(250)	-	-	-	-
Loan Notes exchanged for ordinary shares	8,462	317,288	-	-	-	-	325,750	-	325,750
Shares issued for cash	3,252	121,993	-	-	(46)	-	125,199	-	125,199
Share issue costs	-	(4,032)	-	-	-	-	(4,032)	-	(4,032)
Share-based payments	-	-	-	-	271	8,330	8,601	-	8,601
Profit for the period	-	-	-	-	-	3,361	3,361	(13)	3,348
At 30 June 2013	40,000	435,249	-	(24,521)	(58)	90,592	541,262	(35)	541,227
At 1 January 2013	36	182	3,297	-	(33)	78,901	82,383	(22)	82,361
PAGH shares exchanged for ordinary shares	28,250	(182)	(3,297)	(24,521)	(250)	-	-	-	-
Loan Notes exchanged for ordinary shares	8,462	317,288	-	-	-	-	325,750	-	325,750
Share issued/ bought for cash	3,252	121,993	-	-	(46)	526	125,725	-	125,725
Share issue costs	-	(4,032)	-	-	-	-	(4,032)	-	(4,032)
Share-based payments	-	-	-	-	271	9,053	9,324	-	9,324
Profit for the year	-	-	-	-	-	59,465	59,465	(44)	59,421
At 31 December 2013	40,000	435,249	-	(24,521)	(58)	147,945	598,615	(66)	598,549
At 1 January 2014	**40,000**	**435,249**	**-**	**(24,521)**	**(58)**	**147,945**	**598,615**	**(66)**	**598,549**
Share-based payments	**-**	**-**	**-**	**-**	**-**	**239**	**239**	**-**	**239**
Profit for the period	**-**	**-**	**-**	**-**	**-**	**11,059**	**11,059**	**2**	**11,061**
Disposal of subsidiary	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**64**	**64**
Dividends paid	**-**	**-**	**-**	**-**	**-**	**(12,000)**	**(12,000)**	**-**	**(12,000)**
At 30 June 2014	**40,000**	**435,249**	**-**	**(24,521)**	**(58)**	**147,243**	**597,913**	**-**	**597,913**

Condensed consolidated statement of financial position

As at 30 June 2014

	Note	Half year ended 30 June 2014	Year ended 31 December 2013
		£000's	£000's
Assets			
Property, plant and equipment		13,896	15,459
Goodwill		126,207	126,207
Other intangible assets		16,266	16,401
Financial assets	8	4,274,147	3,950,443
Investment in joint ventures and associates		253	206
Reinsurance assets		3,025,928	2,840,749
Insurance and other receivables		28,861	64,476
Prepayments and accrued income		66,281	70,817
Deferred tax assets		-	424
Cash and cash equivalents		126,980	112,741
Total assets		**7,678,819**	**7,197,923**
Equity			
Share capital		40,000	40,000
Share premium		435,249	435,249
Merger reserve		(24,521)	(24,521)
Shares held by Employee Benefit Trust		(58)	(58)
Retained profit		147,243	147,945
Total equity attributable to owners of the Parent		**597,913**	**598,615**
Non-controlling interest		-	(66)
Total equity		**597,913**	**598,549**
Liabilities			
Insurance liabilities	7	4,653,421	4,347,588
Insurance and other payables		25,740	32,088
Financial liabilities	8	2,394,183	2,201,500
Corporation and other tax liabilities		7,270	18,198
Deferred tax liability		292	-
Total liabilities		**7,080,906**	**6,599,374**
Total equity and liabilities		**7,678,819**	**7,197,923**

Condensed consolidated cash flow statement

For the half year ended 30 June 2014

	Note	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Cash from/ (used in) operations	**9**	41,228	(24,197)	(56,851)
Corporation tax paid		(13,457)	(7,670)	(17,000)
Net cash from/ (used in) operating activities		**27,771**	**(31,867)**	**(73,851)**
Cash flows from investing activities:				
Investment in associate		(48)	-	-
Purchase of property, plant and equipment		(22)	(617)	(13,657)
Purchase of other intangible assets		(1,462)	(3,386)	(7,696)
Net cash used in investing activities		**(1,532)**	**(4,003)**	**(21,353)**
Cash flows from financing activities:				
Proceeds from issuance of share capital		-	121,496	121,693
Repayment of loan notes		-	(7,656)	(7,656)
Proceeds from issuance of loan notes		-	-	(70,000)
Interest payable on external borrowings		-	(1,570)	(2,365)
Dividends paid to shareholders	**6**	(12,000)	-	-
Net cash (used in)/ from financing activities		**(12,000)**	**112,270**	**41,672**
Net increase/ (decrease) in cash and cash equivalents		**14,239**	**76,400**	**(53,532)**
Cash and cash equivalents at beginning of period		112,741	166,273	166,273
Cash and cash equivalents at end of period		**126,980**	**242,673**	**112,741**

Notes to the condensed consolidated financial statements for the period ended 30 June 2014

1. Activities of business and legal structure of the Company

Partnership Assurance Group (PAG) plc (the "Company") is incorporated in the United Kingdom and registered in England and Wales as a public company limited by shares. The Company's registered office address is 5th Floor, 110 Bishopsgate, London, EC2N 4AY.

The principal activity of the Company is that of a holding company. The Company and the entities controlled by the Company (its "subsidiaries") are collectively "the Group".

The share capital of the Company consists of 399,999,971 shares of 10 pence each. The Company has a Premium Listing on the London Stock Exchange.

2. Basis of preparation

The condensed consolidated financial statements for the six months to 30 June 2014 have been prepared in accordance with IAS 34, Interim Financial Reporting, as issued by the International Accounting Standards Board and adopted by the European Union, and the Disclosure and Transparency Rules of the Financial Conduct Authority.

The accounting policies applied in the condensed consolidated financial statements are the same as those applied in the Partnership Assurance Group plc Annual Report and Accounts 2013 ("2013 Report and Accounts"), with the exception of the changes detailed below.

The results for the six months to 30 June 2014 and 2013 are unaudited. The results for the year to 31 December 2013 full year IFRS basis results have been taken from the 2013 Report and Accounts. The auditor has reported on the 2013 Report and Accounts which have been delivered to the Registrar of Companies. The auditor's report was (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The presentation currency of the Group is Sterling. Unless otherwise stated, the amounts shown in the condensed consolidated financial statements are in thousands of pounds Sterling (£'000).

The Directors have undertaken a going concern assessment in accordance with 'Going Concern and Liquidity Risk: Guidance for UK directors of UK Companies 2009', published by the Financial Reporting Council in October 2009. After making enquiries, the Directors have a reasonable expectation that the Group as a whole have adequate resources to continue in operational existence for the foreseeable future.

Changes in accounting policy

The Group has adopted the following new or revised standards that became effective (as adopted by the EU) as of 1 January 2014.
IFRS 10 Consolidated financial statements – This standard sets out the requirements for the preparation and presentation of consolidated financial statements, requiring entities controlled by the parent company to be consolidated as subsidiaries. The standard changes the definition of "control" from that previously established in IFRS. As a result of the adoption of this standard the Group has changed its accounting policy for determining when the Group has control over an entity to the following:

- The Group has control over an entity if all of the following conditions are met are met: (a) the Group has power over an entity; (b) the Group is exposed to, or has rights, to variable returns from its involvement with the investee; (c) the Group has the ability to use its power over the investee to affect its own returns.

The application of IFRS 10 has not resulted in any change in the entities which are determined to be subsidiaries of the Group. There is no impact on the financial statements in the current or comparative periods.

IFRS 11 Joint Arrangements – This standard defines joint arrangements and related accounting principles. The standard established two types of joint arrangement – joint ventures and joint arrangements – based on how rights and obligations are shared by investors in the arrangements. The application of IFRS 11 has no impact on the financial statements in the current or comparative periods.

Other changes in accounting policy are:

Segmental analysis – To reflect changes in the information provided to the Board, revenue attributable to Defined Benefit buy-in / buy out annuities is now presented separately from revenue attributable to Individual retirement annuities in the segmental analysis of revenue. Previously these categories were presented together in a Retirement Annuity segment. Comparative information has been re-analysed accordingly.

3. Segmental analysis

Information is provided to the Board, which identifies operating profit split between that achieved on new business written in the period, that which derives from in-force policies and that relating to the long-term expected return on surplus assets, and therefore this split forms the reportable operating segments in accordance with IFRS 8 “Operating Segments”.

