



Guide to Financial Reporting European Embedded Value and IFRS Results year ended 31 December 2010

This guide to financial reporting is designed to help investors and other users of our financial statements to gain a better understanding of our financials and our business. Reporting in financial services can be complex, particularly so for life assurance, where the accounting standards are still in the process of evolving and fall short of the needs of the market in providing either good performance metrics or valuation tools. In this guide we use the 2010 financial results to explain and illustrate our financial reporting.

A copy of this guide plus a glossary of terms used is available on our web site
www.irishlifepermanent.ie

March 2011

Contents

	Page
1. Changes in Financial Reporting	1
2. Statutory Financial Reporting - IFRS change	1
3. Alternative Group Reporting - European Embedded Value	2
4. Group Income Statement - EEV basis	3
5. Group Balance Sheet - EEV basis	5
6. Shareholders Equity - EEV basis	6
7. Life Assurance Operating Profit - EEV basis	7
8. Banking Operating Profit - IFRS basis	9
9. General Insurance Associate	10
10. Other Activities Operating Profit - IFRS basis	10

Guide to Financial Reporting in Irish Life & Permanent

European Embedded Value & IFRS

1. Changes in Financial Reporting

The principal activities of the Irish Life & Permanent group are life assurance and retail banking. It also has a minority interest in general insurance business. The group is almost exclusively focused on the Irish market with the only exception being its specialist mortgage lending business in the UK.

The quoted parent company of the group - Irish Life & Permanent plc - is a licensed bank and trades as **permanent tsb**. It is also the holding company for the group's principal subsidiary being Irish Life Assurance plc. The group's financial reporting basis for its businesses has been Irish GAAP up to 2004. For banking activities this was an accruals basis of accounting and for life assurance the reporting basis was embedded value.

With effect from 2005 the group's statutory reporting is based on International Financial Reporting Standards ("IFRS"). For banking this involves some modification of the previous accruals basis with the principal changes relating to the spreading of costs and revenues and the elimination of general provisions. Under IFRS life assurance reporting is split into two elements - "insurance" and "investment". Insurance business continues to be reported on an embedded value basis but the (larger) investment component is accounted for on an accruals basis.

While supporting the stated objectives of IFRS the group, and the life industry in general, is of the view that the new IFRS basis is unsatisfactory in terms of the measurement and reporting of the profitability and the value added from writing long term life assurance business, specifically what it is now categorised as "investment" business. Accordingly the group continues to manage all its life assurance business on the basis of embedded value metrics and to provide embedded value results to shareholders and the market by way of supplementary financial reporting.

2. Statutory Financial Reporting - IFRS Changes

IFRS came into effect from January 1st 2005 as the new statutory financial reporting basis for the group. It requires the adoption of new accounting policies and new financial reporting formats which are very different from those previously used.

Group

At group level the most noticeable change relates to the format and presentation of the group's consolidated financials. We are no longer permitted in our primary financial statements to provide separate banking and life assurance & fund management (Life) profit & loss accounts and balance sheets. The three main components now contributing to earnings - banking, Life and the associate general insurance business - each with a different

*IFRS from
Jan 1 2005*

*Continue to
adopt
embedded
value*

*IFRS -
combined
Life and
Banking P&L
and B/S*

accounting basis are compressed into a single profit & loss account. The segmental information is provided in the notes to the accounts.

The adoption of the IFRS policy on pension accounting by the group requires the recognition and provision for pension fund deficits (which would have previously been just disclosed) in the financial statements. Scheme deficits at January 1 2004 were recognised in the balance sheet. Adopting the "corridor approach" subsequent movements are only recognised to the extent that they exceed 10% of pension scheme assets or liabilities.

Provision for pension deficits at Jan 1 2004

Other IFRS changes at group level are on the treatment of goodwill and share based compensation. Goodwill is no longer amortised from 2004 and the new accounting rules in relation to options require that the cost of any options issued must be charged in the P & L account.

Banking

The impact of IFRS on reported banking earnings was principally to do with the spreading of discounts and commissions / fees (payable and receivable) over the expected life of a loan and prohibition of general provisions, most particularly general bad debt provisions.

