

PEARL GROUP LIMITED

Company Registration Number: 05282342

REPORT AND ACCOUNTS
For the year ended 31 December 2006

CONTENTS

	PAGE
Board of Directors	2
Directors' Report	3
Statement of Directors' Responsibilities	8
Independent Auditors' Report	9
Consolidated Profit and Loss Account: Technical Account – General Business	10
Consolidated Profit and Loss Account: Technical Account – Long term Business	11
Consolidated Profit and Loss Account: Non-technical Account	12
Consolidated Statement of Total Recognised Gains and Losses	12
Consolidated Balance Sheet – Assets	13
Consolidated Balance Sheet – Liabilities	14
Company Balance Sheet	15
Consolidated Cash Flow Statement	16
Accounting Policies	17
Notes to the Accounts	24

Registered Office:

The Pearl Centre
Lynchwood
Peterborough
PE2 6FY

Company Registration No: 05282342

BOARD OF DIRECTORS

J P Evans, Chairman (non-executive)

I D Cormack
T Cross Brown
J R Cusins
M Dale
A K Gupta
W A McIntosh
H E M Osmond
S J Robertson
M D Ross
W R Treen

Company Secretary
G A Watson

DIRECTORS' REPORT

The directors have pleasure in presenting the Report and Accounts of Pearl Group Limited ("the Company") and its subsidiary undertakings ("the Group") for the year ended 31 December 2006.

Principal activities

The principal activity of the Group is the transaction of various classes of insurance business through its subsidiary companies: Pearl Assurance Limited (formerly Pearl Assurance plc), National Provident Life Limited, London Life Limited and NPI Limited. The Group has approximately 3.6 million (2005: 3.9 million) policies in force and £26.8 billion (2005: £28.5 billion) of assets under management across annuities, pensions, savings, investment products, industrial branch business and protection policies. The Group has ceased to write new business but continues to accept premiums on in-force business.

Strategy

The strategy of the Company is to maximise shareholder value whilst ensuring the Group, through the different operating companies, continue to treat their customers fairly.

Principal risks and uncertainties

The risk management objectives and policies of the Group are based on the requirement to protect the Group's regulatory capital position, thereby safeguarding policyholders' guaranteed benefits whilst also ensuring the Group can meet its different cash flow requirements. Subject to the above, the Group seeks to use available capital in pursuing investment opportunities that meet agreed return hurdles for risk taken in order to achieve increased investment returns, generating additional value for policyholders and shareholders.

Insurance risk

Insurance risk in the Group arises through exposure to both increased mortality and longevity and to variances between assumed and actual experience in such factors as persistency levels and various management and administrative expenses. The Group manages these risks by holding prudent reserves based on assumptions that reflect past experience and anticipated future trends. During the period the Group has moved to mitigate expense risk by entering into a comprehensive outsourcing arrangement (see material developments below). The Group also continues to take steps to reduce its overall exposure to longevity risk. During the period the Group commenced negotiations to reinsure the Groups book of annuity in payment business (see post balance sheet events below).

Financial instrument risks

The main risks arising from financial instruments are:

- asset valuation risk, since reductions in the value of assets through market fluctuation will restrict assets available to fund long-term fund obligations and may in extreme circumstances require shareholder funds to be transferred to cover any shortfalls;
- interest rate risk, since movements in interest rates will impact the value of future guarantees and the value of fixed interest securities relative to the value of the related liabilities;
- liquidity risk, arising from either the inability to close out a particular position at or near the previous market price as well as from having insufficient liquid assets to meet payment obligations;
- foreign exchange risk, arising from fluctuations in the value of amounts denominated in foreign currencies; and
- credit risk, arising from the default of the counterparty to a particular financial asset, or from a reinsurer's inability to meet the obligations assumed under its reinsurance arrangements.

The Group's exposure to all these risks is monitored by appropriate committees, primarily by the Financial Risk Committee, which agree policies for managing each of these risks on an ongoing basis. Derivatives are used to mitigate the impact of these risks, where appropriate. During the period the Group continued to invest in developing its specialised asset and liability matching capabilities which has resulted in improved deployment of the Groups capital resources.

DIRECTORS' REPORT (CONTINUED)

Material developments

On 10 March 2006 the Group via Pearl Group Services Limited entered into a comprehensive outsourcing service agreement with Diligenta, a newly formed subsidiary of Tata Consultancy Services Limited ("TCS"). As an integral step in this Business Process Outsource ("BPO"), PGL subscribed for 240,000 £1 ordinary shares in Diligenta Limited (formerly SLK Financial Services Limited) at their nominal value, a 24% holding. On 1 April 2006 the relevant transferring staff of Pearl Group Services Limited became employees of Diligenta Limited. The profits of £56m arising from the transactions associated with the BPO have been reported as a non-operating exceptional item within the consolidated profit and loss account.

On 4 May 2006, Axial Investment Management Limited (formerly DBL Capital Management Limited) ("Axial") a new wholly owned subsidiary company of PGL was incorporated. Axial obtained authorisation from the FSA on 12 January 2007 to trade as an asset management company (see post balance sheet events below).

On 12 June 2006 the Group sold the entire issued share capital of Premier Pensions Trustees Limited to JLT Benefit Solutions Limited for consideration of £1m. A provision for £2m was established on disposal to cover anticipated costs arising in respect of the sale. A loss on disposal of £2m was recognised.

Effective from 1 July 2006 the Investment Management Agreements between Henderson Global Investors Limited and the insurance subsidiaries of the Group were renegotiated. This renegotiation resulted in a release of £11m of negative goodwill reported through the consolidated profit and loss account as a non-operating exceptional item.

Agreement was reached with Lloyds TSB on 20 July 2006 for the transfer by Pearl Assurance Limited of the rights to renew existing General Insurance policies and to market General Insurance products to Pearl Group customers. A non-operating exceptional profit of £55m arose on this transaction.

On 1 October 2006 the long-term and shareholder funds of Pearl Assurance (Unit Funds) Limited, Pearl Assurance (Unit Linked Pensions) Limited and London Life Linked Assurances Limited were transferred to NPI Limited under Part VII of the Financial Services and Markets Act 2000.

Performance during 2006

The Group generated a profit before exceptional items and taxation of £180m (13.5 month period ended 31 December 2005: £238m). This result reflects a profit before tax of £165m from the long-term funds of the Group, £1m general insurance profits and a profit before tax of £14m from the Groups' shareholder assets. The long-term profit reflects the emergence of recurring profits from the release of margins as policies run off together with a number of one off items. These non-recurring items include profits arising from changes in the reserving requirements for non-profit business written by life insurers as a result of the FSA's policy statement PS06/14 and gains from yield enhancements in the investment portfolio principally in the Pearl non-profit fund, offset by the strengthening of annuitant mortality assumptions across all insurance subsidiaries.

The consolidated statement of total recognised gains and losses includes £9m of actuarial gains arising in the year (13.5 month period ended 31 December 2005: £18m losses) on the Pearl Group Staff Pension Scheme offset by a corresponding deferred tax movement.

The consolidated cash flow statement of the Group shows a net shareholder cash outflow of £38m available for investment during 2006 (13.5 month period ended 31 December 2005: £930m inflow).

Dividends

The directors have declared and paid dividends of £199m during the year (13.5 month period ended 31 December 2005: £35m).

DIRECTORS' REPORT (CONTINUED)

Position as at 31 December 2006

The consolidated net assets of the Group at 31 December 2006 are £1,108m (2005: £960m). The increase in the year reflects the total recognised gains and losses arising in 2006 of £246m and a net increase in retained profits recorded as at 1 January 2006 following the adoption of FRS26 of £101m (see "accounting policies") offset by the payment of dividends of £199m during the year.

Pension scheme

Pearl Group Limited is the principal employer of the Pearl Group Staff Pension Scheme ("the Scheme"). This Scheme has been valued on an FRS17 basis as at 31 December 2006 with a surplus of £10m (net of deferred tax) (2005: deficit of £22m). This year end surplus has not been recognised in the Company or in the consolidated balance sheets.

Key Performance Indicators ("KPIs")

The Group has made significant progress during the year, measured and monitored by the Board with reference to the following KPIs:

Customers

The directors review various metrics relating to customer servicing standards on a monthly basis. Agreed service standards for the Group were met during the period.

Regulatory capital

The aim of each insurance subsidiary within the Group is to maintain an appropriate margin of regulatory capital over capital resource requirements, both on a Pillar 1 and a Pillar 2 basis. From a Group perspective, capital is measured with reference to the Insurance Groups Directive (IGD).

As at 31 December 2006, the free assets on a Pillar 1 basis of Pearl Assurance Limited, London Life Limited, National Provident Life Limited and NPI Limited were £733m (2005: £600m), £177m (2005: £144m), £93m (2005: £133m) and £116m (2005: £58m) respectively. The reduction of free assets in National Provident Life Limited reflects, inter alia, the repayment of £65m subordinated debt on 9.625% 30 June 2006. The excess of capital over that required to be held by the Group in the IGD was £713m at the balance sheet date (2005: £601m).

Profit after taxation and distributable reserves

The Group is dependent upon the generation of profits in its subsidiaries to support the payment of dividends. During 2006 the Group reported profit after taxation of £240m (13.5 month period ended 31 December 2005: £411m), and Pearl Group Limited paid dividends of £199m (13.5 month period ended 31 December 2005: £35m). As at 31 December 2006, Pearl Group Limited had retained profits of £255m (2005: £79m), of which £136m (2005: £36m) was considered to be distributable.

Cash flows

Shareholder fund cash flows are monitored closely by the business to ensure that obligations can be met as they fall due. The consolidated cash flow statement of the Group reported a net shareholder cash outflow of £38m during 2006 (13.5 month period ended 31 December 2005: £930m inflow).

DIRECTORS' REPORT (CONTINUED)

Post balance sheet events

During January 2007 PGL announced that it will commence distribution of the Pearl With Profits Fund inherited estate to policyholders from July 2007 through enhancements to policyholder asset shares.

On 22 February 2007, reinsurance arrangements between the Pearl Group life companies and Opal Reassurance Limited ("Opal") were approved in principle by the relevant Boards of Directors of the Pearl Group life companies and it is anticipated that reinsurance treaties will be signed during the first half of 2007. These arrangements if finalised will result in the reinsurance of the pension annuity in payment liabilities of Pearl Assurance Limited, NPI Limited and London Life Limited to Opal and will be effective from 1 January 2007.

On 21 December 2006, Pearl Group Limited entered into an agreement to sell 49% of its equity investment in Axial Investment Management (formerly DBL Capital Management Limited) for consideration of £2m subject to the satisfaction of certain criteria, creating nil profit or loss on disposal. It is anticipated that these criteria will be satisfied by the end of March 2007. The consideration for this transaction will be left outstanding as an interest bearing loan.

Directors and their interests

The names of the directors as at the date of this report are set out on page 2. There are no directors interests requiring disclosure under the Companies Act 1985.

Disclosure of Indemnity

It has been resolved, by amendment of company Articles, to provide an Indemnity to certain persons within the Group. In furtherance of this resolution, companies within the Group have entered into Deeds of Indemnity. These persons include nominated Company directors and secretaries, subsidiary directors, alternate directors and approved persons, being persons in relation to whom the Financial Services Authority has given its approval under section 59 of the Financial Services and Markets Act 2000 ("FSMA") for the performance of a controlled function. This indemnity will cover all losses, costs and expenses incurred by an indemnified person incurred in the exercise, execution and discharge of his duties, or connected to the same, to the fullest extent permitted, consistent with the Companies Act 1985.

Audit information

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the group's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Employees

During the year the Group continued its policy of informing and involving employees on matters which concern them and in the achievement of its business goals. The Group has a comprehensive system for consultation and communication involving regular meetings between management and employees, team briefings, opinion surveys and the issue of various bulletins.

Employee development within the Group is promoted by encouraging staff to gain appropriate professional qualifications and assisting with wider personal development.

The Group is committed to providing equal opportunities to all employees irrespective of their sex, age, sexual orientation, marital status, religion, race or disability. It is the Group's policy to give positive consideration to disabled persons with respect to applications for employment, training, career development and promotion, having regard to each individual's particular aptitudes and abilities.

DIRECTORS' REPORT (CONTINUED)

Elective resolutions

The Company has passed elective resolutions under the Companies Act 1985 to dispense with the laying of accounts and reports before general meetings, to dispense with the holding of Annual General Meetings, and to dispense with the annual appointment of auditors.

