(iv) UK insurance operations

The short-term fluctuations in investment returns for UK insurance operations arise from the following types of business:

	2013 £m	2012 £m	
	Half year	Half year	Full year
With-profits[note (a)]	(55)	58	285
Shareholder-backed annuity[note (b)]	(63)	(1)	(3)
Unit-linked and other	26	(32)	33
	(92)	25	315

Notes

(a) In half year 2013, a return of 3.3 per cent on policyholder asset shares was achieved (half year 2012: 3.5 per cent; full year 2012: 10.5 per cent). The short-term fluctuations in investment returns for with-profits business include the impact of the difference between the actual earned and expected rates of return for the policyholder asset shares and unallocated surplus of the fund.
For full year 2012, the credit of £285 million reflected a return on policyholder asset shares and unallocated surplus of the fund of 9.8 per cent against an expected rate of 5.0 per cent for the year.

(b) Short-term fluctuations in investment returns for shareholder-backed annuity business comprise: (1) losses on surplus assets reflecting increases in corporate bond and gilt yields; (2) the difference between actual and expected default experience; and (3) the effect of mismatching for assets and liabilities of different durations and other short-term fluctuations in investment returns.

(v) Other items

Short-term fluctuations of Other operations in half year 2013 of £(30) million (half year 2012: £62 million; full year 2012: £119 million) primarily represent unrealised value movements on investments, including centrally held swaps to manage foreign exchange and certain macro-economic exposures of the Group.

(vi) Economic hedge value movements

This item represents the costs on short-dated hedge contracts taken out in the first half of 2012 to provide downside protection against severe equity market falls through a period of particular uncertainty with respect to the Eurozone. The hedge contracts were terminated in the second half of 2012.

6 Effect of changes in economic assumptions

The effects of changes in economic assumptions for in-force business, net of the related change in the time value of cost of options and guarantees, included within profit before tax (including actual investment returns) arise as follows:

(i) Group summary

	2013 £m	2012* £m	
	Half year	Half year	Full year
Asia operations[note (ii)]	333	(244)	(135)
US operations[note (iii)]	62	(79)	85
UK insurance operations[note (iv)]	289	(38)	48
Total	684	(361)	(2)

* As adjusted for the effect of the Japan Life business sale agreement – see note 1.

Notes on the EEV basis results continued

6 Effect of changes in economic assumptions continued

(ii) Asia operations

The effect of changes in economic assumptions for Asia operations in half year 2013 of £333 million primarily reflects the impact relating to the increase in long-term interest rates in the period, principally in Hong Kong of £374 million, Singapore of £73 million and Taiwan of £56 million for the increase in fund earned rates for participating business. There are partial offsets arising in Indonesia of £(136) million and in Malaysia of £(33) million, mainly reflecting the negative impact of discounting health and protection products at higher rates.

The charge of £(244) million in half year 2012 for the effect of changes in economic assumptions primarily reflected decreases in fund earned rates, mainly arising in Hong Kong of £(79) million and Vietnam of £(63) million due to the reduction in the assumed long-term yields and in Singapore of £(73) million for the narrowing of corporate bond spreads.

The charge of £(135) million in full year 2012 for the effect of changes in economic assumptions principally arose in Hong Kong of £(320) million, primarily reflecting the effect on projected cash flows of de-risking the asset portfolio and the reduction in fund earned rates on participating business, driven by the very low interest rate environment, and in Vietnam of £(47) million, following the fall in bond yields. There were partial offsets totalling £232 million, principally arising in Malaysia and Indonesia, mainly reflecting the positive impact of discounting projected health and protection profits at lower rates, driven by the decrease in risk discount rates.

(iii) US operations

The effect of changes in economic assumptions for US operations reflects the following:

	2013 £m	2012 £m	
	Half year	Half year	Full year
Effect of changes in 10-year treasury rates, beta and equity risk premium:[note (a)]			
Fixed annuity and other general account business[note (b)]	(226)	28	20
Variable annuity (VA) business[note (c)]	288	(107)	(83)
Decrease in additional allowance for credit risk[note (d)]	–	–	148
Total[note (e)]	62	(79)	85

Notes

(a) The effect of changes in economic assumptions represents the aggregate effect of changes to projected returns and the risk discount rate (as shown in note 15(ii)). The risk discount rate, as discussed in note 1(b)(iii), represents the aggregate of the risk-free rate (which is defined as the 10-year treasury rate) and margin for market risk, credit risk and non-diversifiable non-market risk.