Life

Accounting for Life or long term insurance business under IFRS requires splitting the business between "insurance" contracts and "investment" contracts with the defining feature of insurance contracts being that they must contain significant insurance risks. The business represented by insurance contracts can continue to be accounted for as heretofore - that is on an embedded value basis. However the majority of Irish Life's business, being unit-linked, falls into the investment category under IFRS. This investment business is now to be accounted for effectively on an accruals or quasi-cash flow basis under IFRS rather than the current embedded value basis. This accruals basis requires, *inter alia*, the immediate write-off of fixed acquisition costs (whereas front end fees received are spread over the life of the contract) and can in our view produce misleading outcomes in reporting the profitability on long-term savings and pension business.

IFRS splits life assurance into insurance and investment business

3. Alternative Group Reporting – European Embedded Value

Irish Life has, since its flotation in 1991, adopted embedded value accounting as its primary reporting basis for its life assurance activities. In our view it provides a more meaningful estimate of the profitability of long term insurance business than the traditional cash flow based approaches. It is also the basis on which the group manages and assesses the performance of its Life business.

Using embedded value basis since 1991

Embedded value seeks to measure the value of the shareholders' interest in a life assurance business. This consists of the shareholders equity - represented by net assets - plus the present value (i.e. a discounted cashflow) of future profits to be earned from the existing book of in-force business less the cost of required capital. Future profits are estimated using actuarial methods and best estimates assumptions regarding future expenses, lapses, mortality, interest rates etc. Embedded value does not include any value attributable to future new business.

Embedded value attempts to provide a realistic measure of value creation in a life assurance business which conventional accounting fails to do. However historically a lack of transparency and consistency in methodologies across companies has hampered comparability. In May 2004 a group representing the Chief Financial Officers of major European insurers (CFO forum) published a statement of European Embedded Value ("EEV") principles. These principles provide a framework for calculating and reporting supplementary embedded value information.

The IL&P group has adopted the new EEV framework for the financial reporting of all its group results from 2005 (with comparatives for 2004). In the Group EEV results Life activities - covering both insurance and investment contracts - are accounted for on an embedded value basis and banking and other activities are accounting for on an IFRS basis.

In June 2008 the CFO forum published a new set of EV principles called the Market consistent EV principles (MCEV). These MCEV principles are currently under review due to the current turbulent market conditions. When these new MCEV principles are finalised the IL&P group will investigate adopting them. We do not expect any material change to their current EV value based on these new MCEV principles as the group already determines the risk discount rate in uses in the EV based on a market consistent method.

EEV primary reporting basis for market

These group EEV results are the primary basis for reporting to the market and the announcement of results for the year ended 31 December 2010 focuses on the group EEV results

4. Group Income Statement - EEV basis

Below is the group Consolidated Income Statement for the year ended 31 December 2010:

	€m
Operating profit / (loss) on continuing operations	
Life (insurance & investment)	160
Banking	(364)
Share of associate*	9
Other	(2)
Operating (loss) / profit before tax	(197)
Short term investment fluctuations	49
Effect of economic assumption changes	(51)
VIF financing cost	(22)
Adj. on inter operating segments & impairment of assets held for disposal	(16)
(Loss) before tax	(237)
Taxation	39
(Loss) for the year	(198)

* Allianz (Ireland)

Operating profit

The group operating loss consists of the contribution from Life on an embedded value basis and banking and other activities on an IFRS basis. Life covers individual and group life assurance and investment contracts, pensions and annuity business plus the investment management business of Irish Life Investment Managers. Banking activities include the group's retail banking business in Ireland and its mortgage lending business in the UK. We look in more detail at the income statements for life and banking in sections 7 & 8 below.

Included under the heading "Other" are the results from the group's third party administration and brokerage subsidiaries less corporate expenses - i.e. group costs not attributable to the individual businesses. These items netted out at a loss of €2m in 2010.

The group's share of profits in respects of its associate company, Allianz (Ireland), is also included in operating profit but unlike all other items must be reported in this line net of tax. The after-tax profit in 2010 was €9m.

Share of Associate reported net of tax

Below the line

The main "below the line" items relate to the life assurance business and are excluded from operating profit as they are not within the control of management. The Short Term Investment Fluctuations ("STIFs") represent the impact on embedded value of the differences between the actual investment return (on policyholders and shareholder funds) and the expected or assumed investment return.

Under- or out-performing investment assumptions

So, for example, if the expected investment return was, say 6%, and investment markets yielded an actual negative return of 20% then the management fees accruing to shareholders in the period and in subsequent years would decrease significantly and the STIFs line reflects the resultant reduction in value for shareholders. The outcome for 2010 was a positive €49m reflecting improved equity and property markets compared to significant negative property returns on shareholder funds in 2009.