By order of the Board of Directors



G A Watson
Company Secretary
18 March 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ACCOUNTS

The directors are responsible for preparing the annual report and accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare accounts for each financial year. Under that law the directors have elected to prepare the accounts in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The accounts are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable United Kingdom Accounting Standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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 accounts may differ from legislation in other jurisdictions.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PEARL GROUP LIMITED

We have audited the Group and parent Company accounts (the "accounts") of Pearl Group Limited for the year ended 31 December 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, the Consolidated Statement of Total Recognised Gains and Losses and the related notes 1 to 37. These accounts have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors responsibilities for preparing the Annual Report and the accounts in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the accounts.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

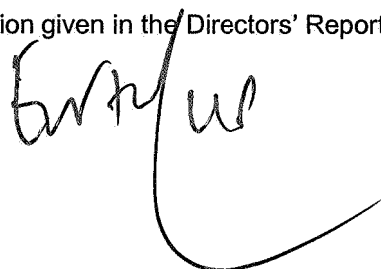
Opinion

In our opinion:

- the accounts give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent Company's affairs as at 31 December 2006 and of the Group's profit for the year then ended;
- the accounts have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the accounts.

Ernst & Young LLP
Registered Auditor
London

28 March 2007



CONSOLIDATED PROFIT AND LOSS ACCOUNT
Technical account for general insurance business
For the year ended 31 December 2006

	Notes	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Allocated investment return transferred from the non-technical account		1	3
Total technical income		<u>1</u>	<u>3</u>
Claims paid:			
Gross amount		(1)	(13)
Reinsurers' share		3	8
Net claims paid		<u>2</u>	<u>(5)</u>
Change in the provision for claims:			
Gross amount		(1)	15
Reinsurers' share		(1)	(7)
Change in the net provision for claims		<u>(2)</u>	<u>8</u>
Claims incurred, net of reinsurance		<u>-</u>	<u>3</u>
Net operating expenses	2.1	-	(1)
Change in equalisation provision	1	-	2
		<u>-</u>	<u>1</u>
Total technical credits		<u>-</u>	<u>4</u>
Balance on the technical account – general business		<u>1</u>	<u>7</u>

All activities relate to discontinued operations.

CONSOLIDATED PROFIT AND LOSS ACCOUNT (CONTINUED)**Technical account for long-term business**

For the year ended 31 December 2006

	Notes	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Gross premiums written	3.1	525	549
Outward reinsurance premiums		(4)	(4)
Earned premiums, net of reinsurance	3.2	<u>521</u>	<u>545</u>
Investment income	4	1,769	1,106
Unrealised gains on investments	4	-	1,828
Other technical income	5	127	17
Total technical income		<u>2,417</u>	<u>3,496</u>
Gross claims paid		(2,402)	(2,289)
Reinsurers' share		1	59
Net claims paid		<u>(2,401)</u>	<u>(2,230)</u>
Change in the gross and net provision for claims		3	3
Claims incurred, net of reinsurance		<u>(2,398)</u>	<u>(2,227)</u>
Change in gross long-term business provision			
- Change in insurance contracts	21	863	(619)
- Change in investment contracts with discretionary participation features	21	610	-
Change in reinsurers' share		<u>(9)</u>	<u>(41)</u>
Change in long-term business provision		1,464	(660)
Change in technical provisions for linked liabilities, net of reinsurance		<u>(417)</u>	<u>(139)</u>
Change in technical provisions, net of reinsurance		<u>1,047</u>	<u>(799)</u>
Net operating expenses	2.1	(134)	(88)
Investment expenses and charges	4	(69)	(49)
Unrealised losses on investments	4	(599)	-
Other technical charges	2.2	(61)	(103)
Taxation charge attributable to the long-term business	6.1	(16)	(127)
Transfer to the fund for future appropriations	18	(68)	(20)
Movement in present value of future profits on non-participating business in the with profits fund	14.2	(4)	19
		<u>(951)</u>	<u>(368)</u>
Total technical charges		<u>(2,302)</u>	<u>(3,394)</u>
Balance on the technical account – long-term business	3.8	<u>115</u>	<u>102</u>
Taxation attributable to the balance on long-term business technical account	6.1	50	37
Profit on long-term business operations before taxation		<u>165</u>	<u>139</u>

All activities relate to continuing operations.

PEARL GROUP LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT (CONTINUED)

Non-technical account

For the year ended 31 December 2006

	Notes	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Balance on the general insurance business technical account			
Discontinued operations		1	7
Balance on the long-term business technical account			
Continuing operations	3.8	115	102
Tax credit attributable to balance on long-term business technical account	6.1	50	37
Shareholders' pre-tax profit from long-term business		165	139
Investment income	4	60	46
Unrealised (losses)/gains on investments	4	(14)	79
Investment expenses and charges	4	(71)	(47)
Allocated investment return transferred to the general business technical account – discontinued operations		(1)	(3)
Other income		50	70
Other charges	2.2	(10)	(53)
Profit on ordinary activities before exceptional items and taxation		180	238
Non-operating exceptional items			
Negative goodwill on acquisition of subsidiary undertakings	10	11	193
Profit on disposals	8	109	-
Profit on ordinary activities before taxation		300	431
Taxation charge on profit on ordinary activities	6.1	(60)	(20)
Profit on ordinary activities after taxation	17.1	240	411

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2006

	Notes	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Profit for the financial period		240	411
Actuarial gains/(losses) on pension scheme	32.1	9	(18)
Tax on items taken directly to equity		(3)	6
Total recognised gains arising in the period		246	399
Opening balance sheet adjustment	17.1	101	
Total recognised gains arising since last financial statements		347	

PEARL GROUP LIMITED

CONSOLIDATED BALANCE SHEET

Assets

At 31 December 2006

	Notes	31 Dec 06 £m	31 Dec 05 £m
Intangible assets			
Goodwill	10	(82)	(147)
Present value of future profits (note 14.2)		74	139
Present value of acquired in force long-term business	14.1	8	8
Deferred origination costs	15.1	26	-
		26	-
Investments			
Land and buildings	11.1	441	425
Investments in joint ventures – share of gross assets	11.3	-	54
Investments in associates	11.4	600	1,074
Other financial investments	11.5/11.6	21,104	22,203
		22,145	23,756
Assets held to cover linked liabilities			
Reinsurers' share of technical provisions			
Long-term business provision (note 21)		13	22
Claims outstanding		185	209
		198	231
Debtors			
Debtors arising out of direct insurance operations	13.1	18	20
Other debtors		83	77
		101	97
Other assets			
Cash at bank and in hand		458	349
Prepayments and accrued income			
Accrued interest and rent		287	287
Deferred acquisition costs	15.2	2	34
Other prepayments and accrued income		14	19
		303	340
Total assets		27,413	29,098

PEARL GROUP LIMITED

CONSOLIDATED BALANCE SHEET

Liabilities

At 31 December 2006

	Notes	31 Dec 06 £m	31 Dec 05 £m
Capital and reserves			
Called up share capital	16.2	596	596
Profit and loss account	17.1	512	364
Equity shareholders' funds	17.1	<u>1,108</u>	<u>960</u>
Fund for future appropriations	18	356	288
Gross technical provisions			
Long-term business provision			
- Insurance contracts	21	12,335	21,566
- Investment contracts with discretionary participation features	21	7,590	-
Claims outstanding	23	308	331
		<u>20,233</u>	<u>21,897</u>
Technical provisions for linked liabilities	19.1	4,182	4,325
		<u>24,415</u>	<u>26,222</u>
Financial liabilities			
Derivative liabilities	20	111	-
Provision for other risks and charges			
Deferred taxation	22.1	44	7
Other provisions	27	90	79
		<u>134</u>	<u>86</u>
Creditors			
Creditors arising out of direct insurance operations		1	2
Debenture loans	26.1	691	840
Amounts owed to credit institutions	26.1	291	300
Other creditors including taxation and social security	28	272	340
		<u>1,255</u>	<u>1,482</u>
Accruals and deferred income		34	38
Total liabilities excluding pension liability		<u>27,413</u>	<u>29,076</u>
Pension liability	32.4	-	22
Total liabilities		<u>27,413</u>	<u>29,098</u>

The accounts were approved by the Board of Directors on 28 March 2007 and signed on its behalf by:

Director



PEARL GROUP LIMITED

COMPANY BALANCE SHEET

At 31 December 2006

	Notes	31 Dec 06 £m	31 Dec 05 £m
Fixed assets			
Investments	11.7	3,074	2,445
Current assets			
Debtors			
- due within one year	13.2	41	29
- due after more than one year	13.2	4	10
Investments	11.7	2	2
Cash at bank		13	5
		60	46
Creditors: amounts falling due within one year	24	(1,654)	(1,147)
Net current liabilities		(1,594)	(1,101)
Total assets less current liabilities		1,480	1,344
Creditors: amounts falling due after more than one year	25	(622)	(647)
Provisions for liabilities and charges	22.1	(7)	-
Net assets excluding pension liability		851	697
Pension liability	32.4	-	(22)
Net assets including pension liability		851	675
Capital and reserves			
Called up share capital	16.2	596	596
Profit and loss account	17.2	255	79
Equity shareholders' funds	17.2	851	675

The accounts were approved by the Board of Directors on ²⁸March 2007 and signed on its behalf by:

Director



CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2006

	Notes	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Operating activities			
Net cash inflow from operating activities	31.1	252	173
Returns on investments and servicing of finance			
Interest paid		(56)	(1)
Interest received		5	-
Net cash outflow from servicing of finance		(51)	(1)
Tax			
Group relief and tax received from long-term funds		18	40
Capital expenditure and financial investments			
New loan investments		(188)	(51)
Acquisitions and disposals			
Net cash inflow / (outflow) from acquisitions and disposals	31.2	130	(284)
Equity dividends paid			
Equity dividends paid		(199)	(35)
Financing activities			
Issue of share capital		-	596
New loans		-	492
Net cash inflow from financing activities		-	1,088
Net cash flows available for investment		(38)	930
Cash flows were invested as follows:			
(Decrease) / increase in cash holdings	31.6	(93)	299
Net purchases of investments	31.6	55	631
Net investment of cash flows		(38)	930

The Consolidated Cash Flow Statement does not include any amounts relating to long-term business except cash transactions between the long-term business and shareholder funds and movements in cash held by the Pacific fund.

ACCOUNTING POLICIES

Basis of preparation

The consolidated accounts of the Company and its subsidiary undertakings have been prepared in accordance with the special provisions for insurance groups of Section 255A of, and Schedule 9A to the Companies Act 1985 except as noted for land and buildings (see accounting policy below). The entity accounts of the Company have been prepared in accordance with Schedule 4 to the Companies Act 1985. The consolidated accounts have also been prepared in accordance with applicable UK accounting standards and under the historical cost accounting rules, modified to include the revaluation of investments, and comply with the UK Statement of Recommended Practice on Accounting for Insurance Business (SORP) issued by the Association of British Insurers in 2005 and amended in 2006.

Changes in accounting policy

The Group has adopted the provisions of FRS26 "Financial Instruments: Measurement" ("FRS26") in these accounts. The effect of the adoption of this standard has been reported as an opening balance sheet adjustment as at 1 January 2006 and, in accordance with the transitional provisions of the standard, no prior period adjustment has been made. The main effects of the resulting changes to the Group's accounting policies are summarised below:

- Prior to the adoption of FRS26, the Group classified all unit linked contracts as insurance contracts and accounted for them in accordance with the requirements of the Prudential Sourcebook for insurers. Following adoption of FRS26, all unit linked contracts have been classified as investment contracts and accounted for under the requirements of FRS26. The long term business provision relating to these contracts has been released and in its place either accounting provisions or technical provisions for linked liabilities have been created in accordance with the recognition criteria of UKGAAP. In some Group companies this net release of liabilities has to an extent resulted in a release of the Present Value of Future Profits (PVFP) asset. Where additional technical provisions for linked liabilities have been recognised, investments have been reclassified as assets held to cover linked liabilities. In addition, deferred acquisition costs relating to these unit linked contracts has been released and a deferred origination costs asset created as appropriate.
- FRS26 has had no impact on the accounting policy of the Group for negative goodwill whereby negative goodwill up to the fair value of non-monetary assets acquired is recognised in the profit and loss account in the periods in which the non-monetary assets are recovered. Therefore the release of the PVFP assets of National Provident Life Limited ("NPLL") and London Life Limited ("LLL") has at a Group level created a matching release of negative goodwill.
- FRS26 also requires investment contracts to be accounted for using "deposit accounting" which has had no profit impact on the financial results of the Group for the period, but has affected the presentation of these results in the Group's 2006 technical account for long-term business.
- Prior to the adoption of FRS26, the Group carried the underlying investments of its insurance subsidiaries at current value at the balance sheet date which for listed investments and investments in authorised collective investments schemes was middle market value. Following the adoption of FRS26, these assets, and any matching liabilities have been valued on a bid basis.

As a result of the adoption of FRS26, at 1 January 2006 the Group has in total released £168m of long term business provision, reduced the carrying value of other financial investments by £30m, released deferred acquisition costs of £30m, increased both assets held to cover linked liabilities and technical provisions for linked liabilities by £9m, created additional accounting and deferred taxation provisions of £25m and £12m respectively, recognised a £30m deferred origination costs asset, released £61m of both PVFP and negative goodwill and increased retained profits by £101m.