New business revenue is reported as Single Premium Equivalent (“SPE”), being the actual single premium for single premium business, and ten times the annual premium for a regular premium business written during the year. These revenue measures are monitored by the Board separately for each core target market.

The table below shows operating profit for each year, together with a reconciliation to profit before tax:

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
New business operating profit	**17,803**	38,162	85,678
In-force operating profit	**6,840**	17,966	34,278
Long-term expected return on surplus assets	**8,746**	3,136	11,435
Operating profit	**33,389**	59,264	131,391
Investment variances	**(9,043)**	3,158	8,643
Non-recurring expenditure	**(9,656)**	(28,517)	(30,769)
Other	**321**	(664)	(1,201)
Interest on borrowings	**-**	(24,679)	(25,403)
Profit from continuing operations before tax	**15,011**	8,562	82,661

Investment variances reflect:

a) the difference between actual performance on investment assets (e.g. cash, gilts, corporate bonds and equity release) over the reporting period and the investment yield allowed for in the calculation of in-force liabilities at the start of the reporting period;

b) the difference between the yield on investment assets allowed for in the calculation of new business profits and the actual investment performance including differences arising from investing at different yields and asset allocations than those expected when pricing new business;

c) the difference between actual performance on investment assets and long-term assumed return on surplus assets; and

d) the impact of changes in the best-estimate credit default allowance made against the Group’s invested assets.

Non-recurring expenditure of £9.7m for the period (HY 2013: £28.5m) includes £1.2m of restructuring costs and £6.0m impairment charge (see note 4). Other non-recurring expenditure includes costs relating to regulatory projects (including Solvency II) and re-engineering of financial processes, development of new products and sales channels.

Other operating expenses, in the Condensed consolidated statement of comprehensive income, includes underlying operating expenses and non-recurring expenditure.

The profit measure used by the Group Board to monitor performance is operating profit before tax, analysed between new business operating profit, in-force operating profit and the long-term expected return on surplus assets. Each component of operating profit is explained as:

- New business operating profit is profit generated from new business completed in the period, calculated using actuarial assumptions applicable at the time the new business was written, and utilising a discount rate based upon investment yields on investment assets (e.g. cash, gilts, corporate bonds and loans secured by mortgages) used to generate the annuity quotation, net of expenses allocated against new business.
- In-force operating profit/ (loss) is generated from the actual experience measured against the assumed experience in the actuarial basis. The actuarial basis includes a number of assumptions, the most material of which are mortality levels, levels of default on investments, expense levels (to maintain the business in-force), levels of inflation, and lapse rates (for regular premium business). In-force operating profit also includes the effect recognised in the IFRS profit arising from changes to the reported value of insurance (and associated financial) liabilities resulting from changes to the actuarial assumptions, valuation methods, or underlying data, made subsequent to the point of sale.
- Return on surplus assets is the long-term, risk adjusted, expected return on investments surplus to those investments that are used to back insurance liabilities. The long-term expected return is derived from applying an average expected yield appropriate to the category of surplus assets held and is adjusted for the best estimate expected level of defaults on those investments. The risk adjusted annual yields applied to surplus assets during the period were:

	Half year ended 30 June 2014	Half year ended 30 June 2013	Year ended 31 December 2013
Cash	**0.5%**	0.5%	0.5%
Gilts	**3.0%**	3.0%	3.0%
Corporate bonds	**4.5%**	4.5%	4.5%
Commodity Trade Finance loans	**10.0%**	n/a	10.0%
Equity Release mortgages	**6.0%**	n/a	n/a

a) Segmental analysis of new business revenue by target market

SPE	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Individual retirement annuities	**334,313**	590,152	1,075,574
Defined benefit buy-in/ buy-out annuities	**36,837**	11,341	84,042
Individual care annuities	**36,354**	28,097	65,854
Individual protection annuities	**1,537**	1,797	3,389
Total SPE	**409,041**	631,387	1,228,859

b) Reconciliation of new business revenue by target market to gross premiums written

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Total SPE	**409,041**	631,387	1,228,859
Adjustment in respect of regular premium business	**100**	(66)	(5)
Change in premiums receivable - not included in SPE	**(23,801)**	(45,399)	(69,335)
Reinsurance premiums received	**-**	43	43
Gross premiums written	**385,340**	585,965	1,159,562

Product revenue information

The following table illustrates revenue by product as required by IFRS 8 'Operating Segments'. All revenues from external customers are predominantly derived from business originated in the UK, and as such no geographical information is disclosed.
The Board consider the Group's external customers to be the individual policyholders. As such, the Group is not reliant on any individual customer.

An analysis of gross premiums written by product is set out below:

Gross premiums written	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Individual retirement annuities	**310,512**	544,753	1,006,240
Defined benefit buy-in/ buy-out annuities	**36,837**	11,341	84,042
Individual care annuities	**36,422**	28,165	65,979
Individual protection annuities	**1,569**	1,663	3,258
Other	**-**	43	43
Total gross premiums written	**385,340**	585,965	1,159,562

4. Provisions and impairment

Following the budget announcement on changes to the pension taxation regime, on 23 June 2014 the Group announced cost management proposals, which are anticipated to result in the loss of approximately 100 roles across its London and Redhill offices.
This has resulted in the establishment of a restructuring provision of £1.2 million at the balance sheet date, with a charge of this amount recognised in the condensed statement of comprehensive income. The restructuring costs are expected to be settled in the second half of 2014.

In addition to establishing a provision, management has reviewed the carrying value of intangible assets and prepayments.

As a result of this review an impairment of £6.0 million has been recognised in respect of prepayment assets relating to sales IT infrastructure following the Budget announcement, reducing the carrying value of the prepayment to its estimated recoverable amount of £1.0 million.

Income tax charge

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Current taxation:			
Tax charge for the year	**3,234**	5,155	23,112
Adjustment in respect of prior periods	**-**	24	394
	3,234	5,179	23,506
Deferred taxation:			
Tax charge/ (credit) for the year	**716**	35	(266)
Net taxation charge	**3,950**	5,214	23,240

The income tax charge for all periods presented is in respect of continuing operations.

The actual tax charge of the Group differs from the expected tax charge, computed by applying the average rate of UK corporation tax for the year of 21.5% (30 June 2014: 21.5%, 31 December 2013: 23.25%), as follows:

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Profit before tax	**15,011**	8,562	82,661
Current taxation at 21.5% (2013: 23.25%)	**3,227**	1,991	19,216
Prior period losses utilised in period	**(3)**	(2)	(5)
Disallowable expenses	**22**	3,156	3,892
Difference between depreciation and capital allowances for tax purposes	**(63)**	1	(110)
Expenses not deductible in determining taxable profit	**-**	9	247
Share base payments crystalised in the period	**-**	-	(2,296)
Add back IFRS 2 share based payment charge	**51**	-	2,168
Deferred taxation	**716**	35	(266)
Adjustment in respect of prior periods	**-**	24	394
Net taxation charge	**3,950**	5,214	23,240

5. Dividends

The final dividend for 2013 of 3.0 pence per ordinary share, amounting to £12 million in total was paid on 30 May 2014 and is reflected as an appropriation of earnings in the statement of changes in equity for the period.

An interim dividend of 0.5 pence per ordinary share, amounting to £2 million in total, has been declared by the Board. This will be reflected as an appropriation of earnings in the statement of changes of equity, when paid, in the second half of 2014.

6. Earnings per share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.
Diluted earnings per share amounts are calculated by dividing the profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The calculation of the basic and diluted earnings per share from continuing operations is based on the following data:

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Profit for the year	**11,061**	3,348	59,421
Less non-controlling interests	**(2)**	13	44
Profit attributable to equity holders of the Parent	**11,059**	3,361	59,465
Effect of dilutive potential ordinary shares:			
Share options	**-**	-	-
Diluted profit attributable to equity holders of the Parent	**11,059**	3,361	59,465

The earnings per share calculation for both comparative periods has been calculated as if the reorganisation (see 2013 report and accounts) had occurred on 1 January 2013.

	Half year ended 30 June 2014 Number of Shares	Half year ended 30 June 2013 Number of Shares	Year ended 31 December 2013 Number of Shares
Basic weighted average number of shares	**399,999,971**	291,523,583	346,138,910
Effect of dilutive potential ordinary shares:			
Share options	**929,557**	2,446,592	1,276,243
Diluted weighted average number of shares	**400,929,528**	293,970,175	347,415,153

The options granted in respect of an ESOP scheme had a dilutive effect up to 16 June 2013, the date of issue.

The Group implemented a number of new employee share-based plans following admission on the London Stock Exchange. The Share Incentive Plan (SIP) has a dilutive effect.