When external economic conditions change these are also generally reflected in the embedded value. So for example when interest rates move this will affect the risk discount rate and the future investment return assumptions used in the embedded value. The resultant positive or negative impact on shareholder value is included in the item "Effect of economic assumption changes". In 2010 the impact of lower European yields on financial options and guarantees and the cost of holding solvency margin resulted in a negative €51m charge for economic assumption changes.

Effect of changes in interest rates

In November 2010 the group completed the raising of loan capital of €100m secured on the book of in-force business. The once-off embedded value costs of €22m associated with this loan were capitalised in 2010.

Taxation

The taxation charge consists of the tax charge on operating profits and on the below the line items. In 2010 there was a tax credit made up as follows:

	€m
Life	17
Banking	(47)
Other activities	0
	<hr/>
	(30)

Economic assumptions	(4)
VIF financing cost	(5)
	<u>(39)</u>

[Note: The earnings from the associate company activities are reported net of tax and the attributable tax is not therefore included in the tax charge above.]

The operating profit / (loss) tax charge / (credit) for life and banking is explained in sections 7 & 8 below.

5. Group Balance Sheet - EEV Basis

Below is the pro-forma group Consolidated Balance Sheet for the year ended 31 December 2010 which has been restated on an EEV basis. The principal items are explained in the notes.

	€bn
Assets	
Investments	29.0
Loans and receivables	40.1
Assets classified as held for sale	2.0
Investment in associate	0.1
Reinsurers' share of provisions	2.2
Shareholder value of in-force business	0.9
Other	1.5
	<u>75.8</u>
Liabilities	
Customer accounts & Deposits by banks	30.4
Debt securities in issue	10.0
Liabilities classified as held for sale	2.0
Insurance contract liabilities	4.2
Investment contract liabilities	24.1
Subordinated liabilities	1.7
Other	1.4
	<u>73.8</u>
Shareholders' equity	2.0
	<u>75.8</u>

- (a) Investments [2010: €29.0bn] are made up of the life policyholder fund investments and fixed interest securities in the bank's treasury operations. The life investments are mainly unit-linked and match policyholder liabilities.
- (b) Loans & receivables [2010: €40.1bn] consists of loans to customers, including securitised loans, as well as loans to other credit institutions.
- (c) Assets and liabilities classified as held for sale [2010: €2.0bn], in February 2011, the group announced the share sale of Irish Life International Ltd (ILI) to a leading Nordic financial services provider. In accordance with accounting standards, ILI's assets have been classified as assets held for sale.
- (d) The reinsurers' share of provisions [2010: €2.2bn] represents life assurance liabilities reinsured. The liabilities reinsured are mainly non-linked and are included in "insurance contract liabilities".

- (e) The shareholders' value of in-force [2010: €0.9bn] is the present value of the shareholders' interest in life business already written - i.e. the existing in-force book of business. This amount does not include the actual "required capital" or solvency capital supporting the business but is net of a deduction in respect of the cost of maintaining the required capital [2010: €146m].
- (f) Customer accounts [2010: €30.4bn] consist of retail and corporate deposits. Customer accounts [€13.4bn] and deposits by banks [€17.0bn].
- (g) Debt securities [2010: €10.0bn] represent debt issued in the wholesale markets to fund the bank's lending programme.
- (h) Insurance contract liabilities [2010: €4.2bn] mainly represent the liabilities in respect of non-linked or traditional life assurance contracts. Our policy is to fully match these liabilities with a high quality bond portfolio of appropriate duration.
- (i) Investment contract liabilities [2010: €24.1bn] are in respect of unit-linked contracts where the investment risk is primarily borne by the policyholder.
- (j) Subordinated liabilities consist of Tier 2 debt capital issued to support the bank's lending programme and €200m perpetual sub-debt raised to support the life company.

6. Shareholders' Equity - EEV Basis

Shareholders' equity in the group, computed on an EEV basis, is analysed below into its component parts.

		31 Dec 2010		1 Jan 2010
	€m	€m	€m	€m
Life				
• Value of in-force	868		1,076	
• Net worth	878		566	
		1,746		1,642
Banking		138		694
Other activities (including goodwill)		65		67
Associate Undertaking		124		122
		<u>2,073</u>		<u>2,525</u>
Deduction in respect of own shares		(6)		(23)
Adjustment on inter-operating segments		(22)		(17)
Shareholders' equity		<u>2,045</u>		<u>2,485</u>

The Life component of shareholders' equity consists of the value of in-force ("VIF") and the life net worth.