During the period the Group has adopted the provisions of FRS 23 "The Effect of Changes in Foreign Exchange Rates" ("FRS23") and FRS 24 "Financial Reporting in Hyperinflationary Economies" ("FRS24"). The adoption of FRS23 and FRS24 has had no impact on the results of the Group.

The Group has also adopted the disclosure requirements of FRS25 "Financial Instruments: Disclosure and Presentation" ("FRS25") in its current accounts. The Group has taken advantage of the exemption available and has not presented the comparative disclosures required by this standard in its first accounts prepared in accordance with FRS25.

ACCOUNTING POLICIES (CONTINUED)

Basis of consolidation

The consolidated accounts incorporate the accounts of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year using consistent accounting policies. No profit and loss account is presented for the Company as permitted by Section 230 of the Companies Act 1985. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal as appropriate. Where there is a loss of control of a subsidiary, the consolidated accounts include the results for the part of the reporting year during which the Group has control. Minority interests represent the equity interests in subsidiaries not held by the Group.

Interests in Property Limited Partnerships (PLPs) and Jersey Property Unit Trusts (JPUTs) within the long-term business which effect or establish policyholders' rights or are otherwise held as part of the Group's investment portfolio are accounted for as subsidiaries, joint ventures, associates or investments in land and buildings depending on the holdings of the Group and on the level of influence and control that the Group exercises. Where the interest is managed by a contractual agreement such that no one party exerts control, notwithstanding the Group's share, both direct and indirect, may be greater than 50%, such interests have been accounted for as joint ventures. Where the interest is managed by a contractual agreement, such that the Group can exercise a significant influence, but one other party controls the partnership, such interests have been accounted for as associates. Where the Group holds minority stakes, with no disproportionate influence, the relevant investments are included in land and buildings at their market value.

Principal associated undertakings (both associates and joint ventures) are accounted for by the equity method in the consolidated accounts. The profit or loss in respect of interests in associated undertakings attributable to the long-term business fund are treated as unrealised gains or losses within the technical account for long-term business.

General business

Basis of accounting

All classes of business have been discontinued. Provision has been made for obligations that have been incurred that are not expected to be covered by the future profits of the operation, including the expected future investment return on the related assets and their disposal.

Claims

Full provision is made for the estimated cost of claims, including claims incurred but not reported after taking into account handling costs, anticipated inflation and settlement trends. Any difference between the estimated provision and subsequent settlement is dealt with in the technical accounts of later years.

Equalisation provisions

Equalisation provisions have been established in accordance with the requirements of the Prudential Sourcebook for Insurers to mitigate exceptional high loss ratios for classes of business displaying a high degree of claims volatility.

Classification of contracts

Contracts under which the Group accepts significant insurance risk are classified as insurance contracts. Contracts under which the transfer of insurance risk to the Group from the policyholder is not significant are classified as investment contracts. For 2005 all contracts were classified as insurance contracts.

Insurance contracts and investment contracts with discretionary participation features (DPF)

Premiums

Long-term insurance contract premiums, investment contracts with DPF and annuity considerations are credited when they become due, which for single premium business is the date from which the policy is effective. For regular premium contracts, receivables are recorded at the date when payments are due. Reinsurance premiums are charged when they are payable. For 2005 all investment contracts including those without DPF were accounted for as insurance contracts.

ACCOUNTING POLICIES (CONTINUED)

Insurance contracts and investment contracts with discretionary participation features (DPF) (continued)

Premiums (continued)

Funds at retirement under individual pension contracts left with the Group are classified as new business single premiums and for accounting purposes are included in both claims incurred and as single premiums within gross premiums written.

Claims

Claims payable on maturity on insurance contracts and investment contracts with DPF are recognised when the claim becomes due for payment and on death are accounted for on notification. Surrenders are accounted for at the earlier of the payment date or when the policy ceases to be included within the long-term business provision. Where claims are payable and the contract remains in force, the claim instalment is accounted for when due for payment. Claims payable include the costs of settlement. For 2005 all investment contracts including those without DPF were accounted for as insurance contracts.

Long-term business provision for insurance contracts and investment contracts with DPF

Participating business

The provision for participating, or with profits, business is calculated initially to comply with the requirements of the Financial Services Authority's realistic capital regime, as set out in section 1.3 of the Prudential Sourcebook for Insurers. The results are then adjusted to exclude the shareholders' share of future bonuses and the associated tax liability and to deduct amounts recognised for the present value of future profits on non participating business written in the with profits fund. The principal assumptions are given in note 21.

Non participating business

The long-term business provision for non participating non linked business is calculated initially to comply with the requirements under the Prudential Sourcebook for Insurers using a gross premium valuation method or a method at least as prudent as the gross premium method. The provision is adjusted where necessary to remove excessively prudent margins required for statutory solvency purposes by eliminating the undistributed surplus carried forward together with general contingency reserves and reserves required under the Prudential Sourcebook for Insurers. The principal assumptions are given in note 21.

In accordance with changes made to the Prudential Sourcebook for Insurers the provision at 31 December 2006 includes allowance for prudent lapses and also allows policies with no guaranteed surrender values and policies where guaranteed surrender values only become applicable after a specified period of time, in the periods where they do not have guaranteed surrender values, to have negative values. At 31 December 2005 the provision did not include allowance for prudent lapses and policies with negative values were included at nil value. This change in estimation basis has resulted in a reduction in the long-term business provision for non participating business of £44m.

Deferred acquisition costs

Acquisition costs, comprising all direct and indirect costs arising from the conclusion of non participating insurance contracts, are deferred as an explicit acquisition cost asset, gross of tax. This asset is amortised over the period in which the costs are expected to be recoverable out of margins from matching revenues from related policies and in accordance with the pattern of such margins. At the end of each accounting period, deferred acquisition costs are reviewed for recoverability, by category, against future margins from the related policies in force at the balance sheet date.

Profit recognition and the fund for future appropriations

The Group has adopted the modified statutory solvency basis approach in the determination of profit on non participating business.

ACCOUNTING POLICIES (CONTINUED)

Insurance contracts and investment contracts with discretionary participation features (DPF) (continued)

Profit recognition and the fund for future appropriations (continued)

Surpluses arising from participating business, as a result of the annual actuarial valuation of the related assets and liabilities, are subject to appropriation by the directors of the relevant life company subsidiaries to participating policyholders, by way of bonuses, and to shareholders. The shareholders' share of the appropriated surplus determines the profit reported in respect of participating business. All surplus in other business is attributable to shareholders and included in profit.

Following the application of Guidance Note 45, issued by the actuarial profession in December 2005, the fund for future appropriations (FFA) comprises the shareholders share of the inherited estate of the Groups closed participating businesses and other shareholder items only. The policyholders share of this estate is included within the long-term business provision.

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

In determining the realistic value of liabilities for with profits contracts the value of future profits on non-participating business written in the with profits fund is taken into account. Although not separately identifiable, the long term business provision, or where appropriate, the contingent loan valuation, includes the excess of the value of those future profits that are taken into account in calculating the realistic liabilities. Since it is not possible to apportion the future profits on this non participating business between the amount relating to the policyholder liabilities and the business held in the long-term business provision or the contingent loan, the present value of future profits (PVFP) on this business is recognised as an asset and changes in its value are recorded in the long-term business technical account. Where the future profits on this non participating business are fully attributable to the long-term business provision, the PVFP is deducted in arriving at the long-term business provision.

The value of the PVFP is determined in accordance with the FSA's realistic capital regime. The principal assumptions used to calculate the PVFP are the same as those used in calculating the long-term business provision (note 21).

Investment contracts without DPF

Receipts and payment on investment contracts without DPF are accounted for using deposit accounting, under which the amounts collected and paid out are recognised in the balance sheet as an adjustment to the liability to the policyholder. For 2005 all investment contracts without DPF were accounted for as insurance contracts.

Revenue from investment contracts

Revenue from investment contracts comprise amounts assessed against policyholders' account balances for policy administration and surrender charges and are recognised as the related services are provided and presented as other technical income. For 2005 all investment contracts were accounted for as insurance contracts.

Technical provisions for linked liabilities on investment contracts without DPF

The technical provision in respect of linked business is determined by reference to the value of the underlying assets that are held to meet these liabilities. Where the surrender value of such contracts exceed the value determined by reference to underlying assets, the difference is recognised as part of the long-term business provision.

Deferred origination costs

Origination costs, comprising all incremental costs arising from the conclusion of investment contracts are deferred as an explicit intangible asset, gross of tax. This asset is amortised over the period in which the costs are expected to be recoverable out of margins from matching revenues from related policies and in accordance with the pattern of such margins. Deferred origination cost amortisation is presented within net operating expenses in the technical account for long-term business. At the end of each accounting period, deferred origination costs are reviewed for recoverability, by category, against future margins from the related policies in force at the balance sheet date.

ACCOUNTING POLICIES (CONTINUED)

Investment income, realised and unrealised gains and losses on investments

Dividends are included as investment income on the date that the right to receive payment has been established. Interest income is recognised as the interest accrues using the effective yield method. Rental income on investment properties is accounted for on a straight line basis over the lease term on ongoing leases.

Gains and losses (both realised and unrealised) on financial assets designated as at fair value through profit or loss are recognised in the consolidated profit and loss account.

Realised gains and losses on investments are calculated as the difference between the net sales proceeds and original cost. Unrealised gains and losses on investments represent the difference between the valuation of investments at the balance sheet date and their original cost, or if they have been previously revalued, the valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the period also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period. Regular way purchases and sale of financial assets are accounted for at trade date.

An allocation of investment return from the non-technical account to the general business technical account is made based upon the level of technical provisions and capital allocated to back these provisions.

Goodwill

Goodwill arising on acquisitions, being the difference between the fair value of the purchase consideration and the fair value of net assets acquired, is capitalised in the balance sheet and amortised over its useful economic life or twenty years if shorter. Negative goodwill up to the fair value of non-monetary assets acquired is recognised in the consolidated profit and loss account in the periods in which the non-monetary assets are recovered. Any negative goodwill in excess of the fair value of the non-monetary assets acquired is recognised in the consolidated profit and loss account in the periods expected to be benefited. The carrying value of goodwill is reviewed for impairment at the end of the first full year following an acquisition and when events or changes in circumstances indicate that the carrying amount may not be recoverable.

Land and buildings

Included within land and buildings is investment property, which is property held to earn rentals and/or for its capital appreciation. Investment property is initially measured at cost including all transaction costs and is subsequently stated at its fair value at the balance sheet date. Gains or losses arising from changes in the fair value of investment property are included in the consolidated profit and loss account in the period in which they arise.

Investment properties are derecognised when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the derecognition of an investment property are recognised in the consolidated profit and loss account in the year of derecognition.

In accordance with SSAP19 "Investment Properties", no depreciation is provided on land and buildings. This is a departure of the Companies Act 1985 which require all properties to be depreciated. However, these properties are held solely for investment purposes and management consider that systematic depreciation would be inappropriate. Depreciation is only one of the factors reflected in the annual valuation of properties and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified. The accounting policy adopted is therefore necessary for the accounts to give a true and fair view.

Financial Instruments

Financial assets - Group

Debt securities, equity securities and holdings in authorised collective investment schemes are designated as at fair value through profit and loss in accordance with the documented risk strategy of the Group and are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are included in net profit or loss for the period.

ACCOUNTING POLICIES (CONTINUED)

Financial Instruments (continued)

Financial assets – Company

Investments in shares in subsidiary undertakings are included at cost less any provision for impairment where circumstances indicate that the carrying value may not be recoverable. From 1 January 2006, investments in loans to subsidiary undertakings are designated as loans and receivables and valued at amortised cost. Prior to this date, loans to subsidiary undertakings were included at cost less any provision for impairment where circumstances indicated that the carrying value may not be recoverable. Investments in contingent loans to subsidiary undertakings are designated as a loan and receivable valued at amortised cost, containing an embedded derivative reflecting the contingent nature of the loan recognised at its fair value. Fair value is measured by reference to the contingent loan liability in the subsidiary undertaking.

Financial liabilities

Non-linked liabilities are stated at amortised cost. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. The carrying value of borrowings will also reflect any unrecognised fair value adjustments from the application of acquisition accounting. Any difference between the proceeds, net of transaction costs and the redemption value is recognised in the consolidated profit and loss account over the period of the financial liability using the effective interest method.

Derivative financial instruments

The Group uses derivative financial instruments to mitigate against market, liquidity and credit risk.

Derivative financial instruments are classified as held for trading and carried at fair value as assets or liabilities. Fair values are based on quoted market prices or valuation techniques as appropriate. Changes in fair values are recognised in the consolidated profit and loss account. Derivative financial instruments include swaps, swaptions, futures, forwards and option contracts, all of which derive their value mainly from the underlying interest rates, foreign exchange rates, equity and debt instruments.

Fair value estimation

The fair value of financial instruments traded in active markets (such as publicly traded securities and derivatives) are based on quoted market prices at the balance sheet date. The quoted market price used for financial assets is the current bid price on the trade date. The fair value of investments that are not traded in an active market is determined using valuation techniques. The fair value of shares and other variable yield securities and of derivative financial instruments, are estimated using pricing models or discounted cash flow techniques. Where pricing models are used, inputs are based on market related data at the balance sheet date. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market related rate for a similar instrument.