It is current intention that the Long Term Incentive Plan (LTIP) or the share element of the Deferred Share Bonus Plan (DBSP) be settled by fresh issue of shares at the awards vest. The weighted average number of shares calculation above has been derived on the assumption that the vesting of shares in respect of the LTIP and DSBP awards will be settled by a fresh issue of shares when the awards vest and hence will be dilutive.

7. Insurance liabilities and reinsurance assets

	Half year ended 30 June 2014 £000's	Year ended 31 December 2013 £000's
Long term business provision	**4,653,421**	4,347,588
Reinsurers' share of long term business provision	**(3,025,928)**	(2,840,749)
Net provision	**1,627,493**	1,506,839

a) Principal assumptions

The principal assumptions underlying the calculation of the long-term business provision are as follows:

		Mortality tables	Valuation discount rates
Medically underwritten annuity products	Half year ending 30 June 2014	Modified E&W Population Mortality with CMI 2012u (1.75%) and CMI 2012F (1.50%)	4.15%
	Year ending 31 December 2013	Modified E&W Population Mortality with CMI 2012u (1.75%) and CMI 2012F (1.50%)	4.31%
Other annuity products	Half year ending 30 June 2014	Modified PCMA/PCFA00u2014 p-spline	1.90%
	Year ending 31 December 2013	Modified PCMA/PCFA00u2014 p-spline	1.70%
Term and whole of life products	Half year ending 30 June 2014	86.25% TM/TF00Select	1.61%
	Year ending 31 December 2013	86.25% TM/TF00Select	1.44%

Valuation discount rate assumptions are set with regards to yields on supporting assets. An allowance for risk is included by making an explicit deduction from the yields on debt and other fixed income securities based on historical default experience and expected experience of each asset class. The allowance for credit risk has been set at 49% (31 December 2013: 47%) of the spread on the yield of the corporate bonds over the yield on gilts.

The changes in the valuation discount rates at each period end reflect changes in yields on the supporting assets and changes made to the allowance for risk.

The mortality tables used have been adjusted to reflect additional mortality based on the proprietary data held by the Group developed from actual experience incurred. The valuation basis used to calculate the long-term business provisions includes an allowance for future expenses.

b) Movements

Movements in the carrying amount of insurance liabilities and reinsurance assets are explained as follows:

For the period ended 30 June 2014	**Gross £000's**	**Reinsurance £000's**	**Net £000's**
At 1 January 2014	**4,347,588**	**(2,840,749)**	**1,506,839**
Increase in liability from new business	**349,153**	**(203,908)**	**145,245**
Release of in-force liability	**(66,467)**	**42,321**	**(24,146)**
Release of liability due to recorded deaths	**(34,319)**	**16,878**	**(17,441)**
Economic changes	**60,252**	**(40,018)**	**20,234**
Non-economic changes	**(5,053)**	**-**	**(5,053)**
Other	**2,267**	**(452)**	**1,815**
At 30 June 2014	**4,653,421**	**(3,025,928)**	**1,627,493**

For the year ended 31 December 2013	£000's	£000's	£000's
At 1 January 2013	3,723,298	(2,412,551)	1,310,747
Increase in liability from new business	1,038,011	(678,827)	359,184
Release of in-force liability	(111,110)	75,012	(36,098)
Release of liability due to recorded deaths	(69,967)	31,040	(38,927)
Economic changes	(209,299)	144,164	(65,135)
Non-economic changes	(25,847)	1,609	(24,238)
Other	2,502	(1,196)	1,306
At 31 December 2013	4,347,588	(2,840,749)	1,506,839

c) Analysis of expected maturity

The following table analyses insurance liabilities and reinsurance assets by duration.

	Expected cash flows (undiscounted)				
At 30 June 2014	**less than one year £000's**	**one to five years £000's**	**five to ten years £000's**	**more than ten years £000's**	**Carrying value (discounted) £000's**
Gross	**395,238**	**1,443,193**	**1,538,569**	**4,055,478**	**4,653,421**
Reinsurance	**(254,553)**	**(951,542)**	**(1,035,174)**	**(2,652,830)**	**(3,025,928)**
Net	**140,684**	**491,651**	**503,395**	**1,402,648**	**1,627,493**

	Expected cash flows (undiscounted)				
At 31 December 2013	less than one year £000's	one to five years £000's	five to ten years £000's	more than ten years £000's	Carrying value (discounted) £000's
Gross	373,419	1,360,968	1,450,164	3,829,024	4,347,588
Reinsurance	(241,692)	(903,711)	(985,311)	(2,544,018)	(2,840,749)
Net	131,727	457,257	464,853	1,285,006	1,506,839

d) Sensitivity analysis

Life insurance results are inherently uncertain due to actual experience being different to modelled assumptions. Sensitivity analysis is provided below to illustrate the impact of changes in key assumptions.

Sensitivity factor	Description of sensitivity factor applied
Interest rate & investment return	The impact of a change in the market interest rates by +/– 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6% respectively). The test allows consistently for similar changes to investment returns and movements in the market backing fixed interest securities.
Credit spreads	The impact of credit spreads widening by 50bps with a corresponding pro-rated change to defaults.
Expenses	The impact of an increase in maintenance expenses by 10%.
Mortality rates	The impact of a decrease in mortality rates by 5%.
Property values	The impact of an immediate decrease in the value of properties by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the equity release assets used to back the liabilities.
Voluntary redemptions	The impact of an increase in voluntary redemption rates on equity release loans by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the equity release assets used to back the liabilities.

The table below demonstrates the effect of a change in a key assumption whilst other assumptions remain unchanged. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs.

	Increase / (decrease) in profit before tax	
Change in assumption:	**Half year ended 30 June 2014 £000's**	Year ended 31 December 2013 £000's
Interest rates + 1%	**7,076**	2,954
Interest rates - 1%	**(9,513)**	(3,308)
Credit spreads + 0.5%	**(11,007)**	(10,917)
Expenses + 10%	**(10,323)**	(9,962)
Mortality - 5%	**(24,537)**	(22,140)
Property prices - 10%	**(29,081)**	(25,313)
Voluntary redemptions + 10%	**(4,667)**	(2,402)

8. Financial instruments – fair value disclosures

All financial instruments, with the exception of external borrowings are classified at fair value through profit and loss. In accordance with IFRS 13 Fair Value measurement, financial instruments at fair value have been classified into three categories.
Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);

Level 3: Inputs for the assets or liabilities that are not based on observable market data (that is, unobservable inputs)

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. All these financial assets and liabilities relate to recurring fair value measurements. There are no non-recurring fair value measurements as at 30 June 2014 and 31 December 2013.

At 30 June 2014	**Level 1 £000's**	**Level 2 £000's**	**Level 3 £000's**	**Total £000's**
Financial investments (a)	**3,303,240**	**-**	**2,076**	**3,305,316**
Loans secured by mortgages (b)	**-**	**-**	**936,786**	**936,786**
Derivative assets (c)	**-**	**32,045**	**-**	**32,045**
Total financial assets held at fair value	**3,303,240**	**32,045**	**938,862**	**4,274,147**
Payables arising from reinsurance contracts (d)	**-**	**-**	**2,342,878**	**2,342,878**
Derivative liabilities (c)	**-**	**51,305**	**-**	**51,305**
Total financial liabilities held at fair value	**-**	**51,305**	**2,342,878**	**2,394,183**

At 31 December 2013	Level 1 £000's	Level 2 £000's	Level 3 £000's	Total £000's
Financial investments (a)	3,063,140	-	10,824	3,073,964
Loans secured by mortgages (b)	-	-	840,066	840,066
Derivative assets (c)	-	36,413	-	36,413
Total financial assets held at fair value	3,063,140	36,413	850,890	3,950,443
Payables arising from reinsurance contracts (d)	-	-	2,169,109	2,169,109
Derivative liabilities (c)	-	32,391	-	32,391
Total financial liabilities held at fair value	-	32,391	2,169,109	2,201,500

The Group's policy is to recognise transfers into and transfers out of levels 1, 2 and 3 as of the date at which the Consolidated Statement of Financial Position is prepared.

There are no transfers between Levels 1, 2 and 3 during the period to 30 June 2014.

The table below reconciles the opening and closing recorded amount of level 3 of recurring financial liabilities and financial assets which are stated at fair value.