The value of in-force business is the present value of the shareholders' interest in life business already written - i.e. the present value of all cashflows accruing to shareholders from the existing in-force book of business. The balance sheet amount is net of the cost of holding the required capital and is net of tax. The cost of holding the required capital amounted to €146m at the end of 2010. This cost reflects the lower expected return on assets backing the required capital versus the risk discount rate used in the EV calculation. The value of in-force is an intangible item, is non-distributable and does not count for regulatory capital purposes.

Deduction from value of in-force for cost of capital

The life net worth of €878m is net of €216m of perpetual debt. The total amount - €1,094m – represents available capital (less inadmissible items) to meet regulatory capital requirements. As of the end 2010 life regulatory capital requirements (solvency cover) were covered 1.75 times, for the main life entity Irish Life Assurance. The 2010 solvency cover is post a €243m available dividend from the life assurance business to its parent (before the available dividend the solvency cover was 2.4 times).

Life net worth is net of €205m perpetual debt

Most of the other items making up group shareholders' equity are straightforward. The "other activities" represent the group's share of the reserves of subsidiaries Cornmarket and Irish Progressive Services International ("IPSI") which are engaged in brokerage and third party administration respectively. The associate undertaking represents the group's 30% shareholding in the general insurance business of Allianz (Ireland).

The final item is a deduction of €6m in respect of own shares. These are shares in Irish Life & Permanent plc which are held in the unit-linked policyholder funds entirely for the benefit of policyholders. They are not treasury shares and the shareholder has absolutely no interest in them. This is specifically provided for and permitted under Irish legislation. However we are required under accounting rules to deduct the value of these shares from shareholders' equity and to exclude them in computing earnings per share. We consider this to be misleading - understating equity and overstating EPS - and adjust for this item when reporting to the market.

Misleading treatment of "own shares"

7. Life Operating Profit - EEV Basis

Life activities, on the EEV basis, cover both insurance and investment contracts as well as investment management. The income arising is split into the contribution from new business and the return from the existing book of in-force business.

Life Year ended 31 December 2010

Profit before tax	€m
New business contribution	52
Profit from existing business	
• Expected return (Value of in-force + Net Worth)	131
• Experience variances	18
• Operating assumption changes	(41)
Operating profit before tax	160
Taxation	(17)

New business

The contribution from new business written in the period [2010: €52m] represents the present value of the profits accruing to shareholders from the sale of new contracts, and increases to premiums under existing contracts. The bulk of the contribution is from the life business [2010: €37m] with the balance representing the contribution from the institutional inflows into ILIM [2010: €15m]. The value of the new business contribution is calculated as of the point of sale (rolled forward to year-end) using the embedded value assumptions applicable at the start of the period.

The new business margin is expressed as the contribution from new business as a percentage of sales in the period. Under the EEV basis sales are defined as the present value of future new business premiums (PVNBP) which includes the full value of any single premium contracts written and the discounted value of premiums expected to be received under new regular premium contracts. In 2010 for example the PVNBP of life sales (excluding institutional sales by ILIM) was €2.3bn made up of single premium sales of €1,584m and new regular premium contracts with annual premiums of €162m. To get the present value of those regular premium contracts a multiplier of 4.3 times is applied to the quantum of annual premiums. So the new business life margin for 2010 on an EEV basis was 1.6% (37/2,288*100).

Life new business margin PVNBP basis

Under the traditional reporting basis the measure used for sales was annual premium equivalent or APE which was based on 10% of new single premiums and the annual premium amount for new regular premium contracts. In 2010 life sales on an APE basis were €320m giving a new business margin of 11.5% based on the new life business contribution (EEV basis) of €37m.

APE basis

Existing business

There are a number of components making up the embedded value profit from the existing book of life business. Broadly these are the expected returns from the value of the in-force ("VIF") and from the net worth, variances in actual operating experience against opening assumptions and the financial impact of any changes made to operating assumptions.

The starting point for estimating the total expected return is the sum of the VIF and required capital ("RC") at the risk discount rate. However this number has to be adjusted for the effect of cashflows during the period and the requirement to gross-up the result for tax.

Estimating the expected return on the in-force business

To illustrate the total expected return on continuing business for 2010 was €131m, with €117m from the value of in-force plus €14m from net worth, arrived at broadly as follows:

	€m
[VIF + RC at end 2009] x RDR : €1,710m * 7.5%	128
<i>less</i>	
Cashflow effect	(8)
<i>plus</i>	
Tax gross-up	11
Total Expected Return	131

When calculating embedded value it is necessary to make assumptions regarding future operating outcomes, investment returns and economic

Experience variances indicate how

conditions. The operating assumptions cover items such as persistency (how long will a policy or contract stay in force), future expense levels, mortality and morbidity, taxation etc. Actual experience in any year will inevitably differ from these assumptions and the differences or experience variances are reported as part of operating profit [2010: positive €18m].