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

For 2005 equities and fixed income securities were stated at current value. Listed investments and investments in authorised collective investments schemes were valued at middle market price. Unlisted investments were valued at directors estimates of market value. Derivative financial instruments were carried at fair value.

Present value of acquired in force business

The present value of acquired in force business (PVIF) is recognised in the balance sheet as an asset. To the extent that the acquired PVIF will be recognised as profit over the remaining lifetime of the related in force policies, it is amortised on a systematic basis, and the discount unwound, over the anticipated lives of the related contracts of the portfolios. The carrying value of the asset is tested annually for indicators of impairment. Any amortisation or impairment charge is recorded as other technical charges in the long-term business technical account. The principal assumptions used to calculate the PVIF are the same as those used in calculating the long-term business provision (note 21).

ACCOUNTING POLICIES (CONTINUED)

Taxation

The Group recognises deferred tax assets and liabilities on a discounted basis to reflect the time value of money. A discount rate has been selected that reflects the yield on government bonds which have a maturity date similar to the likely average period for assets upon which deferred tax liabilities and assets arise. Deferred tax is recognised in respect of all timing differences that have originated but not reversed by the balance sheet date with the exception of deferred tax assets which are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax on changes in the fair value of investments is recognised in the profit and loss account.

Expenses and assets are recognised net of the amount of VAT except where this tax is not recoverable, in which case the VAT is recognised as part of the cost of acquisition of the asset or as part of the expense item. Receivables and payables are stated with the amount of VAT included. The net amount of VAT recoverable from, or payable to the taxation authority is included as part of receivables or payables in the balance sheet.

The transfer from the long-term business account to the non-technical account is grossed up at the longer term effective rate of corporation tax.

Employee benefits

The Group provides employees with retirement benefits through both defined benefit and defined contribution plans. The assets of these plans are generally held separately from the Group's general assets in trustee-administered funds and are valued at fair value. Defined benefit obligations and cost of providing benefits are determined annually by qualified actuaries using the projected unit credit method. The obligation is measured as the present value of the estimated future cash outflows using a discount rate based on corporate bonds of appropriate duration and quality. The resulting recoverable surplus/deficit of defined benefit assets less liabilities is recognised in the consolidated balance sheet. The Group's expense related to these plans is accrued over the employees' service periods based upon the actuarially determined cost for the period. Actuarial gains and losses are recognised in full in the period in which they occur in the consolidated statement of total recognised gains and losses. Contributions to the defined contribution scheme are charged to the consolidated profit and loss account as they become payable in accordance with the rules of the scheme.

Other defined benefit post-employment benefits, such as medical care and life insurance, are also provided for certain employees. The cost of such benefits is accrued over the service period of the employee based upon the actuarially determined cost for the period using a methodology similar to that for defined benefit pension plans.

Foreign currencies

Transactions in currencies other than the functional currency of the undertaking concerned are recorded at the rate appropriate at the time of accounting for the transaction. Currency balances at the year end are converted at the year-end spot rate. For monetary assets and liabilities within the long-term funds and general insurance business, the resulting exchange adjustments are included within the respective technical accounts. For assets and liabilities held outside of the long-term funds and general insurance business, any resulting exchange adjustments are taken to the non-technical account.

NOTES TO THE ACCOUNTS

1. General business – equalisation provisions

Equalisation provisions are established in accordance with the requirements of the Prudential Sourcebook for Insurers to mitigate exceptional high loss ratios for classes of business displaying a high degree of claims volatility. These provisions, which are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, are required by Schedule 9A to the Companies Act 1985 to be included within technical provisions in the balance sheet notwithstanding that they do not represent liabilities at the balance sheet date. This has had the effect of reducing shareholders' funds by £nil as at 31 December 2006 (2005 : £nil). The movement in equalisation provisions during the year resulted in an increase in the general business technical account result and the profit before taxation of £nil (13.5 month period ended 31 December 2005 : £2m).

2. Net operating expenses and other charges

2.1 Net operating expenses

	Technical account General business		Technical account Long-term business	
	31 Dec 06	13.5 month period ended 31 Dec 05	31 Dec 06	13.5 month period ended 31 Dec 05
	£m	£m	£m	£m
Acquisition costs:				
Commission	-	-	2	1
Other	-	-	3	2
Change in deferred origination costs (note 15.1)	-	-	4	-
Change in deferred acquisition costs (note 15.2)	-	-	2	6
Administrative expenses	-	1	123	79
	<u>-</u>	<u>1</u>	<u>134</u>	<u>88</u>

2.2 Other technical charges and other charges

	Technical account Long-term business		Non - technical account	
	31 Dec 06	13.5 month period ended 31 Dec 05	31 Dec 06	13.5 month period ended 31 Dec 05
	£m	£m	£m	£m
Increase in contingent loan liabilities	47	79	-	-
Other technical charges	14	24	-	-
Other charges	-	-	10	53
	<u>61</u>	<u>103</u>	<u>10</u>	<u>53</u>

Included in other charges in the 2005 non-technical account are £44m of costs incurred by the Company on the acquisition of Life Services. These costs included assessing the underlying feasibility of the acquisition and establishing appropriate ongoing functions sufficient to facilitate the running of a regulated Group.

2.3 Analysis of staff costs

Staff costs comprise:	13.5 month period ended	
	31 Dec 06	31 Dec 05
	£m	£m
Salaries and wages	29	31
Social security costs	3	3
Pension costs (note 32.1)	5	5
Total	<u>37</u>	<u>39</u>

NOTES TO THE ACCOUNTS (CONTINUED)

2. Net operating expenses and other charges (continued)

2.4 Average employee numbers

The average number of employees of the Group during the year ended 31 December 2006 was 424 (period 14 April to 31 December 2005 : 1,230).

2.5 Auditors' remuneration

	31 Dec 06	13.5 month period ended 31 Dec 05 restated
	£m	£m
Fees payable to the Company's auditor for the audit of the Company's annual accounts	0.2	0.2
Fees payable to the Company's auditor and its associates for other services:		
The audit of the Company's subsidiaries pursuant to legislation	0.9	0.8
Other services pursuant to legislation	0.4	0.3
All other services	0.1	0.2
	<u>1.6</u>	<u>1.5</u>

Auditors' remunerations for the 13.5 month period ended 31 December 2005 have been restated to reflect the presentational changes arising from the amendments to the Companies Act 1985 from SI2005/2417.

3. Segmental information – Long-term business

Almost all business is direct and written in the UK in respect of continuing operations.

3.1 Analysis of gross premiums written

	31 Dec 06	13.5 month period ended 31 Dec 05
	£m	£m
Premiums from individuals	511	525
Premiums from group contracts	14	24
	<u>525</u>	<u>549</u>
Life business	162	148
Annuity business	4	12
Pension business	359	389
	<u>525</u>	<u>549</u>

NOTES TO THE ACCOUNTS (CONTINUED)

3. Segmental information – Long-term business (continued)

3.2 Analysis of earned premiums, net of reinsurance

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Premiums from individuals	511	526
Premiums from group contracts	10	19
	<u>521</u>	<u>545</u>
Life business	157	146
Annuity business	5	10
Pension business	359	389
	<u>521</u>	<u>545</u>

3.3 Analysis of gross premiums written by way of direct insurance split by premium type

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Regular premiums	282	303
Single premiums	243	246
	<u>525</u>	<u>549</u>

Industrial branch premiums of £12m (13.5 month period ended 31 December 2005: £11m) are classified as regular premium with profits life business in the above analysis.

3.4 Analysis of gross premiums written by way of direct insurance split by contract type

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Non profit contracts	260	175
With profits contracts	265	254
Linked contracts	-	120
	<u>525</u>	<u>549</u>

Following the adoption of FRS26 in 2006, investment contracts without DPF (i.e. linked contracts) are accounted for using deposit accounting, with amounts collected being recognised in the balance sheet as an adjustment to the liability to the policyholder. For 2005, linked contracts were accounted for as insurance contracts.

NOTES TO THE ACCOUNTS (CONTINUED)

3. Segmental information – Long-term business (continued)

3.5 Analysis of new gross written premiums

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Annuity business	4	87
Pension business	239	160
	<u>243</u>	<u>247</u>

3.6 New business annual premium equivalent

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Annual premium equivalent	<u>24</u>	<u>26</u>

3.7 Analysis of new gross premiums written by way of direct insurance

	31 Dec 06 £m	13.5 month Period ended 31 Dec 05 £m
Regular premiums (annualised)	-	1
Single premiums	243	246
	<u>243</u>	<u>247</u>
Non profit contracts	224	152
With profits contracts	19	44
Linked contracts	-	51
	<u>243</u>	<u>247</u>

In classifying new business premiums, the basis of recognition adopted is as follows:

- incremental increases on existing policies are classified as new business premiums;
- rebates from the Department of Social Security are classified as new single premiums; and
- funds at retirement under individual pension contracts left with the Group are classified as new business single premiums and for accounting purposes are included in both claims incurred and as single premiums within gross written premiums.

NOTES TO THE ACCOUNTS (CONTINUED)

3. Segmental information – Long-term business (continued)

3.8 Analysis of balance on technical account.

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Non-linked:		
Life and annuity business	34	26
Pension business	25	58
Shareholders' attributable assets	(3)	17
	<u>56</u>	<u>101</u>
Linked:		
Life business	33	8
Pension business	17	(7)
	<u>50</u>	<u>1</u>
Release of fair value adjustment for subordinated debt	9	-
Balance on technical account – long-term business	<u>115</u>	<u>102</u>

4. Investment return

	Technical account Long-term business		Non-technical account	
	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Income from land and buildings	11	9	-	-
Income from other investments	1,128	903	56	33
Gains on realisation of investments	630	194	-	2
Net expected return on pension scheme (note 32.1)	-	-	4	11
Investment income	<u>1,769</u>	<u>1,106</u>	<u>60</u>	<u>46</u>
Unrealised (losses)/gains	<u>(599)</u>	<u>1,828</u>	<u>(14)</u>	<u>79</u>
Investment management expenses and charges	(49)	(24)	(1)	(1)
Losses on realisation of investments	-	-	(2)	-
Other loan interest	(20)	(25)	(68)	(46)
Investment expenses and charges	<u>(69)</u>	<u>(49)</u>	<u>(71)</u>	<u>(47)</u>
Total investment return	<u>1,101</u>	<u>2,885</u>	<u>(25)</u>	<u>78</u>

Included in the 2006 technical account investment return above is £11m of interest income and £20m of interest expenses calculated using the effective rate of interest on financial assets and financial liabilities that are not held at fair value through profit or loss.

Included in the 2006 non-technical account investment return above is £10m of interest income and £68m of interest expenses calculated using the effective rate of interest on financial assets and financial liabilities that are not held at fair value through profit or loss.

NOTES TO THE ACCOUNTS (CONTINUED)

4. Investment return (continued)

The amount of unrealised gains/(losses) in 2006 relating to the change in fair value of financial investments determined using valuation techniques other than published prices is £138m in the technical account for long term business and £(12)m in the non-technical account.

5. Other technical income

	Technical account Long-term business	
	31 Dec 06	13.5 month period ended 31 Dec 05
	£m	£m
Investment contract income	55	-
Decrease in contingent loan liability	59	-
Other	13	17
	<u>127</u>	<u>17</u>

As a result of the adoption of FRS26, from 1 January 2006 investment contracts are accounted for using deposit accounting.

6. Taxation

6.1 Taxation

	Technical account Long-term business		Non-Technical account	
	31 Dec 06	13.5 month period ended 31 Dec 05	31 Dec 06	13.5 month period ended 31 Dec 05
	£m	£m	£m	£m
United Kingdom corporation taxation				
Current tax charge/(credit) for the year	27	129	-	(11)
Adjustments for previous years	(28)	5	(4)	(1)
	<u>(1)</u>	<u>134</u>	<u>(4)</u>	<u>(12)</u>
Tax attributable to the balance on long-term business technical account	-	-	50	37
Total current taxation	<u>(1)</u>	<u>134</u>	<u>46</u>	<u>25</u>
Deferred taxation				
Origination and reversal of timing differences	19	(9)	8	-
Adjustment to the estimated recoverable amount of deferred tax assets arising in previous periods	-	-	-	(12)
(Decrease) / increase in discount	(2)	2	-	1
Total charged to deferred taxation	<u>17</u>	<u>(7)</u>	<u>8</u>	<u>(11)</u>
Charged to staff pension scheme				
Origination and reversal of timing differences	-	-	6	6
Total deferred taxation	<u>17</u>	<u>(7)</u>	<u>14</u>	<u>(5)</u>
Total tax charge	<u>16</u>	<u>127</u>	<u>60</u>	<u>20</u>

After taking into account reliefs to which the Group is entitled, UK corporation tax on taxable profits attributable to shareholders has been accounted for at the rate of 30%. The tax rate for the life policyholders is 20%.