	Payables arising out of reinsurance contracts £000's	**Commodity Trade Finance Loans £000's**	**Loans secured by mortgages £000's**
At 1 January 2014	**(2,169,109)**	**10,824**	**840,066**
Loans (received)/advanced	**(230,974)**	**3,949**	**79,893**
Total (losses)/gains in Consolidated Statement of Comprehensive Income excluding reinsurance restructure	**(20,782)**	**(5,421)**	**11,135**
Redemptions made/(received)	**123,163**	**(7,998)**	**(24,050)**
(Interest payable accrued)/interest receivable accrued	**(45,176)**	**722**	**29,742**
At 30 June 2014	**(2,342,878)**	**2,076**	**936,786**

	Payables arising out of reinsurance contracts £000's	Commodity Trade Finance Loans £000's	Loans secured by mortgages £000's
At 1 January 2013	(1,728,998)	-	478,097
Loans (received)/advanced	(733,849)	23,990	416,473
Total (losses)/gains in Consolidated Statement of Comprehensive Income excluding reinsurance restructure	155,522	(3,135)	(63,151)
Redemptions made/(received)	217,075	(11,306)	(34,187)
(Interest payable accrued)/interest receivable accrued	(78,859)	1,275	42,834
At 31 December 2013	(2,169,109)	10,824	840,066

The gains and losses are included within net investment income in the Consolidated Statement of Comprehensive Income.

The unrealised gains/ (losses) in respect of payables arising out of reinsurance contracts, commodity trade finance loans and loans secured by mortgages for the period to 30 June 2014 are £(20.8)m, £0.4m and £40.9m respectively (30 June 2013: £105.6m, £0.7m and £(14.1)m respectively: 31 December 2013: £155.5m, £(1.1)m and £(20.3)m respectively). These unrealised gains and losses are included within net investment income in the Consolidated Statement of Comprehensive Income.

Level 3 Sensitivity Analysis

At 30 June 2014	Significant assumption	Current fair value £000's	Reasonably possible alternative assumptions: Change in fair value £000's	Reasonably possible alternative assumptions: Change in fair value £000's
Assets				
Commodity Trade Finance Loans	Expected defaults	2,076	559	(1,880)
Loans secured by mortgages	Discount Rate, Value of no-negative equity guarantee	936,786	115,229	(96,715)
Liabilities				
Payables rising out of reinsurance contracts	Discount Rate, Value of no-negative equity guarantee	(2,342,878)	(203,290)	177,719

At 31 December 2013	Significant assumption	Current fair value £000's	Reasonably possible alternative assumptions: Change in fair value £000's	Reasonably possible alternative assumptions: Change in fair value £000's
Assets				
Commodity Trade Finance Loans	Expected defaults	10,824	350	(528)
Loans secured by mortgages	Discount Rate, Value of no-negative equity guarantee	840,066	100,863	(86,046)
Liabilities				
Payables rising out of reinsurance contracts	Discount Rate, Value of no-negative equity guarantee	(2,169,109)	(182,645)	161,733

The impacts of reasonably possible alternative assumptions are estimated by modelling alternative scenarios for the key assumptions for each valuation model.

a) Financial investments

All financial investments are designated at fair value through profit and loss. All financial investments excluding commodity trade finance are listed.
In assessing the fair value of the debt securities and other fixed income securities, the Directors have relied upon values provided by an independent third-party which specialises in providing such values to companies. The third-party provides prices based upon quoted market prices, or where not available, modelled prices using observable market inputs. At 30 June 2014 and 31 December 2013, 100% of the values provided were based on quoted market prices that are observable for the asset or liability.

Due to the short-term nature of the commodity trade finance ("CTF") loans, the fair value of these instruments is estimated as the principal amount borrowed plus accrued interest from the date of acquisition, adjusted for incurred and expected defaults. These CTF loans are considered to be Level 3 within the valuation category prescribed by IFRS 13 as the inputs to the fair value calculation are not based on observable market data, and includes the Company's own assumptions.

The change in the fair value of level 3 financial instruments from period to period is analysed into loans advanced, loans repaid/redemptions, and interest accrued, with the remaining balance representing fair value measurement gains and losses recognised in the Statement of Comprehensive Income.

Interest rate: The interest rate used in deriving the fair value of the CTF loans as at 30 June 2014 was 13.0% p.a. (30 June 2013:9.1% p.a: 31 December 2013:12.0% p.a.).

b) Loans secured by mortgages

The fair value recognised in the financial statements for loans secured by mortgages is determined using a marked to model valuation technique where a significant proportion of inputs are not based on observable market data and so these assets are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model discounts the expected future cash flows using an interest rate swap curve with an additional spread or yield factor minus the cost of the no-negative equity guarantee. The no-negative equity guarantee represents an embedded guarantee that the repayment of the loan cannot exceed the value of the property at the time of repayment.

Although such valuations are sensitive to estimates, it is the discount rate and no-negative equity guarantee assumptions would have significant impact on the fair value.

Discount rate: Loans secured by mortgages are valued using the swap rate appropriate to the term of each contract with adjustment to reflect the credit and liquidity risk associated with such long-dated contracts. The risk adjusted swap rate for the portfolio weighted by average value at 30 June 2014 was 6.01% (31 December 2013: 6.24%).

No-negative equity guarantee: The fair value of loans secured by mortgages takes into account an explicit provision in respect of the no-negative equity guarantee which is calculated using a variant of the Black Scholes option pricing model. The key assumptions used to derive the value of the no-negative equity guarantee include property growth, volatility and over-valuation. The property growth and volatility assumed at 30 June 2014 were 5.5% (31 December 2013: 5.5%) and 13% (31 December 2013: 13% respectively). The over-valuation assumption used as at 30 June 2014 was 24% (31 December 2013: 22%). The value of the no-negative equity guarantee as at 30 June 2014 was £79.4m (31 December 2013: £67.3m).

The valuation technique that the Group uses to assess the fair value of loans secured by mortgages is consistent with that used to derive the prices applied at the initial transaction. As such, there is no difference between the fair value of loans secured by equity release mortgages at initial recognition and the amount that would have been determined at that date using the valuation technique.

c) Derivative assets and liabilities

The estimated fair value of derivative instruments reflects the estimated amount the Group would receive or pay in an arm's length transaction. All the derivatives held at 30 June 2014 and 31 December 2013 were purchased over the counter.

The Group’s derivative assets and liabilities largely relate to forward currency positions, interest rate swaps and inflation swaps.

Forward currency positions: Forward currency exchange contracts are priced from independent third parties.

Interest rate swaps: The fair value of the interest rate swaps is derived using an interest rate swap pricing model, using a time series of historic Libor rates, an applicable zero coupon interest rate swap curve to derive future cash flows (‘forward curve’) and an applicable zero coupon interest rate swap curve to discount future cash flows (‘discount curve’) as inputs. The forward curve is used by the pricing model to determine the future Libor rates to be applied in the calculation of the floating leg cash flow(s). The discount curve is used to calculate the present value of the future cash flow(s) of both the fixed and floating legs of the swap and its composition is driven by the terms of the Credit Support Annex under which the swap is traded.

Inflation swaps: The fair value of the inflation swaps is derived using the inflation swap pricing model, using a time series of historic inflation index levels, a zero coupon swap inflation expectation curve, an inflation seasonality model and a zero coupon interest rate swap curve as inputs. The inflation swap pricing model generates a future cash flow for both the fixed and inflation legs of a swap for which a present value is determined using zero coupon interest rate swap curve.

The derivative assets and liabilities are presented on a gross basis in the Consolidated Statement of Financial Position. All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual group entities and relevant counterparties in place under each of these market master agreements. As at 30 June 2014, the Group had pledged £29.9m (31 December 2013: £10.1m) and held collateral of £3.9m (31 December 2013: £0.9m) in respect of over-the-counter derivative transactions.

d) Payables arising from reinsurance contracts

The fair value recognised in the financial statements is determined using a marked to model valuation technique where not all inputs are based on observable market data and so these liabilities are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model discounts the expected future cash flows using a discount rate, derived from the assets hypothecated to back these liabilities at a product level.

As payables arising from reinsurance contracts do not have a single fixed maturity date it is not possible to determine an amount that would be contractually required to pay at maturity.

Discount rate: The key inputs to the derivation of the discount rate include market observable gross redemption yields, contractual investment expenses and an allowance for credit risk on a best estimate basis. The discount rate used as at 30 June 2014 for Retirement and Care was 4.74% and 2.24% respectively (31 December 2013: 4.95% and 1.97% respectively).