(b) For fixed annuity and other general account business, the charge of £(226) million in half year 2013 principally arises from the effect of a higher discount rate on the opening value of the in-force book, driven by the 70 basis points increase in the risk-free rate. The projected cash flows for this business principally reflect projected spread, with secondary effects on the cash flows also resulting from changes to assumed future yields and resulting policyholder behaviour. The credit of £28 million in half year 2012 reflected a 20 basis points decrease in the risk free rate and in full year 2012 the credit of £20 million reflected a 10 basis point decrease in the risk free rate, partially offset by the effect for the acquired REALIC book (reflecting a 20 basis point increase in the risk-free rate from the 4 September acquisition date to 31 December 2012).

(c) For VA business, the credit of £288 million principally reflects an increase in projected fee income and a decrease in projected benefit costs, arising from the increase in the rate of assumed future return on the underlying separate account assets, driven the 70 basis points increase in the risk-free rate. There is a partial offset arising from the increase in the discount rate applied to those cash flows. The charge of £(107) million in half year 2012 and £(83) million in full year 2012 reflected a decrease in the risk free rate of 20 basis points and 10 basis points respectively.

(d) For full year 2012, the £148 million effect of the decrease in the additional allowance for credit risk within the risk discount rate reflected the reduction in credit spreads and represented a 50 basis points decrease for spread business, including the acquired REALIC business (from 200 basis points to 150 basis points), and a 10 basis points decrease for VA business (from 40 basis points to 30 basis points), representing the proportion of business invested in the general account (as described in note 1(b)(iii)).

(e) The total effect of changes in economic assumptions for US operations of a credit of £62 million for half year 2013 includes a charge of £(20) million for the effect of the change in required capital from 235 per cent to 250 per cent of risk-based capital (see note 1(b)(ii)).

(iv) UK insurance operations

The effect of changes in economic assumptions of a credit of £289 million for UK insurance operations for half year 2013 comprises the following:

	2013 £m	2012 £m	
	Half year	Half year	Full year
Shareholder-backed annuity business[note (a)]			
Effect of change in:			
Expected long-term rates of return, risk discount rates and other changes	(137)	18	140
Tax regime[note (b)]	–	–	(46)
	(137)	18	94
With-profits and other business[note (c)]			
Effect of changes in expected long-term rates of return	586	(112)	(62)
Effect of changes in risk discount rates	(160)	67	24
Other changes	–	(11)	(8)
	426	(56)	(46)
	289	(38)	48

Notes

(a) For shareholder-backed annuity business the overall effect of changes in expected long-term rates of return and risk discount rates for the periods shown above reflect the combined effects of the changes in economic assumptions, which incorporate a default allowance for both best estimate defaults and in respect of the additional credit risk provisions (as shown in note 15(iii)).

(b) In full year 2012, the effect of the change in tax regime of £(46) million reflected the change in pattern of taxable profits for shareholder-backed annuity business arising from the acceleration of tax payments due to the altered timing of relief on regulatory basis provisions.

(c) For with-profits and other business the total credit in half year 2013 of £426 million (half year 2012: £(56) million; full year 2012: £(46) million) includes the net effect of the changes in fund earned rates and risk discount rate (as shown in note 15(iii)), driven by the 70 basis points increase (half year and full year 2012: a reduction of 20 basis points) in the 15-year gilt rate.

7 Agreement to sell Japan Life business

On 16 July 2013, the Group reached an agreement to sell the life insurance business in Japan, PCA Life Insurance Company Limited, which was closed to new business in 2010, to SBI Holdings Inc. for US$85 million (£56 million at 30 June closing exchange rate). Completion of the transaction is dependent on regulatory approval.

Consistent with the classification of the business as held for sale for IFRS reporting, the EEV carrying value has been set to £53 million at 30 June 2013, representing the estimated proceeds, net of related expenses.

In order to facilitate comparisons of the Group's retained businesses, the presentation of the Group's EEV basis results have been adjusted to show separately the results for the Japan Life business. Accordingly, the presentation of the comparative results for half year and full year 2012 have been retrospectively adjusted. For half year 2013, the result for the period, including short-term fluctuations in investment returns and the effect of changes in economic assumptions, together with the adjustment to the carrying value have given rise to an aggregate loss of £(47) million. The half year and full year 2012 amounts of £5 million and £21 million respectively, represent the previously reported profits before tax for this business.