NOTES TO THE ACCOUNTS (CONTINUED)

6. Taxation (continued)

6.2 Factors affecting tax charge for year

The tax assessed in the year is lower than the standard rate of corporation tax in the UK and the differences are explained below.

The standard rate of tax has been determined by using the UK rate enacted for the year for which the profits will be taxed.

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Profit on ordinary activities before taxation	<u>300</u>	<u>431</u>
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30%	90	130
Effects of:		
Non-taxable book losses/(gains) on revaluation of long-term business	3	(24)
Non-taxable goodwill write back	(5)	(58)
Other disallowable expenses	5	5
Timing differences other than on long-term business	(16)	(21)
Adjustment to taxation charge in prior years	(4)	(1)
Current taxation losses surrendered for £nil value	-	6
Non taxable income	(27)	(12)
Current taxation charge for the period	<u>46</u>	<u>25</u>

7. Dividends

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Interim ordinary paid dividends: 33.39p per £1 share (2005: nil per £1 share)	199	-
Final ordinary paid dividend: Nil per £1 share (2005 : 5.87p per £1 share)	-	35
	<u>199</u>	<u>35</u>

NOTES TO THE ACCOUNTS (CONTINUED)

8. Exceptional items – Profit on disposals

The non-operating exceptional items have arisen from the following disposals:

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Business Process Outsource	56	-
Premier Pension Trustees Limited	(2)	-
General Insurance	55	-
	<u>109</u>	<u>-</u>

Business Process Outsource

On 10 March 2006 the Group via Pearl Group Services Limited entered into a comprehensive Business Process Outsource (“BPO”) agreement with Diligenta Limited, a newly formed subsidiary of TCS which has given rise to a profit of £56m in the year. £21m of this profit emerged within Pearl Group Services Limited representing a one off cash receipt for the transfer of know how and goodwill, offset by the recognition of liabilities for future transformation and redundancy costs. A further £12m of profit is a curtailment gain within the FRS17 valuation of the Pearl Group Staff Pension Scheme following the transfer of relevant staff out of the scheme on 1 April 2006 (note 32.1). The remaining £23m profit represents the unrealised gain recognised on the Company’s 24% equity investment acquired as an integral step in the BPO and classified as at fair value through profit and loss (note 11.7(c)). The tax effect in the non-technical accounting relating to this non-operating exceptional item is a tax charge of £16m.

Premier Pension Trustees Limited

On 12 June 2006 the Group sold the entire issued share capital of Premier Pensions Trustees Limited to JLT Benefit Solutions Limited for consideration of £1m. A provision for £2m was established on disposal to cover anticipated costs associated with the sale. A loss on disposal of £2m was recognised.

General Insurance

Agreement was reached with Lloyds TSB on 20 July 2006 for the transfer by Pearl Assurance Limited (formerly Pearl Assurance plc) (“Pearl”) of the rights to renew existing General Insurance policies and to market General Insurance products to Pearl customers using the Pearl brand. A net upfront profit of £55m arose on this transaction. The tax effect in the non-technical accounting relating to this non-operating exceptional item is a tax charge of £17m.

9. Directors’ emoluments

	31 Dec 06 £’000	13.5 month period ended 31 Dec 05 £’000
Emoluments (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	2,838	1,461

No directors are members of either a money purchase or a defined benefit pension scheme or have received awards during the year in the form of shares under long-term incentive schemes.

	31 Dec 06 £’000	13.5 month period ended 31 Dec 05 £’000
Highest paid director’s remuneration:		
Aggregate amount of emoluments and awards under long-term incentive schemes (excluding pension contributions, share options gains and share awards arising from long-term incentive schemes)	<u>955</u>	<u>421</u>

NOTES TO THE ACCOUNTS (CONTINUED)

9. Directors' emoluments (continued)

The highest paid director is not a member of a defined benefit pension scheme.

The emoluments disclosed in the notes to these accounts are in respect of the directors with qualifying services for the Group and for those directors comprise their total emoluments in respect of services to the Group. These total emoluments have also been included in each of the other Group companies for which the director has qualifying services.

10. Goodwill

	£m
Cost	
At 1 January 2006	(340)
Increase in cost in the year	(11)
At 31 December 2006	<u>(351)</u>
Amortisation and impairment	
At 1 January 2006 as previously reported	193
Opening balance sheet adjustment	61
At 1 January 2006 as restated	<u>254</u>
Non-operating exceptional item	11
Amortisation for the year	4
At 31 December 2006	<u>269</u>
Net book value	
At 31 December 2006	<u>(82)</u>
At 31 December 2005	<u>(147)</u>

On 30 June 2006, £11m was received by the Company following renegotiation of the Investment Management Agreement (IMAs) with Henderson Global Investors Limited. This was accounted for within the Company as a reduction of £11m in its cost of investment in Pearl Assurance Group Holdings Limited, creating an additional £11m of negative goodwill within the consolidated balance sheet. This additional negative goodwill was released during the year as a non-operating exceptional item.

In 2005 £193m of negative goodwill arising on the acquisition of Life Services on 13 April 2005 was written back to the profit and loss account during the period as a non-operating exceptional item as the benefit to the Group had been immediately realised. As a result of the adoption of FRS26, at 1 January 2006 the Group also released £61m of negative goodwill (see accounting policies section for further details).

A further £4m of negative goodwill was released in the period to bring negative goodwill as at 31 December 2006 of (£82m) to an amount equal to the value of the PVFP (£74m) and the PVIF (£8m) at this balance sheet date. The remaining negative goodwill will be recognised in the profit and loss account in the periods in which these non-monetary assets are recovered.

NOTES TO THE ACCOUNTS (CONTINUED)

11. Investments

11.1 Investments – Land and buildings

Group	Freehold	Long leasehold	Total
	£m	£m	£m
At 1 January 2006	106	319	425
Additions	54	10	64
Disposals	(47)	(36)	(83)
Surplus on revaluation	31	4	35
At 31 December 2006	<u>144</u>	<u>297</u>	<u>441</u>
Land and buildings at cost:			
At 31 December 2006	<u>102</u>	<u>267</u>	<u>369</u>
At 31 December 2005	<u>139</u>	<u>293</u>	<u>432</u>

All investment properties held by the Group were valued as at 31 December 2006, by qualified professional valuers working for the companies DTZ Debenham Tie Leung, CB Richard Ellis Limited or Atisreal. The investment properties were valued on the basis of market value. All valuers are Chartered Surveyors, being members of the Royal Institution of Chartered Surveyors (RICS). All valuations were carried out in accordance with the RICS Appraisal and Valuation Manual.

Other than for leasehold properties where the lease has less than twenty years unexpired term, no provision is made for depreciation of investment properties.

Leasehold properties include £262m (2005: £272m) property reversions arising from sales of the NPI Extra Income Plan. The reversionary interest is valued as the NPI Limited and NPLL proportion of the current market value, projected for the lifetime of the policyholder at the assumed future increase in house prices, then discounted back by the valuation rate of interest.

Included in the opening figures shown for current value is £30m in respect of buildings which were owned and occupied by the Group. These properties were disposed of during the year.

11.2 Investments in participating interests

Group	Cost		Carrying Value	
	31 Dec 06 £m	31 Dec 05 £m	31 Dec 06 £m	31 Dec 05 £m
Investments in joint ventures (note 11.3)	-	51	-	54
Investments in associates (note 11.4)	435	842	600	1,074
Total	<u>435</u>	<u>893</u>	<u>600</u>	<u>1,128</u>

NOTES TO THE ACCOUNTS (CONTINUED)

11. Investments (continued)

11.3 Investments in joint ventures

Group	Long-term business £m
At 1 January 2006	54
Disposals	(54)
At 31 December 2006	<u>-</u>

11.4 Investments in associates

Group	Long-term business		Non long- term business	Total carrying value £m
	Share of capital and reserves £m	Loan £m	Loan £m	
At 1 January 2006	784	259	31	1,074
Operating profit for the period after taxation	143	-	-	143
Disposals	(607)	(6)	(4)	(617)
Movements in the period	<u>(464)</u>	<u>(6)</u>	<u>(4)</u>	<u>(474)</u>
At 31 December 2006	<u>320</u>	<u>253</u>	<u>27</u>	<u>600</u>

11.5 Other financial investments - 2006

In accordance with the first time adoption rules available within FRS25, the Group has taken advantage of the exemption available to not provide comparatives for the following disclosures.

The Group's other financial assets are classified in the consolidated balance sheet as other financial investments and are summarised by measurement category as follows:

Group	31 Dec 06	
	Carrying value £m	Cost £m
Fair value through profit and loss	20,883	19,825
Loans	221	221
Total other financial investments	<u>21,104</u>	<u>20,046</u>

The fair value of the Groups other financial investments is the same as their carrying values. The effective interest rates on loans ranges from 0% to 12%.

NOTES TO THE ACCOUNTS (CONTINUED)

11. Investments (continued)

11.5 Other financial investments – 2006 (continued)

Financial assets at fair value through profit and loss

	31 Dec 06	
	Carrying value	Cost
	£m	£m
Share and other variable yield securities and units in unit trusts	4,923	4,011
Debt securities and other fixed income securities	15,215	15,273
Deposits with credit institutions	369	369
Derivative assets	376	172
	<u>20,883</u>	<u>19,825</u>
Listed investments included above	<u>19,784</u>	<u>18,803</u>

The fair value of collateral received in respect of stock loan agreements by the Group from third parties at 31 December 2006 is £4,965m. Included within other financial investments above are derivative assets of £376m (see note 20).

Included within shares and other variable yield securities and units in unit trusts at 31 December 2006 is £2m of units in unit trusts held in escrow by the Company for additional contributions into the Pearl Group Staff Pension Scheme.

11.6 Other financial investments - 2005

Group

	31 Dec 05	
	Market value	Cost
	£m	£m
Shares and other variable yield securities and units in unit trusts	4,763	4,053
Debt securities and other fixed income securities	16,726	15,638
Loans secured by mortgage	1	1
Other loans	119	119
Deposits with credit institutions	594	594
	<u>22,203</u>	<u>20,405</u>
Listed investments included above	<u>21,060</u>	<u>19,142</u>
Assets held to cover linked liabilities	<u>4,325</u>	<u>3,780</u>

Included within shares and other variable yield securities and units in unit trusts at 31 December 2005 is £2m of units in unit trusts held in escrow by the Company for additional contributions into the Pearl Group Staff Pension Scheme.

NOTES TO THE ACCOUNTS (CONTINUED)

11. Investments (continued)

11.7 Investments of the Company

Fixed Asset

	Note	31 Dec 2006 £m	31 Dec 2005 £m
Shares in subsidiary undertakings	11.7 (a)	2,723	2,251
Loans to subsidiary undertakings	11.7 (b)	-	143
Contingent loan	11.7 (b)	154	-
Loans to external undertakings	11.7 (b)	174	51
Other financial investments	11.7 (c)	23	-
Total fixed asset investment		3,074	2,445

(a) Shares in subsidiary undertakings

	Shares in subsidiary undertakings £m
Cost	
At 1 January 2006	2,251
Additions	620
Disposals	(148)
At 31 December 2006	<u>2,723</u>
Provision for impairment	
At 1 January 2006	-
Charge for the year	(5)
Disposals	5
At 31 December 2006	<u>-</u>
Net book value	
At 31 December 2006	<u>2,723</u>
At 31 December 2005	<u>2,251</u>

On 30 June 2006, £11m was received following renegotiation of the IMAs between Henderson Global Investors Limited and the insurance subsidiaries of the Group. This was accounted for as a reduction of £11m in the Company's cost of investment in Pearl Assurance Group Holdings Limited.

On 1 July 2006 the Company acquired 100% of the issued share capital of Pearl Assurance (Unit Funds) Limited ("PAUF") and Pearl Assurance (Unit Linked Pensions) Limited ("PAULP") from Pearl. The fair value of the consideration paid by the Company was £69m and £71m respectively and was settled by the assignment to the Company of existing loans of Pearl and the creation of a new interest bearing inter-company loan. On the same date the Company acquired 100% of the issued share capital of London Life Linked Assurances Limited ("LLLA") from London Life Holdings Limited. The fair value of the consideration paid by the Company was £8m and was settled by the part repayment of the outstanding loan with London Life Holdings Limited (see note 11 (b)).

During July 2006, PAUF and LLLA paid dividends of £4m and £1m respectively to the Company, triggering impairments of £5m.

On 1 October 2006 the Company contributed 100% of the issued share capital of PAUF, PAULP and LLLA to NPI Limited. The fair value of the asset transferred was £65m, £71m and £7m respectively. The Company at the same time assigned loan liabilities to the value of £64m to the Company.