9. Notes to the Condensed Cash Flow Statement

	Half year ended 30 June 2014	Half year ended 30 June 2013	Year ended 31 December 2013
	£000's	£000's	£000's
Profit before income tax including discontinued operations	**15,011**	8,562	82,661
Non-cash movements in profit before income tax:			
Fair value gains and interest accrued on financial assets	**(51,069)**	43,504	(32,028)
Fair value losses and interest accrued on financial liabilities	**53,715**	(82,280)	54,214
Depreciation of property, plant and equipment	**1,585**	838	1,843
Amortisation of intangible assets	**1,596**	2,866	1,997
Assets written off	**-**	-	1,684
Profit on the disposal of a subsidiary	**(94)**	-	-
Share of loss of joint venture	**166**	10	162
Share based payment charge	**239**	8,601	9,324
Share of profits in associate	**(8)**	-	-
Amortisation of capitalised loan note debt issuance costs	**-**	2,519	2,519
Amortisation of capitalised bank loan debt issuance costs	**-**	1,490	1,765
Interest accrued on Loan notes	**-**	19,125	19,125
Interest on bank loan	**-**	1,545	1,995
Net investment in financial assets	**(272,636)**	(394,401)	(759,414)
Net receipt of financial liabilities	**138,968**	274,575	368,521
Increase in reinsurance assets	**(185,179)**	(202,880)	(428,198)
Decrease in insurance and other receivables excluding Corporation Tax	**35,615**	33,169	30,405
Decrease/ (increase) in prepayments and accrued income	**4,536**	(9,338)	(7,694)
Increase in insurance liabilities	**305,833**	282,365	624,290
Increase in insurance and other payables	**(6,348)**	(20,632)	(30,860)
(Decrease)/ increase in other taxes and social security payables	**(704)**	6,165	838
Cash from/ (used in) operations	**41,228**	(24,197)	(56,851)

10. Related party transactions

Balances and transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

During the period, the Group entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into and balances outstanding at the end of each reporting date are detailed below.

a) Financing transactions

Prior to the Group reorganisation in 2013, as set out in the 2013 Report and Accounts, the Fourth Cinven Fund held a number of loan notes issued by the Group. Prior to admission to listing on the London Stock Exchange in 2013 these loan notes were transferred on a pound-for-pound basis to the Company in exchange for the allotment and issue of ordinary shares in the Company.

Prior to this exchange, interests accrued on the loan notes, as set out below. In addition, monitoring fee payment were made to Cinven up to February 2013 including fees for two of the Group's non-executive directors who are also employees of Cinven Capital Management.

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Interest accrued on loan notes	**-**	18,629	18,629
Monitoring fee payments	**-**	216	216
Total	**-**	18,845	18,845

b) Remuneration of key management personnel

Key management personnel consist of the directors of the Company. The key management personnel changed during the period to 30 June 2013 reflecting the group reorganisation. The remuneration of the Directors, who are the key management personnel of the Group, is set out below:

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Short-term employee benefits	**995**	1,139	2,060
Post-employment benefits	**14**	47	55
Share based payments	**-**	-	-
Total	**1,009**	1,186	2,115

c) Directors' loans

A number of directors who are defined as key management personnel of the Company held loans during the period. The loans owed to/by the Directors are detailed as follows:

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Amounts owed by directors:			
Loan advances	**302**	289	289
Total	**302**	289	289

The loan advances to directors accrue interest fixed at 4% per annum and are repayable in whole or in part at any time.

Prior to admission to listing on the London Stock Exchange a number of Directors held loan notes issued by the Group. As set out in the 2013 Reports and Accounts these loan notes were settled as part of a reorganisation on admission to listing. Prior to this settlement interest accrued as below:

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Interest payable accrued on B and Vendor loan notes	**-**	663	663
Interest receivable accrued on Directors' loan advances	**(6)**	(7)	(14)
Total	**(6)**	656	649

d) Other related party transactions

During the period the group entered into transactions with other entities controlled by Cinven Limited as set out below. All transactions were on a commercial basis.

	Half year ended 30 June 2014 £000's	Half year ended 30 June 2013 £000's	Year ended 31 December 2013 £000's
Fees for Directors and management services	**68**	75	558
Total	**68**	75	558

e) Other related party transactions

As at 30 June 2014 a majority of the Company's ordinary shares are held by the partnerships comprising the Fourth Cinven Funds (the "Cinven Funds"), being funds managed and advised by Cinven Limited, a company incorporated under the laws of England and Wales. Accordingly, the Directors consider the Company's ultimate controlling party to be Cinven Limited, the manager and advisor to the Cinven Funds.

Statement of Directors' Responsibilities in respect of the Market Consistent Embedded Value ('MCEV') basis

The MCEV methodology adopted by the Group is in accordance with the CFO Forum MCEV principles (© Stitching CFO Forum foundation 2008) published in October 2009. When compliance with the MCEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the methodology contained in the MCEV Principles and to disclose and explain any non-compliance in the guidance included in the MCEV Principles.

In preparing the MCEV supplementary information, the Directors have:

- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent;
- provided additional disclosure when compliance with the specific requirements of the MCEV principles is insufficient to enable users to understand the impact of particular transactions, other events and conditions and the Group's financial position and financial performance; and
- described the basis on which business that is non-covered has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group condensed consolidated IFRS financial statements.

By order of the Board

Steve Groves
Chief Executive Officer
London
13 August 2014

David Richardson
Chief Financial Officer

Note:

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

Independent Auditor's Review Report to the Directors of Partnership Assurance Group plc on the Consolidated Partnership Group Market Consistent Embedded Value (MCEV) Supplementary Information

We have been engaged by the Company to review the Consolidated Partnership Group Market Consistent Embedded Value supplementary information (MCEV supplementary information) in the half-year financial report for the six months ended 30 June 2014 which comprises the Group MCEV analysis of Earnings (net of tax), Covered business Analysis of Movement in Embedded Value (net of tax), Reconciliation of Group IFRS net assets to MCEV and the related notes 1 to 5. We have read the other information contained in the half-year financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the MCEV supplementary information.

We have reported separately on the condensed financial statements of Partnership Assurance Group plc for the six months ended 30 June 2014. The information contained in the MCEV supplementary information should be read in conjunction with the condensed set of financial statements prepared on an IFRS basis. This information is described within the Partnership Assurance Group plc condensed set of financial statements in the half-year financial report as having been reviewed.

This report is made solely to the Company's Directors in accordance with our engagement letter and solely for the purpose of expressing an opinion as to whether anything has come to our attention that causes us to believe that the MCEV supplementary information for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with the Market Consistent Embedded Value principles issued in June 2008 by the European CFO Forum and supplemented by an amendment to the MCEV principles issued by the same body in October 2009.

Our work has been undertaken so that we might state to the Company's Directors those matters we are required to state to them in an independent review 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's Directors, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The MCEV supplementary information is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the MCEV supplementary information in accordance with the Market Consistent Embedded Value principles issued in June 2008 by the European CFO Forum and supplemented by an amendment to the MCEV principles issued by the same body in October 2009.

Our responsibility

Our responsibility in relation to the MCEV supplementary information is to express to the Company a conclusion on the MCEV supplementary information based on our review.

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the MCEV supplementary information for the six months ended 30 June 2014 has not been properly prepared in accordance with the MCEV principles using the methodology and assumptions set out in notes 1 and 2.

Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
13 August 2014

MCEV FINANCIAL INFORMATION

Group MCEV analysis of Earnings (net of tax)

For the half year ended 30 June 2014

		Half year ended 30 June 2014			Half year ended 30 June 2013	Year ended 31 December 2013
	Note	Covered business MCEV £000's	Non covered business IFRS £000's	Total Group MCEV £000's	Total Group MCEV £000's	Total Group MCEV £000's
Opening Group MCEV		**463,494**	**56,139**	**519,633**	9,890	9,890
Opening adjustments		**-**	**-**	**-**	-	-
Adjusted opening Group MCEV		**463,494**	**56,139**	**519,633**	9,890	9,890
					-	-
Operating MCEV earnings	**3**	**41,862**	**-**	**41,862**	54,028	107,236
Non-operating MCEV earnings	**3**	**(4,822)**	**(363)**	**(5,185)**	(55,643)	(54,225)
Total MCEV earnings		**37,040**	**(363)**	**36,677**	(1,615)	53,011
Other movements in IFRS net equity	**4**	**-**	**239**	**239**	455,519	456,732
Closing adjustments	**3**	**-**	**(12,000)**	**(12,000)**	-	-
Closing Group MCEV		**500,534**	**44,015**	**544,549**	463,794	519,633

Covered business Analysis of Movement in Embedded Value (net of tax)

For the half year ended 30 June 2014

	Note	Half year ended 30 June 2014				Half year ended 30 June 2013	Year ended 31 December 2013
		Free surplus	Required capital	VIF	MCEV	MCEV	MCEV
		£000's	£000's	£000's	£000's	£000's	£000's
Opening MCEV		**58,840**	**354,330**	**50,324**	**463,494**	383,600	383,600
Opening adjustments		**-**	**-**	**-**	**-**	-	-
Adjusted opening MCEV		**58,840**	**354,330**	**50,324**	**463,494**	383,600	383,600
New business value	**3**	**(29,495)**	**43,378**	**4,412**	**18,295**	41,034	81,094
Expected existing business contribution (reference rate)	**3**	**-**	**-**	**2,006**	**2,006**	1,312	2,800
Transfers from VIF and required capital to free surplus		**14,315**	**(9,376)**	**(3,174)**	**1,765**	2,536	5,226
Experience variances	**3**	**(364)**	**-**	**(269)**	**(633)**	(403)	(301)
Assumption changes	**3**	**6,682**	**(6,202)**	**1,953**	**2,433**	6,520	9,799
Other operating variances	**3**	**16,846**	**(9,663)**	**10,813**	**17,996**	3,029	8,618
Operating MCEV earnings		**7,984**	**18,137**	**15,741**	**41,862**	54,028	107,236
Economic variances	**3**	**4,208**	**(11,285)**	**9,772**	**2,695**	(4,973)	1,734
Other non-operating variances	**3**	**(6,208)**	**(1,415)**	**106**	**(7,517)**	(307)	(4,076)
Total MCEV earnings		**5,984**	**5,437**	**25,619**	**37,040**	48,748	104,894
Closing adjustments	**3**	**-**	**-**	**-**	**-**	-	(25,000)
Closing MCEV		**64,824**	**359,767**	**75,943**	**500,534**	432,348	463,494

Reconciliation of Group IFRS net assets to MCEV

As at 30 June 2014

	Half year ended 30 June 2014			Year ended 31 December 2013		
	Covered Business Adjusted Net Worth £000's	**Non Covered Business Adjusted Net Worth £000's**	**Group £000's**	**Covered Business Adjusted Net Worth £000's**	**Non Covered Business Adjusted Net Worth £000's**	**Group £000's**
Group Net Assets as reported under IFRS	**426,923**	**170,990**	**597,913**	415,501	183,114	598,615
Goodwill	**(1,332)**	**(124,875)**	**(126,207)**	(1,332)	(124,875)	(126,207)
Intangibles	**(1,000)**	**(2,100)**	**(3,100)**	(1,000)	(2,100)	(3,100)
MCEV Net Worth	**424,591**	**44,015**	**468,606**	413,169	56,139	469,308
VIF	**75,943**	**-**	**75,943**	50,325	-	50,325
MCEV (net of taxation)	**500,534**	**44,015**	**544,549**	463,494	56,139	519,633

Notes to the MCEV financial statements for the period ended 30 June 2014

1. Basis of preparation

The supplementary information which comprises the Group MCEV analysis of Earnings (net of tax), Covered business Analysis of Movement in Embedded Value (net of tax), Reconciliation of Group IFRS net assets to MCEV and the related notes 1 to 5 has been prepared on a Market Consistent Embedded Value (MCEV) basis and results for non-covered business on the International Financial Reporting Standards (IFRS) basis.

The MCEV methodology adopted is in accordance with the MCEV Principles published by the CFO Forum in October 2009.

Covered business

The MCEV calculations cover all lines of insurance business within PLACL. No other Group companies contain any covered business and the value of these companies has been included in the Group MCEV at IFRS net asset value, less the value of goodwill and intangibles, to the extent that their recovery is supported by future profits.

Group financing

The Group MCEV includes the value of external debt, at the outstanding face value, within the net worth of Group companies outside of PLACL. The Group has been debt free during 2014 and does not make use of any financial reinsurance.

MCEV methodology

Overview

Under the MCEV methodology, profit is recognised as it is earned over the life of products defined within covered business. The total profit recognised over the lifetime of a policy is the same under MCEV and IFRS, but the timing of recognition is different.

Embedded value

The embedded value is the sum of the adjusted net worth of the Group companies plus the value of in-force on the covered business, this being the present value of profits that will emerge over time.

The embedded value is calculated net of the impacts of reinsurance and allows for taxation based on current legislation and known future changes.

i) Net worth

The net worth is the market value of the shareholders' funds and the shareholders' interest in the surplus held in the long-term business fund. This is the Net Assets on a regulatory basis for the life company and the IFRS net asset value for other Group companies, less the value of goodwill and intangibles, to the extent that their recovery is supported by future profits.

The net worth is equal to the sum of the required capital and free surplus in the Group.

ii) Required Capital

Required capital is the market value of assets attributed to the covered business in excess of assets required to back liabilities for covered business, and for which distribution to shareholders is restricted. The level of required capital is set equal to the higher of:

- The level of capital at which the regulator is empowered to take action;
- The capital requirement under the Group's Economic Capital framework; and
- The target capital level

This methodology reflects the level of capital considered by the directors to be appropriate to manage the business, and includes any additional shareholder funds not available for distribution. The same definition of required capital is used for both existing and new business.

The level of required capital is disclosed as the percentage of the EU minimum capital requirement (Capital Resources Requirement).

The free surplus is the market value of any assets allocated to, but not required to support, the in-force covered business at the valuation date.

iii) Value of in-force covered business (VIF)

The value of in-force covered business consists of the following components:

- present value of future profits;
- time value of financial options and guarantees;
- frictional costs of required capital; and
- cost of residual non-hedgeable risk

a) Present value of future profits (PVFP)

The PVFP is the present value of the distributable profits to shareholders arising from the in-force covered business projected on a best estimate basis. Distributable profits generally arise when they are released following actuarial valuations. These valuations are carried out in accordance with PRA statutory requirements designed to ensure and demonstrate solvency in long-term business funds. Future distributable profits will depend on experience in a number of areas such as investment return, mortality, lapse rates and administration costs. Releases to shareholders arising in future years from the in-force covered business and associated required capital can be projected using assumptions of future experience.

Future profits are projected using best estimate non-economic assumptions and market consistent economic assumptions. In principle, each cash flow is discounted at a rate that appropriately reflects the riskiness of that cash flow, so higher risk cash flows are discounted at higher rates. In practice, the PVFP is calculated using the 'certainty equivalent' approach, under which the reference rate is used for both the investment return and the discount rate. This approach ensures that asset cash flows are valued consistently with the market prices of assets without options and guarantees. Further information on the risk-free rates is in the following pages.

b) Time value of financial options and guarantees (TVOG)

The PVFP calculation is based on a single (base) economic scenario; however, a single scenario cannot appropriately allow for the effect of certain asset features. If an option or guarantee affects shareholder cash flows in the base scenario, the impact is included in the PVFP and is referred to as the intrinsic value of the option guarantee; however, future investment returns are uncertain and the actual impact on shareholder profits may be higher or lower. The covered business does not contain any significant policyholder options or guarantees and therefore the TVOG is zero.

The assets backing the covered business include mortgages secured against individual domestic property (Equity release mortgages). The mortgages contain guarantees where if the value of the property is lower than the mortgage balance at the time of death or entry into a care home, then the lower of the property value and mortgage balance is repaid. The time value of this option and guarantee is allowed for in the asset valuation using closed form calculations.

c) Frictional costs of required capital (FCoRC)

The additional costs to a shareholder of holding the assets backing required capital within an insurance company rather than directly in the market are called frictional costs. They are explicitly deducted from the PVFP. The additional costs allowed for are the taxation costs and any additional investment expenses on the assets backing the required capital. The level of required capital has been set out in the net worth section.

Frictional costs are calculated by projecting forwards the future levels of required capital. The projection of the required capital has been based on an approximate method assuming that the required capital is a constant proportion of the Long Term Insurance Capital Requirement. Tax on investment return and investment expenses are payable on the assets backing required capital, up until the point that they are released to shareholders.

d) Cost of residual non-hedgeable risks (CoNHR)

The cost of residual non-hedgeable risks (CoNHR) covers risks not already allowed for in the time value of options and guarantees or the PVFP. The allowance includes the impact of both non-hedgeable financial and non-financial risks. The most significant risks not included in the PVFP are operational risks and equity release property risks.