*robust
embedded
value
assumptions
are*

The assumptions on which the embedded value is calculated need to be reviewed regularly. If the actual outcomes are consistently different from that assumed then the assumptions are changed to reflect current experience. The financial impact of any such change is part of operating profit for the period and is reported as an “operating assumption change” [2010: negative €41m].

Taxation

The effective tax rate on life operating profits is below the standard corporation tax rate of 12.5% with new business profits having a much higher effective tax rate than existing business. In 2010 the effective tax rate on life operating profit was lower at 10.6%.

The taxation of life company profits in Ireland was changed from 2001. However the changes only applied to new business written since that date and the old rules apply to pre-2001 business still in force. So the tax outcome on new business is very different from existing business where the mix of pre and post-2001 business significantly affects the tax result. The other major factor influencing the effective tax rates on new and existing business is the tax treatment of the required capital - it is not tax allowable when set aside for new business and is not taxed when it is later released.

*Effective tax
rate on
operating
profit lower
than
standard CT
rate*

The nominal tax rate on new business profits is 12.5%. However the disallowance of tax relief for the cost of capital increases the effective tax rate on new business to circa 21%. The low effective tax rate on pre-2000 business profits coupled with the zero tax on the release of required capital can give a very low effective tax rate on existing (i.e. in-force) business profits. This rate should increase over time as the pre-2001 taxed business runs off.

8. Bank Operating Profit - IFRS Basis

Profits from the group’s banking activities are reported on an IFRS basis both in the statutory accounts and in the supplementary group EEV financials.

Banking

Year ended 31 December 2010

	€m	
Net interest income	402	
Other income	39	
Government guarantee	(110)	
Investment return / other	(3)	
Total income	328	
Expenses	(272)	
Operating profit before provisions	56	
Impairment provisions	(420)	
Operating (loss) before tax	(364)	
Taxation	47	
Operating (loss) after tax	(317)	

*IFRS basis
for banking
spreads
costs over
life of loan*

The largest component of bank earnings is net interest income. Interest receivable and payable is recognised on an accrual basis and related discounts, fees and commission payable and fees received in relation to the advancing of a loan are also included in net interest income and spread over the expected life of the loan.

Other income is made up of non-loan related fees, charges and commissions. However the profits arising from the sale by the bank of life products (bancassurance) are included within life profits and not in banking. The bank recovers all its direct costs associated with bancassurance.

The Government guarantee charge for 2010 was €110m. The cost is calculated as a percentage of the liabilities which are covered by the scheme and is payable on a quarterly basis. This is split into the CIFS government guarantee charge of €13m and the new ELG government guarantee scheme which the group participated in from January 2010, resulting in a charge of €97m.

Impairment provisions for bad and doubtful debts are recognised and provided for on an incurred loss basis and general provisions are not usually permitted or included. The significant increase in the charge for 2010 is mainly due to an increase in arrears and falling property values and also reflects an increase in the assumed peak to trough house price fall in Ireland in our impairment provision model. These provisions comprise primarily of a higher collective / IBNR (incurred but not reported) provision put in place due to the economic downturn.

The taxation charge in respect of banking activities consists of two elements. Profits from activities in Ireland are taxed at 12.5% while the profits arising in the group's UK operations, Capital Home Loans, are taxed at 27%. In 2010 the loss incurred in the banking operations results in a tax credit for the year.

9. General Insurance Associate

The group holds a 30% interest in a general (property and casualty) insurance business in Ireland. Allianz is the majority shareholder.

The group's share of the loss incurred by the company [2010: positive €9m] is included in the profit and loss account net of tax.

10. Other Activities Operating Profit - IFRS Basis

"Other activities" consist of the businesses of two subsidiaries - Cornmarket Group, a specialist brokerage company and Irish Progressive Services International (IPSI), a third party administration business.

Profits from these other activities are accounted for on an IFRS basis both in the statutory accounts and in the supplementary group EEV financials.

The operating profit for other activities consists of the profits from Cornmarket and IPSI offset by corporate costs. In 2010 the result netted out at a loss of €2m as corporate costs of €16m offset profits of €14m.