NOTES TO THE ACCOUNTS (CONTINUED)

11. Investments (continued)

11.7 Investments of the Company (continued)

(a) Shares in subsidiary undertakings (continued)

On 24 November 2006 the Company acquired 100% of the issued share capital of London Life Holdings Limited, Pearl ISA Limited, PGS2 Limited, UKLS Financial Services Limited, Pearl (Martineau Phase 1) Limited, Pearl (Martineau Phase 2) Limited, Pearl (Moor House) Limited, Pearl MP Birmingham Limited and Pearl MG Birmingham Limited from Pearl Assurance Group Holdings Limited. The fair value of the consideration paid by the Company was £230m which was left outstanding on interest bearing inter-company account.

On the same date the Company acquired 100% of the issued share capital of LLL from London Life Holdings Limited. The fair value of the provisional consideration paid by the Company was £171m which was left outstanding on interest bearing inter-company account.

On 20 December 2006 the Company subscribed an additional £3m for the issue of new ordinary shares in Axial Investment Management Limited (formerly DBL Capital Management Limited) issued at par.

(b) Loans

	Loans to subsidiary undertakings Note (i) £m	Loans to external undertakings Note (ii) £m	Contingent loan Note (iii) £m	Total £m
At 1 January 2006	143	51	-	194
Additions	7	-	157	164
Loan repayments	(150)	-	(286)	(436)
Loan advances	-	123	286	409
Surplus on revaluation	-	-	(3)	(3)
At 31 December 2006	<u>-</u>	<u>174</u>	<u>154</u>	<u>328</u>
Cost				
At 31 December 2006	<u>-</u>	<u>174</u>	<u>286</u>	<u>460</u>
At 31 December 2005	<u>143</u>	<u>51</u>	<u>-</u>	<u>194</u>

(i) On 1 January 2006 outstanding loan interest of £7m on this loan was capitalised. On 21 March 2006 and 1 June 2006, £1m and £4m respectively of this loan was repaid in cash. On 1 July 2006, £8m was repaid in consideration for the purchase of LLLA from London Life Holdings Limited (see note 11 (a)). The remaining balance was repaid on 24 November 2006 as part consideration for the purchase of the issued share capital (see note 11(b)) and contingent loan asset (see note (iii) below) of LLL.

(ii) On 7 October 2005, pursuant to the loan facility dated 27 April 2005 the Company provided a £51m loan to Sun Capital Investments Limited and Hera Investments One Limited with an interest rate of 12% per annum and maturity date of 14 April 2014. During the period the Company issued a further £123m under this loan facility. The fair value of this asset at 31 December 2006 was £174m.

NOTES TO THE ACCOUNTS (CONTINUED)

11. Investments (continued)

11.7 Investments of the Company (continued)

(b) Loans (continued)

- (iii) On 24 November 2006 London Life Holdings Limited assigned to the Company a contingent loan receivable due from LLL for consideration at fair market value of £157m. This consideration was used to repay in full the balance of the loan due to the Company from London Life Holdings Limited of £150m (see note (i) above) with the balance left outstanding on interest bearing inter-company account.

On 31 December 2006 the contingent loan was repaid in full at the outstanding original principal of £286m and on this same date a new contingent loan was issued for £286m on similar terms but with an extended interest moratorium until 31 December 2009. Interest will start accruing on this contingent loan after 1 January 2010. The loan has an indefinite term.

(c) Other financial investments

	31 Dec 06		31 Dec 05	
	Carrying value £m	Cost £m	Carrying value £m	Cost £m
Ordinary shares	<u>23</u>	<u>-</u>	<u>-</u>	<u>-</u>

On 22 February 2006 the company subscribed for 240,000 £1 ordinary shares in Diligenta Limited at par, a 24% equity investment. This investment has been valued at the fair value of the future option price exercisable by the Company in 2011. The unrealised gain recognised in the period has been reported as a non-operating exceptional profit in the consolidated profit and loss account (see note 8).

Current Assets

	Units in unit trusts £m
Cost/Net book value	
At 10 November 2004	-
Additions	3
Disposals	(1)
At 31 December 2005 and 2006	<u>2</u>

12. Risk Management Objectives and Policies for Mitigating Risks

In accordance with the first time adoption rules available within FRS25, the Group has taken advantage of the exemption available to not provide comparatives for the following disclosures.

The risk management objectives and policies of the Group are based on the requirement to protect the Group's regulatory capital position, thereby safeguarding policyholders' guaranteed benefits whilst also ensuring the Group can meet its different cash flow requirements. Subject to the above, the Group seeks to use available capital in pursuing investment opportunities that meet agreed return hurdles for risk taken in order to achieve increased investment returns, generating additional value for policyholders and shareholders.

Financial assets principally comprise investments in equity securities, fixed interest investments, derivatives, trade and other receivables, and banking deposits. Financial assets are held to provide an investment return to policyholders and shareholders. Financial liabilities comprise investment contracts, borrowings for financing purposes, trade and other payables.

NOTES TO THE ACCOUNTS (CONTINUED)

12. Risk Management Objectives and Policies for Mitigating Risks (continued)

The main risks arising from financial instruments are:

- asset valuation risk, since reductions in the value of assets through market functions will restrict assets available to fund long-term fund obligations and may in extreme circumstances require shareholder funds to be transferred to cover any shortfalls;
- interest rate risk, since movements in interest rates will impact the value of future guarantees and the value of fixed interest securities relative to the value of related liabilities;
- liquidity risk, arising from either the inability to close out a particular position at or near the previous market price as well as from having insufficient liquid assets to meet obligations;
- foreign exchange risk, arising from fluctuations in the value of amounts denominated in foreign currencies, and
- credit risk, arising from the default of the counterparty to a particular financial asset, or from a reinsurer's inability to meet the obligations assumed under the reinsurance arrangements.

In addition to these risks the Group is exposed to insurance risk arising from its Life assurance business.

The Group's exposure to all these risks is monitored by appropriate committees, primarily by the Financial Risk Committee, which agree policies for managing each of these risks on an ongoing basis. Derivatives are used to mitigate the impact of these risks, where appropriate. During the period the Group continued to invest in developing its specialised asset and liability matching capabilities which has resulted in improved deployment of the Groups capital resources.

12.1 Insurance Risk

Life insurance risk in the Group arises through its exposure to mortality and to variances between assumed and actual experience in factors such as persistency levels and management and administrative expenses.

Mortality risk

This involves exposure to unanticipated volumes of deaths on assurance business or improvements in longevity for annuity business. To the extent that the risk has already been accepted only limited mitigation is possible. However, the position can be managed through reinsurance; selective underwriting; a good understanding of trends and the use of prudent assumptions; and adequate charging for new risks accepted.

Persistency

Persistency risk arises where assumed levels of withdrawals diverge from actual experience. Where there are too few lapses and the policy provides a guarantee at a future point in time, the Group will need to provide for the cost of those additional guarantees, or have a suitable hedge. Where there are higher than assumed lapses and there are onerous surrender values, this will lead to financial loss and a potential weakening of the capital position. Persistency risk is mitigated within the Group by a number of measures, chiefly involving managing the surrender bases and using actuarial investigations to support prudent assumption setting.

Expense risk

Expense risk arises from a mismatch between revenues and expenses primarily in Pearl Group Services Limited, the service company and from failures in expense management. This risk is mitigated through routine and timely review of management information and forecasting.

12.2 Credit Risk

Exposure to credit risk arises from counterparties failing to meet all or part of their obligations or changes to the market value of assets caused by changes in perception of the creditworthiness of counterparties. The maximum exposure is equal to the carrying amount of those assets.

NOTES TO THE ACCOUNTS (CONTINUED)

12. Risk Management Objectives and Policies for Mitigating Risks (continued)

12.2 Credit Risk (continued)

Credit risk is managed by monitoring of aggregate Group exposures to individual counterparties and by appropriate credit risk diversification. In certain cases, protection against exposure to particular credit risk types may be achieved through use of derivatives.

An indication of the Group's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The Group is most exposed to credit risk on debt and other fixed income securities. Debt and other fixed income securities mainly comprise government bonds and corporate bonds. Given the nature of government bonds the credit risk associated with these is considered negligible and the Group therefore focuses on monitoring the quality of its corporate bonds.

The carrying amount of assets on the balance sheet at 31 December 2006 represents the maximum credit exposure.

	AAA	AA	A	BBB	BB	B	Non Rated	Total exposed to interest rate risk	Risk Free	Total
Debt securities and other fixed interest	4,951	1,269	2,488	966	259	465	333	10,731	4,484	15,215

Credit risk arising from government bonds is considered negligible and they are therefore included as risk free assets in the credit risk table above.

The Group is exposed to concentrations of risk with individual reinsurers, due to the nature of the reinsurance market. The Group's largest reinsurance counterparty is National Indemnity Company. At 31 December 2006 the reinsurance asset recoverable was £117m. The Group operates a policy to manage its reinsurance counterparty risk and the impact from reinsurer default is measured regularly.

12.3 Interest Rate Risk

Interest rate risk is the risk that the Group will sustain losses in revenue through adverse movements in interest rates, due to the effect such movements have on the value of interest-bearing assets. There is an exposure to interest rates on banking deposits held in the ordinary course of business.

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

NOTES TO THE ACCOUNTS (CONTINUED)

12. Risk Management Objectives and Policies for Mitigating Risks (continued)

12.3 Interest Rate Risk (continued)

The following table summarises the expected maturity profile of financial assets and financial liabilities of the Group as at 31 December 2006:

2006	0-5 years	5-10 years	10-15 years	15-20 years	Greater than 20 years	No fixed term	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Property related financial assets	-	-	-	-	-	262	262
Shares and other variable yield securities and units in unit trusts	28	-	-	-	-	4,895	4,923
Debt securities and other fixed interest	2,060	3,318	1,983	1,816	6,038	-	15,215
Deposits with credit institutions	369	-	-	-	-	-	369
Derivative assets	77	128	37	19	113	2	376
Other loans	47	174	-	-	-	-	221
Liabilities							
Investment contracts with discretionary participation features	2,518	1,682	1,123	852	1,390	25	7,590
Derivative liabilities	29	35	14	1	30	2	111

Technical provisions for linked liabilities have no fixed term and cash at bank and in hand is due within one year. See note 26 for maturity analysis of debenture loans and amounts owed to credit institutions.

With profit business and non profit business within the with profits funds are exposed to interest rate risk as guaranteed liabilities are valued relative to market interest rates and investments include fixed interest stocks and derivatives. For with profits business the profit or loss arising from mismatches between such assets and liabilities is largely offset by increased or reduced discretionary policyholder benefits.

12.4 Asset Valuation Risk

Asset valuation risk is the risk that a reduction in the value of assets through market fluctuation will restrict assets available to fund long-term fund obligations, which could create liquidity risk and may also require shareholder funds to be transferred to cover any shortfalls.

Asset valuation risk is managed separately for policyholders and shareholders. This is achieved by the agreement and monitoring of financial risk profiles that are appropriate for each of the Group's life funds in respect of maintaining adequate regulatory capital and treating customers fairly. This is largely achieved through asset class diversification.

12.5 Currency Risk

Currency risk arises from financial assets and financial liabilities denominated in foreign currencies. There is a risk that the Group will suffer losses through adverse movements in currency exchange rates.

Foreign currency risk is managed separately for policyholders and shareholders and is managed through appropriate monitoring and use of forward contracts to mitigate risk where this is beneficial.

NOTES TO THE ACCOUNTS (CONTINUED)

12. Risk Management Objectives and Policies for Mitigating Risks (continued)

12.6 Liquidity Risk

Liquidity risk arises from either the inability to close out a particular position at or near the previous market price as well as from having insufficient liquid assets to meet payment obligations.

Liquidity risk is managed separately for policyholders and shareholders. For shareholders, the Group's policy is to maintain rolling forecasts of shareholder cashflow requirements and to manage liquidity of shareholder funds in order to meet these. For policyholders, the Group's policy is to monitor current assets to ensure there are sufficient readily realisable assets within policyholder funds to settle claims obligations as they fall due.

13. Debtors

13.1 Debtors arising out of direct insurance operations

Group	31 Dec 06 £m	31 Dec 05 £m
Amounts owed by policyholders	18	20

All debtors are expected to be recovered within 12 months

13.2 Other debtors

Company – due within one year	31 Dec 06 £m	31 Dec 05 £m
Amounts due from Group undertakings	28	14
Other debtors	7	6
Prepayments and accrued income	6	9
	41	29
Company – due after more than one year	31 Dec 06 £m	31 Dec 05 £m
Other debtors	4	10

14. Present value of future profits

14.1 Present value of acquired in force business

Cost/Net book value	£m
At 1 January/31 December 2006	8

No amortisation has been charged on the acquired PVIF in the period since the value in use exceeds the current carrying value.

NOTES TO THE ACCOUNTS (CONTINUED)**14 Present value of future profits (continued)***14.2 Present value of future profits on non participating business in the with profits fund*

The value of the PVFP is determined in accordance with the FSA's realistic capital regime. The principal assumptions used to calculate the PVFP are the same as those used in calculating the long-term business provision (note 21).