Asymmetric risks allowed for in the PVFP are described earlier in the basis of preparation. No allowance has been made within the cost of non-hedgeable risk for symmetrical risks as these are diversifiable by

investors. The CoNHR includes an allowance for non-modelled non-hedgeable risks. For ease of comparison the CoNHR is expressed as percentage cost of non-hedgeable capital.

New business

All annuity business is written on a single premium basis. Premium increments received following policy issue are excluded from the value of new business. Single and regular premium protection business is included in new business.

Point of sale economic and non-economic assumptions are used to value the new business. Any variances or changes in assumptions after the point of sale are recorded within the analysis of the MCEV earnings as operating experience variances or operating assumption changes.

Participating business

The Group does not contain any policies where the policyholders participate in the profits of the business.

2. Assumptions

Reference rates

Reference rates are calculated using corporate bond and equity release liquidity premiums added to the swap curve. The liquidity premium on corporate bond assets is calculated by deducting an allowance for credit default, individually assessed for each bond based on credit rating, and comparing the resulting risk adjusted internal rate of return on the portfolio to the swap curve.

The equity release assets are valued using a mark to model approach that allows for the cost of the no negative equity guarantee, where relevant, with the liquidity premium calculated on a consistent basis.

For protection business, cash flows are assumed to be liquid and as such are discounted with no allowance for a liquidity premium.

The liquidity premiums used for the annuity in-force business are as follows:

	Liquidity premium
30 June 2014	179 bps
31 December 2013	180 bps
30 June 2013	205 bps

The liquidity premium on new business is determined using an approach consistent with that for the in-force business. For new business, the liquidity premium in excess of swaps is derived on a daily basis using the prevailing market conditions.

The weighted average liquidity premiums used for the new business MCEV calculations are as follows:

	Liquidity premium
30 June 2014	247 bps
31 December 2013	216 bps
30 June 2013	187 bps

Swap Rates

The swap curve is constructed from cash rates, future strips, and semi-annual swap rates sourced from a variety of counterparties and brokers with flat interpolation beyond 50 years.

The table below sets out the swap rates used for the MCEV valuations as at period end. These rates have been supplied by PLACL's investment manager.

	6 months	1 year	2 years	5 years	10 years	15 years	20 years
30 June 2014	0.90%	0.90%	1.34%	2.20%	2.85%	3.17%	3.32%
31 December 2013	0.71%	0.71%	1.03%	2.17%	3.10%	3.47%	3.57%
30 June 2013	0.67%	0.67%	0.80%	1.57%	2.64%	3.13%	3.37%

Operating earnings

For operating earnings, PLACL uses the risk adjusted yield on the asset portfolio backing liabilities in order to determine the total existing business contribution. This represents management's long-term expectations of total return on the portfolio.

The expected return has been calculated by reference to the internal rate of return on the backing assets less an appropriate risk margin.

Mortality rates

Assumed future mortality, morbidity and lapse rates have been derived from PLACL's historical experience data. The assumption is set as a best estimate of future experience. Improvements in annuitant longevity have been included in this best estimate.

Expenses

Maintenance expenses are based on the costs allocated or recharged to the PLACL in-force business. No credit for future productivity gains or economies of scale has been included in the MCEV.

Non-recurring expenses, associated with the covered business, are charged to the non-operating earnings in the year incurred and are excluded from the per policy maintenance expense assumptions. These amounted to £9.7m for the 6 month period to 30 June 2014 (30 June 2013: £3.1m, 31 December 2013: £5.2m).

Best estimate expense inflation applied as at 30 June 2014 was 4.7% p.a. (30 June 2013: 4.7%, 31 December 2013: 4.8%).

Taxation

The current and future tax rates are corporation tax rates as published by HM Treasury and take into account both taxes enacted by legislation and those disclosed in budget announcements. The effective tax rate in PLACL in first half of 2014 is consistent with the current corporation tax rate. All significant external debt, which previously reduced the effective tax rate in PLACL, was repaid in 2013. The effective tax rate for the 6 months to 30 June 2014 was 21.5% (30 June 2013: 8.4%, 31 December 2013: 17.1%).

For the purposes of modelling tax on future profits, a calendar assumption is set using a pro rata method based on months at each effective rate. This is implemented as prescribed by HMRC.

The blended corporation tax rates used were as follows:

	Half year ended 30 June 2014	**Year ended 31 December 2013**	**Half Year ended 30 June 2013**
2013	23.25%	23.25%	23.25%
2014	21.50%	21.50%	21.50%
2015	20.25%	20.25%	20.25%
2016+	20.00%	20.00%	20.00%

Volatilities and correlations

Residential property volatility is the only direct volatility input to the MCEV calculations and is used in the evaluation of the "No Negative Equity Guarantee ("NNEG") on Equity release assets. As at 30 June 2014 the assumption was set to 12% (30 June 2013: 12%, 31 December 2013: 12%).

Correlations between the risks inherent in the business are used for the calculation of the CoNHR total non-hedgeable risk capital. The correlations are consistent with the Group's Economic Capital assumptions which are based on historic correlations with adjustment for prudence as required.

Non-hedgeable risk

For the balance sheet and operating profit, a charge of 1.1% (30 June 2013: 1.2%, 31 December 2013: 1.2%) has been applied to the non-hedgeable capital required for a 1-in-200 year basis over the remaining lifetime of in-force business. The charge includes an allowance for all material non-hedgeable risks identified which are not already included in the PVFP calculation.

The capital levels used are consistent with those used in the Economic Capital calculation for those risks covered. Diversification benefits are included between non-hedgeable risks of the covered business. No diversification credit has been taken with hedgeable risks in the covered or non-covered business. The capital has been projected as running off over the remaining lifetime of the covered business in line with the capital resources requirement.

Frictional cost of required capital

The required capital has been set to be 176% of the capital resources requirement (30 June 2013: 186%, 31 December 2013: 185%). The required capital has been projected as running off over the remaining lifetime of the covered business in line with the capital resources requirement.

The total frictional cost allowance for investment expenses and tax on investment income earned on the required capital is 0.7% as at 30 June 2014 (30 June 2013: 1.1%, 31 December 2013: 1.1%).

3. Commentary on the analysis of movement in embedded value (net of tax)

Covered business

New business volumes in the first half of 2014 are less than in the first half of 2013. This was the key driver in the reduction of MCEV earnings from the value of new business written over the period.

The total expected existing business contribution and transfers from VIF and required capital to free surplus have increased in the period as a result of continued growth in the portfolio.

Experience variances in the period are negligible in aggregate and there were no significant individual components.

During the period the methodology for the calculation of frictional cost of capital has been reassessed to more accurately reflect the assets backing required capital, resulting in a one off increase in MCEV of £10m that has been included in other operating variances.

Other operating variances also include expected long-term return on excess assets of £6.8m (£9.5m at 31 December 2013 and £2.9m at 30 June 2013).

An adjustment to the provision for tax in the calculation of required capital has contributed to the movement in the allocation of required capital and free surplus in other operating variances but does not result in an overall change to MCEV.

Economic variances on VIF predominantly relate to a reduction in risk free rates over the period which reduced reference rates and hence increased PVFP.

The impact of economic variances on the economic capital balance sheet has contributed to the movement in the allocation of required capital and free surplus in the economic variances line but has no net impact on MCEV.

Non-operating variance free surplus predominantly consists of non-recurring expenses of £7.6m, further detail of which is provided in note 3 (which is presented on a pre-tax basis) to the consolidated financial statements presented with this supplementary information.

Non-covered business

In December 2013 Partnership Life Assurance Company Limited declared and paid a £25m dividend to Partnership Group Holdings Limited. In the 2013 Report and Accounts the receipt of the £25m dividend was included in non-covered other movements in IFRS net equity in the Group MCEV analysis of earnings (net of tax).

In the 2014 half year statement, this receipt has been included in closing adjustments, offsetting the payment from covered business.

This change in presentation has been made so as to more clearly present intra-group dividends and dividends paid out to shareholders. There has been no change to the group MCEV at 31 December 2013.

The non-operating MCEV loss in the period has arisen in the non-insurance companies in the group.

The principal change in the value of non-covered business is due to the payment of the 2013 final dividend of £12.0m.

4. Commentary on the movements in IFRS net equity (net of tax)

The other movements in IFRS net equity have arisen as the share based payment reserve has been increased to reflect the charge arising from the Group's non-cash employee benefits.

5. Sensitivities

No future management actions are modelled following the change to the assumptions. The results are shown net of tax. The Required Capital has not been recalculated in each scenario and is modelled as a level percentage of the Capital Resources Requirement (CRR) (although the CRR will have increased or decreased as a result of any change in IFRS reserves and will impact on the FCoRC).