As a result of the adoption of FRS26, at 1 January 2006 the Group released £61m of PVFP. During the year a further £4m of PVFP was released to the technical account for long-term business.

15. Deferred costs*15.1. Deferred origination costs*

	Long-term business £m
At 1 January 2006 as previously reported	-
Opening balance sheet adjustment	30
At 1 January 2006 as restated	<u>30</u>
Decrease in period	(4)
At 31 December 2006	<u><u>26</u></u>

As a result of the adoption of FRS26, at 1 January 2006 the Group created deferred origination cost assets of £30m (see accounting policies section for further details).

15.2 Deferred acquisition costs

	Long-term business £m
At 1 January 2006 as previously reported	34
Opening balance sheet adjustment	(30)
At 1 January 2006 as restated	<u>4</u>
Decrease in period	(2)
At 31 December 2006	<u><u>2</u></u>

As a result of the adoption of FRS26, at 1 January 2006 the Group released £30m of deferred acquisition costs on investment contracts (see accounting policies section for further details).

NOTES TO THE ACCOUNTS (CONTINUED)

16. Share capital

16.1 Share capital authorised

	31 Dec 06 £m	31 Dec 05 £m
596,000,100 ordinary shares of £1 each	<u>596</u>	<u>596</u>

16.2 Share capital allotted

	31 Dec 06 £m	31 Dec 05 £m
Allotted, called up and fully paid equity shares:		
596,000,020 ordinary shares of £1 each	<u>596</u>	<u>596</u>

On incorporation on 10 November 2004, the Company had authorised share capital of 100 ordinary shares of £1 each of which 1 was issued at par on this date. A further 19 ordinary shares of £1 each were issued at par on 9 December 2004.

On 13 April 2005, the Company increased its authorised share capital to 596,000,000 ordinary shares of £1 each which were issued at par on this date.

17. Reserves and reconciliation of movement in shareholders' funds

17.1 Group

	Share capital £m	Profit and loss account £m	Shareholders' funds £m
At 10 November 2004	-	-	-
Proceeds from share issue (note 16.2)	596	-	596
Profit after taxation for the 13.5 month period ended 31 December 2005	-	411	411
Dividends (note 7)	-	(35)	(35)
Actuarial losses on pension scheme	-	(18)	(18)
Deferred tax origination and reversal of timing difference on items taken directly to equity	-	6	6
At 31 December 2005	<u>596</u>	<u>364</u>	<u>960</u>
Opening balance sheet adjustment	-	101	101
At 1 January 2006 as restated	<u>596</u>	<u>465</u>	<u>1,061</u>
Profit after taxation for the year ended 31 December 2006	-	240	240
Dividends (note 7)	-	(199)	(199)
Actuarial gains on pension scheme	-	9	9
Deferred tax origination and reversal of timing difference on items taken directly to equity	-	(3)	(3)
At 31 December 2006	<u>596</u>	<u>512</u>	<u>1,108</u>

As a result of the adoption of FRS26, at 1 January 2006 the consolidated profit and loss account reserve was increased by £101m (see accounting policies section for further details).

NOTES TO THE ACCOUNTS (CONTINUED)

17. Reserves and reconciliation of movement in shareholders' funds (continued)

17.2 Company

	Share capital £m	Profit and loss account £m	Shareholders' funds £m
At 10 November 2004	-	-	-
Proceeds from share issue (note 16.2)	596	-	596
Profit after taxation for the 13.5 month period ended 31 December 2005	-	89	89
Dividends (note 7)	-	(35)	(35)
Actuarial gains on pension scheme	-	36	36
Deferred tax origination and reversal of timing difference on items taken directly to equity	-	(11)	(11)
At 31 December 2005	596	79	675
Profit after taxation for the year ended 31 December 2006	-	369	369
Dividends (note 7)	-	(199)	(199)
Actuarial gains on pension scheme	-	9	9
Deferred tax origination and reversal of timing difference on items taken directly to equity	-	(3)	(3)
At 31 December 2006	596	255	851

The profit and loss account of the Company at 31 December 2006 includes £119m (2005 : £43m) which is non-distributable.

18. Fund for future appropriations

	31 Dec 06 £m	31 Dec 05 £m
At 1 January 2006/10 November 2004	288	-
Arising on acquisition of Life Services	-	268
Transfer from the technical account	68	20
At 31 December	356	288

The Group's with-profit fund is closed to new business. In accordance with the principles established by FRS 27: Life Assurance and Guidance Note 45, the whole of the unappropriated surplus attributable to policyholders has been included in the long-term business provision. As a result, the fund for future appropriation represents the shareholders' share of the inherited estate and other shareholder items only.

NOTES TO THE ACCOUNTS (CONTINUED)

19. Technical provisions for linked liabilities and assets held to cover linked liabilities*19.1 Technical provisions for linked liabilities - 2006*

The movement in the year is analysed below:

	31 Dec 06
	£m
At 1 January 2006 as previously reported	4,325
Opening balance sheet adjustment	9
At 1 January as restated	<u>4,334</u>
Movement in the year	(152)
At 31 December 2006	<u><u>4,182</u></u>

As a result of the adoption of FRS26, at 1 January 2006 the Group increased technical provisions for linked liabilities by £9m (see accounting policies section for further details). Fair value is determined by reference to the value of the underlying assets and changes in value are taken through the long-term technical account. The movement in the year primarily represents deposits collected under investment contracts without DPF, amounts released on termination of these contracts and investment income attributable to these contracts.

19.2 Assets held to cover linked liabilities - 2006

The Groups assets held to cover linked liabilities are summarised by measurement category as follows:

	31 Dec 06	
	Carrying Value £m	Cost £m
Fair value through profit and loss	<u>4,182</u>	<u>3,400</u>
Listed investments included above	<u>4,102</u>	<u>3,346</u>

The carrying value is the fair value of these assets.

20. Derivatives

The Group purchases derivative financial instruments in the connection with the management of its insurance contract and investment contract liabilities.

The fair values of derivative financial instruments at 31 December 2006 are as follows:

	Derivative assets £m	Derivative liabilities £m
Forward currency	2	6
Credit default swaps	3	4
Interest rate swaps	171	100
Swaptions	117	-
Inflation swaps	83	1
	<u>376</u>	<u>111</u>

Derivative assets are disclosed in the consolidated balance sheet within "other financial investments".

NOTES TO THE ACCOUNTS (CONTINUED)

21. Policyholder liabilities

Material judgement is required in calculating the long-term business provision. In particular there is discretion over the assumptions used. The variance of actual experience from that assumed may result in such liabilities differing from the provisions made for them. In calculating the realistic liabilities, account has also been taken of future management actions consistent with those set out in the Principles and Practices of Financial Management (PPFM). The most significant of these is that bonus rates in the with profits funds are assumed to change as markets change to target asset shares subject to guarantees and smoothing constraints.

The Group is subject to a number of inherent risks that impact the value of policy liabilities, including interest rate risk, market fluctuations and demographic changes. If interest rates fall, the impact of discounting on the long-term business provision will reduce, resulting in an increased provision. Similarly, if annuitant mortality were assumed to increase, then the long-term business provision in respect of annuities would increase, whilst that in respect of assurances would decrease. Where policies have been sold that include options, provision is made to allow for assumed policyholder behaviour, however, where that behaviour differs from expectations there will be a corresponding change in the provisions required.

Liabilities may also arise in respect of claims relating to the interpretation of such contracts, or the circumstances in which policyholders have entered into them. The extent of such liabilities is influenced by the actions and requirements of the FSA, the Ombudsman rulings, by industry compensation and by court judgements.

Assumptions are set by reference to publicly available market data and then validating that the current assumptions continue to reflect actual experience.

For participating business, the long-term business provision is calculated in accordance with the FSA's realistic capital regime, adjusted to exclude the shareholder's share of the future bonuses and the associated tax liability as required by FRS27 "Life Assurance". Non participating liabilities are valued using a gross premium method allowing for a prudent level of discontinuances.

The present value of future profits on non-participating business written in the with profit fund, offset against the long-term business provision and not recognised as an asset as at 31 December 2006 was £14m (2005: £9m).

Management considers that the fair value of investment contracts with discretionary participation features is the best estimate. Although there is no reliable basis for measuring the fair value of these contracts, the method corresponds with principles used to fair value other products.

Long-term business provision comprises:

	Insurance contracts 31 Dec 06 £m	Investment contracts with DPF 31 Dec 06 £m
At 1 January 2006 as previously reported	21,566	-
Opening balance sheet adjustments:		
- Reclassification of investment contracts with DPF	(8,200)	8,200
- Other FRS26 adjustments	(168)	-
At 1 January 2006 as restated	<u>13,198</u>	<u>8,200</u>
Profit and loss movement	(863)	(610)
At 31 December 2006	<u><u>12,335</u></u>	<u><u>7,590</u></u>

As a result of FRS 26, at 1 January 2006 the Group released £168m of the long-term business provision (see accounting policies section for further details) and £8,200m was reclassified from insurance contracts to investment contracts with DPF within the long-term business provision.

The principal assumptions used to calculate the long-term business excluding linked business liabilities are set out below.

NOTES TO THE ACCOUNTS (CONTINUED)

21. Policyholder liabilities (continued)

21.1 Participating business

For participating business, a market consistent valuation is used to calculate the long-term business provision. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out in the tables below.

Interest rates

The risk free interest rates assumed are:

Year	1	5	10	15	20	25	30	35	40
31 December 2006	5.42%	5.15%	4.83%	4.71%	4.48%	4.25%	4.10%	3.98%	3.89%
31 December 2005	4.30%	4.31%	4.25%	4.23%	4.13%	4.10%	4.05%	4.00%	3.97%

Other assumptions

Best estimate assumptions are set for inflation, mortality and expenses:

	31 Dec 06	31 Dec 05
Inflation:		
Retail price inflation	3.20%	2.90% - 3.00%
Expense inflation	3.40% - 4.20%	3.10% - 4.00%
Earnings inflation	4.70%	4.40% - 4.50%
Asset mix for assets backing asset shares at the valuation date:		
Gilts and cash	21.54% - 68.20%	17.30% - 67.00%
Corporate bonds	24.20% - 63.11%	27.00% - 69.05%
Equities	0.28% - 35.50%	0.02% - 36.90%
Property	4.40% - 15.08%	4.00% - 11.10%
Mortality rate:		
Basic life assurance	55% AM/F80, 95% AM/F92 Ultimate, 75% AM/F80 Ultimate, 60% ELT 14 Male all with adjustments	55% AM/F80, 95% AM/F92 Ultimate, 75% AM/F80 (2) Select, 60% ELT 14 Male all with adjustments
Pension business	97.5% PMA00 average (mc,lc), 97.5% PFA00 average (mc,lc), 65% AM/F80, 70% AM/F92 Ultimate, 75% AM/F80 Ultimate all with adjustments	100% PM/A92MC, 100% PFA92MC, 65% AM/F80, 70% - 95% AM/F92 Ultimate, 75% AM/F80 Ultimate all with adjustments
Pension annuity in payment	115% of RM/FV92, I with adjustments	100% RMV92, 91% RFV92 all with adjustments
Unitised with-profits	75% AM/F80 Ultimate	75% AM/F80 (2) Select, 75% AM/F80 Ultimate
Per policy expenses – regular premiums:		
Basic life assurance	£29.88 - £106.17	£30.00 - £77.79
Pension business	£19.24 - £447.30	£18.72 - £435.25
Unitised with-profits	£31.20 - £79.00	£30.00 - £76.20
Private Health Insurance	£31.90	£30.70

A percentage of these amounts is used for single premium and paid up policies.

NOTES TO THE ACCOUNTS (CONTINUED)

21. Policyholder liabilities (continued)

21.1 Participating business (continued)

Persistency - Lapses / Surrenders / Paid Up Rates

A review of persistency is carried out annually. The review is based on a trend analysis of persistency, the results of which are then applied to existing assumptions. Assumptions are adjusted where necessary to reflect more recent experience as evidenced in the persistency trend analysis, or to reflect expected future trends as a result of anticipated future events.

Options and Guarantees

Some products give potentially valuable guarantees or policyholders the option to change policy benefits. These can be exercised at the policyholders' discretion. For example, some pension contracts include guaranteed annuity options where the policyholder can choose to take policy benefits in the form of an annuity based on guaranteed conversion rates. There are also further contractual guarantees, primarily arising from sum assured and reversionary bonuses on conventional with profits business and the guaranteed cash amount and reversionary bonuses on the deferred annuities business.

The measurement of financial options and guarantees is achieved through stochastic modelling which aims to reproduce the market cost of similar financial instruments. The total amount provided in respect of the future costs of guaranteed annuity options was £458m (2005: £449m) and in respect of other guarantees was £1,401m (2005: £1,058m).