The sensitivity of the embedded value and the value of new business to changes in economic and non-economic assumptions is as follows:

	In-force		New business	
	Impact on MCEV	Change in MCEV	Impact on MCEV	Change in MCEV
30 June 2014 Sensitivity	**£'000**	**%**	**£'000**	**%**
Embedded Value (Base)	**500,534**		**18,295**	
Interest rate environment +100 bps	**(1,367)**	**0%**	**n/a**	**n/a**
Interest rate environment -100 bps	**(961)**	**0%**	**n/a**	**n/a**
Swaption implied volatilities + 25%	**n/a**	**n/a**	**n/a**	**n/a**
Property volatilities +25%	**(30,563)**	**-6%**	**(1,120)**	**-6%**
Property Values -10%	**(22,514)**	**-4%**	**n/a**	**n/a**
Lapses -10% (including equity release)	**2,240**	**0%**	**n/a**	**n/a**
Mortality -5% (annuities)	**(17,727)**	**-4%**	**(1,040)**	**-6%**
Expenses -10%	**6,248**	**1%**	**141**	**1%**
Mortality improvements +0.25%	**(8,573)**	**-2%**	**(715)**	**-4%**
Decrease in liquidity premium 25 bps	**(66,760)**	**-13%**	**(5,985)**	**-33%**
Required capital set to be 100% of CRR	**11,201**	**2%**	**2,407**	**13%**

	In-force		New business	
	Impact on MCEV	Change in MCEV	Impact on MCEV	Change in MCEV
31 December 2013 Sensitivity	**£'000**	**%**	**£'000**	**%**
Embedded Value (Base)	**463,494**		**81,094**	
Interest rate environment +100 bps	760	0%	n/a	n/a
Interest rate environment -100 bps	(4,802)	-1%	n/a	n/a
Swaption implied volatilities + 25%	n/a	n/a	n/a	n/a
Property volatilities +25%	(23,601)	-5%	(4,100)	-5%
Property Values -10%	(17,364)	-4%	n/a	n/a
Lapses -10% (including equity release)	1,861	0%	n/a	n/a
Mortality -5% (annuities)	(16,892)	-4%	(3,179)	-4%
Expenses -10%	5,842	1%	1,322	2%
Mortality improvements +0.25%	(7,149)	-2%	(1,986)	-2%
Decrease in liquidity premium 25 bps	(60,529)	-13%	(17,363)	-22%
Required capital set to be 100% of CRR	16,813	4%	6,466	8%

Notes to the sensitivities:

- Interest rate environment +/-100 bps – this sensitivity is modelled as a 100bp change to the yield on each asset. The sensitivity allows for the resulting change in asset value and the change in liability value that follows from the change in risk adjusted internal rate of return on the portfolio. In the -100bp sensitivity the reference rate has a floor of 0%.
- No sensitivity to swaption implied volatilities has been shown as swaption volatilities are not used in any part of the MCEV calculation for PLACL.
- 25% increase in property volatility – this sensitivity allows for the change in equity release asset value as a result of the change in the cost of the “No Negative Equity Guarantee” and the corresponding change in liabilities as a result of the yield change.
- 10% fall in property values – this sensitivity allows for the change in asset value arising from an immediate fall of 10% in property prices, thereby increasing the cost of the “No Negative Equity Guarantee” and the change in liabilities as a result of the consequent change in yield on the equity release asset.
- 10% proportionate change in lapses (e.g. base lapse rate of 5% becomes 90% * 5%) - equity release repayment rates are also adjusted, the IFRS reserves are changed in this scenario as a result of changing yields on equity release mortgages.
- 5% decrease in base mortality – this sensitivity is modelled for the annuity business only. Remaining products are not material. This is modelled as a change in the best estimate mortality level and the prudent margins remain unchanged.
- 10% decrease in maintenance expenses – modelled as a 10% change in the expense reserve. There is no change to expense inflation and no change to valuation interest rates.
- Mortality improvements +0.25% - this sensitivity is modelled as an additional 0.25% improvement in each future year within the best estimate basis. Prudent margins are unchanged.
- 25bps decrease in liquidity premiums – this sensitivity is modelled as a 25bp parallel shift in the reference rates used for annuity business. This equates to an increase in best estimate credit defaults of 34bps per annum for corporate bond holdings.
- The required capital sensitivity is modelled by reducing capital from 176% to 100% of the capital resource requirement. This has no impact on net worth and increases the VIF as a result of lower frictional costs of capital.
- Interest rate and property value sensitivities are not modelled for new business as the group actively reviews its pricing, and in the event of a sudden movement in asset values the pricing of new business would be changed.

Glossary

"Admission"	the admission of the Ordinary Shares to the premium listing segment of the Official List and to trading on the London Stock Exchange's main market for listed securities
"Board"	the board of directors of the Company
"Company"	Partnership Assurance Group plc
"DB"	defined benefit pension scheme
"DC"	defined contribution pension scheme
"Directors"	the Executive Directors and the Non-executive Directors of PAG plc
"Economic Capital"	is based on the Boards view of capital required to withstand a 1 in 200 risk event.
"Economic Capital Coverage Ratio"	the ratio of economic capital surplus over economic capital requirements assessed at the Group level.
"Economic Capital Surplus"	surplus capital of the Group in excess of an assessment of the level of capital that would be required for the Group to withstand the impact of an event that is commensurate with a level of severity of a 1 in 200 year event.
"EU"	the European Union
"Global Offer"	the issue of New Ordinary Shares by the Company and the sale of Existing Ordinary Shares by the Selling Shareholders to institutional investors in the United Kingdom and elsewhere
"Group"	Partnership Assurance Group plc and its subsidiaries and subsidiary undertakings from time to time
"GWP"	gross written premium or gross premiums written, the line item on the Group's consolidated income statement which reflects the revenue recognised in respect of premiums paid for its policies
"IGD surplus capital resources"	The IGD surplus capital resources is defined by the FCA in the Insurance Groups Directive. It is calculated as the surplus of the available capital resources over the capital resources requirement. It excludes the surplus capital held within the long-term funds.
"INA"	immediate needs annuity, otherwise known as a care annuity, which is designed to provide income for life to fund care costs in return for a one-off premium and is designed for adults requiring immediate financial support with their long-term care costs
"In-force Operating Profit"	profit generated from the actual experience measured against the assumed experience in the actuarial basis. The actuarial basis includes a number of assumptions, the most material of which are mortality levels, levels of defaults on investments, expense levels (to maintain the business in-force), levels of inflation, and lapse rates (for regular premium business). In-force Operating Profit also includes the effect recognised in the IFRS profit arising from changes in the reported value of insurance (and associated

	financial) liabilities resulting from changes to the actuarial assumptions, valuation methods, or underlying data, made subsequent to the point of sale.
"IPO"	Initial public offering
"Longevity risk"	the risk that on average annuitants will live longer than expected
"Long-term expected return on surplus assets"	the long-term, risk adjusted, expected return on investments surplus to those investments that are used to back insurance liabilities. The long-term expected return is derived from applying an average expected yield appropriate to the category of surplus assets held and is adjusted for the best estimate expected level of defaults on those investments
"mortality risk"	the risk that on average protection policyholders will not live as long as expected
"New Business Margin"	the ratio of New Business Operating Profit to New Business Premiums
"New Business Operating Profit"	profit generated from new business completed in the period, calculated using actuarial assumptions applicable at the time the new business was written, utilising a discount rate based upon expected investment yields on investment assets (e.g. cash, gilts, corporate bonds and loans secured by equity release mortgages) used to generate the annuity quotation, net of expenses allocated against new business
"New Business Premiums"	New Business Premiums represent the value, measured as single premium equivalent ("SPE"), of new insurance contracts completed during the reporting period.
"PLACL"	Partnership Life Assurance Company Limited
"PRA"	the Prudential Regulation Authority
"RDR"	Retail Distribution Review
Surplus assets"	investments held by the Group that are not required to back insurance liabilities
"SPE"	single premium equivalent, which is calculated as total single premiums plus 10 times annual regular premiums; an industry accepted measure of revenue
"Total Operating Profit"	Total Operating Profit is the sum of New Business Operating Profit and In-force Operating Profit, together with the long-term expected return from investments held by the Group that are not required to back insurance liabilities (termed "surplus assets").
"VIF"	"Value of In-Force" represents the current value of future profits expected to emerge from the in-force insurance liabilities