In common with other life companies in the United Kingdom which have written pension transfer and opt out business, the Group has set up provisions for the review and possible redress relating to personal pension policies. These provisions, which have been calculated from data derived from detailed file reviews of specific cases and using a certainty equivalent approach, which give a result very similar to a market consistent valuation, are included in the long-term business provision. The total amount provided in respect of the review and possible redress relating to pension policies, including associated costs, was £420m (2005 : £475m).

The directors are of the opinion that the provisions are consistent with the principles of treating customers fairly.

Provision for bonuses

The total cost of bonuses attributable to the accounting period, being amounts representing an allocation of surplus for the year is £155m (2005: £111m).

Other specific matters

The Financial Services Authority carried out a review of low-cost mortgage endowments in 1999. As a result all such mortgage endowment policyholders were provided with information on the performance of their policy. The Group took action to ameliorate the financial impact on those policyholders who were most impacted by the reduction in expected future investment returns. Provision has been made in these accounts for the expected costs of the action taken and to meet the potential costs arising from any complaints associated with low-cost mortgage endowments. The total amount provided for was £79m (2005 : £97m).

NOTES TO THE ACCOUNTS (CONTINUED)

21. Policyholder liabilities (continued)

21.2 Non participating business

For non participating business, valuation assumptions have been determined in accordance with the rules relating to the valuation of liabilities as published by the Financial Services Authority in its Prudential Sourcebook for insurers.

	31 Dec 06	31 Dec 05
Interest rate:		
Basic life assurance	3.8% - 4.7%	2.7% - 4.3%
Pension business	-	3.7%
Pension annuity in payment	4.7% - 5.2%	3.7% - 4.0%
Unitised with-profits	3.1% - 3.9%	3.2% - 4.0%
Mortality rate:		
Basic life assurance	100% AM/F92, 72%IML/IFL92, Year of use, all with adjustments	85% AM/F80, 100% AM/F92, 72% IM/FL92, A67/70 Ultimate, 90% PM/FA92MC all with adjustments
Pension business	65% AM/F80	65% AM/F80
Pension annuity in payment	105% - 110% RMV92, 100% - 108% RFV92, 87.5% PM/F00 average (mc,lc) all with adjustments	95% -102% RMV92,82.5% -85% RFV92 Year of use, 72% IML/IFL92 all with adjustments
Unitised with-profits	100% AM/F92	100% AM/F92

Options and Guarantees

There are no significant options and guarantees in the non participating fund.

22. Deferred taxation

22.1 Provisions for taxation

Group

Reconciliation of movements in deferred tax:	31 Dec 06	31 Dec 05
	£m	£m
At 1 January /10 November 2004 as previously reported	7	-
Opening balance sheet adjustment	12	-
At 1 January as restated	19	-
Arising on acquisition of Life Services	-	25
Charge / (release) for the year:		
Technical account – long-term business	17	(7)
Non-technical account	8	(11)
At 31 December	44	7

As a result of the adoption of FRS26, at 1 January 2006 the Group recognised additional provisions for deferred taxation of £12m (see accounting policies section for further details).

Company

Reconciliation of movements in deferred tax:	31 Dec 06	31 Dec 05
	£m	£m
At 1 January /10 November 2004	-	-
Charge for the year:	7	-
At 31 December	7	-

NOTES TO THE ACCOUNTS (CONTINUED)

22. Deferred taxation (continued)

22.2 Deferred taxation provisions

Group

The components of the net deferred tax liability are as follows:

	31 Dec 06	31 Dec 05
	£m	£m
Unrealised gains in investments	49	24
Deferred acquisition costs	(4)	(14)
Capital allowances	1	(1)
Trading losses	(2)	(12)
Other short term timing differences	-	8
Total undiscounted	<u>44</u>	<u>5</u>
Total on a discounted basis	<u>44</u>	<u>7</u>

A deferred tax asset has been recognised in respect of long-term business acquisition expenses where relief is deferred under corporation tax legislation. It has been determined that taxable income of future periods will be sufficient to enable relief for these expenses as they fall due to be deductible. A deferred tax asset has been recognised in respect of trading losses as reliable forecasts indicate that future taxable profits will be available to offset against the tax losses. Due to the uncertainty of the quantum, source and timing of future taxable profits or chargeable gains, no provision has been made for the assets listed in note 22.3.

Company

The components of the net deferred tax liability are as follows:

	31 Dec 06	31 Dec 05
	£m	£m
Unrealised gain	7	-
Total undiscounted	<u>7</u>	<u>-</u>
Total on a discounted basis	<u>7</u>	<u>-</u>

On 22 February 2006 the company subscribed for 240,000 £1 ordinary shares in Diligenta Limited at par, a 24% equity investment. This investment has been valued at the fair value of the future option price exercisable by the Company in 2011. The unrealised gain recognised in the period has been reported as a non-operating exceptional profit in the consolidated profit and loss account and a deferred tax liability has been recognised.

22.3 Factors that may affect future taxation charges

Group

The deferred tax assets, which have not been recognised due to the uncertainty of their recoverability in the foreseeable future, comprise:

	Long-term business		Non long-term business	
	31 Dec 06	31 Dec 05	31 Dec 06	31 Dec 05
	£m	£m	£m	£m
Capital and trading losses	16	26	4	4
Provisions and other timing differences	-	4	5	7
	<u>16</u>	<u>30</u>	<u>9</u>	<u>11</u>

NOTES TO THE ACCOUNTS (CONTINUED)

22. Deferred taxation (continued)

22.3 Factors that may affect future taxation charges (continued)

The unrecognised assets have not been discounted. Further analysis is as follows:

- £16m (2005 : £30m) arises on realised capital losses on chargeable securities and will be available to offset against realised chargeable gains of future years; and
- £9m (2005 : £11m) in respect of provisions and other timing differences will be available to offset against taxable profits in future periods when the timing differences reverse or provisions are utilised.

23. Claims outstanding

	31 Dec 06	31 Dec 05
	£m	£m
General business	208	230
Life business	100	101
	<u>308</u>	<u>331</u>

The technical provisions for future claims payments have primarily been assessed using chain ladder methods. Where there is a notable exposure to long-term asbestos, pollution and health hazard liabilities, external independent actuaries provide best estimate benchmarks. An appropriate prudential margin is applied to all lines of business, as it is recognised that the estimation of certain future claims payments is an inherently uncertain exercise and future experience could be more adverse.

In calculating the technical provisions in respect of UK Industrial disease business, the future investment income on the assets held to cover the related provisions has been taken into account by discounting future cash flows. The average period before the liability will be settled has been estimated at 8.4 years for 2006 (2005 : 9.8 years). The provision has been discounted at an interest rate of 3.5% for 2006 (2005 : 3.5%).

The overall effect is to reduce the gross and net technical provisions for those classes of business referred to above at 31 December 2006 by £8m (2005 : £5m) from £28m to £20m. The total amount of the investment return which corresponds to the unwinding of the discount is £1m (2005 : £1m).

24. Creditors: amounts falling due within one year

Company	31 Dec 06	31 Dec 05
	£m	£m
Trade creditors	-	9
Amount owed to Group undertakings	1,421	1,088
Loans due to Group undertakings (note 26.1)	164	-
Other creditors	27	9
Accruals and deferred income	42	41
	<u>1,654</u>	<u>1,147</u>

25. Creditors: amounts falling due after more than one year

Company	31 Dec 06	31 Dec 05
	£m	£m
Loans due to Group undertakings (note 26.1)	162	187
Loans due to external undertakings (note 26.1)	460	460
	<u>622</u>	<u>647</u>

NOTES TO THE ACCOUNTS (CONTINUED)

26. Debenture loans and amounts owed to credit institutions

26.1 Debenture loans and amounts owed to credit institutions

	Group		Company	
	31 Dec 06 £m	31 Dec 05 £m	31 Dec 06 £m	31 Dec 05 £m
£289 million 12% subordinated loans (note a)	289	289	289	289
£171 million 12% subordinated loans (note b)	171	171	171	171
£31.8 million loan (note c)	32	32	-	-
Loans due to Group undertakings	-	-	326	187
Debenture loans	492	492	786	647
Subordinated guaranteed bonds undated (note d)*	-	139	-	-
Limited recourse bonds 2012 7.39% (note e)*	81	91	-	-
Limited recourse bonds 2022 7.59% (note e)*	118	118	-	-
Total debenture loans	691	840	786	647
Refinancing loan (note f)	291	300	-	-
Total amounts owed to credit institutions	291	300	-	-
Total borrowings	982	1,140	786	647

Notes

* Borrowings of NPLL long-term fund.

- (a) Subordinated loans of £144.5m each were issued by Sun Capital Investments Limited and Hera Investments One Limited to the Company at par on 13 April 2005 at an interest rate of 12% per annum and will continue without limit of time. The fair value of this liability at 31 December 2006 was £289m and the effective interest rate is 12%.
- (b) Subordinated loans of £85.5m each were issued by Sun Capital Investments Limited and Hera Investments One Limited to the Company at par on 13 April 2005 at an interest rate of 12% per annum and mature on 13 April 2015. The fair value of this liability at 31 December 2006 was £171m and the effective interest rate is 12%.
- (c) The £31.8 million loan is due to Henderson Finance, a subsidiary undertaking of Henderson Group plc. The loan is repayable on 12 April 2008 and accrues interest at a rate equivalent to 5% 2005 treasury stock. The fair value of this liability at 31 December 2006 was £32m and the effective interest rate is 5.62%.
- (d) On 30 June 2006, both the £100m 9.625% subordinated guaranteed bonds and the £30m 9.6257% subordinated guaranteed bonds in issue by NPLL were repaid in full.
- (e) In 1998, NPI raised £260m of capital through the securitisation of embedded value on a block of existing unit linked and unitised with profit life and pension policies. On demutualisation of NPI, these were transferred to NPLL. The bonds are split between two classes, which rank pari passu. The £140m 7.39169% class A1 limited recourse bonds have an average life of 8 years maturing in 2012 and the £120m 7.5873% limited recourse bonds have an average life of 18 years maturing in 2022. The bonds are repaid out of margins emerging from the securitised block of business and from a collateral fund of £138m (2005 : £134m). The fair value of the liabilities at 31 December 2006 were £84m and £126m respectively and the effective interest rates are 8.69% and 7.50%.

NOTES TO THE ACCOUNTS (CONTINUED)

26. Debenture loans and amounts owed to credit institutions (continued)

26.1 Debenture loans and amounts owed to credit institutions (continued)

- (f) The refinancing loan from Abbey National plc relates to the sale of Extra-Income Plan policies that Abbey National plc finances to the value of the associated property reversions. As part of the arrangement Abbey National plc receive the movement in the Halifax House Price Index and NPLL and NPI Limited have undertaken to indemnify Abbey National plc against profits or losses arising from mortality or surrender experience which differs from the basis used to calculate the reversion amount. Repayment will be on a policy-by-policy basis and is expected to occur over the next 10 to 20 years. The fair value of this liability at 31 December 2006 was £291m and the effective interest rate is 0%.

26.2 Time period for payment

Payable as follows:	31 Dec 06 £m	31 Dec 05 £m
Group		
In one year or less, or on demand	12	150
Between one and two years	45	12
Between two and five years	44	73
In five years or more	881	905
	<u>982</u>	<u>1,140</u>
Company		
In one year or less, or on demand	164	-
Between one and two years	-	138
In five years or more	622	509
	<u>786</u>	<u>647</u>

26.3 Nature of borrowings

Group	31 Dec 06 £m	31 Dec 05 £m
Fixed rate borrowings	691	840
Interest free borrowings	291	300
Total borrowings	<u>982</u>	<u>1,140</u>

27. Provisions

Group	Restructure £m	Leasehold Properties £m	Staff Related £m	Investment Contracts £m	Other £m	Tot £
At 1 January 2006 as previously reported	13	28	21	-	17	79
Opening balance sheet adjustment	-	-	-	25	-	25
At 1 January 2006 as restated	<u>13</u>	<u>28</u>	<u>21</u>	<u>25</u>	<u>17</u>	<u>104</u>
Amount utilised	(2)	(2)	-	(6)	(1)	(11)
Increase in provision	5	-	-	2	13	20
Unutilised amount reversed	(7)	(2)	(1)	(5)	(8)	(23)
At 31 December 2006	<u>9</u>	<u>24</u>	<u>20</u>	<u>16</u>	<u>21</u>	<u>90</u>

NOTES TO THE ACCOUNTS (CONTINUED)

27. Provisions (continued)

The restructure provision has been made for costs of restructuring management and staffing across the Group. It is expected that most of the expenditure will be incurred in the next two years.

The leasehold properties provision has been made for amounts in respect of the excess of lease rentals and other payments on properties that are currently vacant or expected to become vacant over the amounts to be recovered from subletting these properties on a discounted basis at 7.3% (2005: 4.1%). The provision is expected to be utilised over the next 15 years.

Staff related provisions include £13m (2005: £14m) held in respect of healthcare costs for former employees. The healthcare cost provision has been calculated on assumptions of medical expense inflation of 10% (2005: 12%) and a valuation interest rate of 4.4% (2005: 4.2%).

As a result of the adoption of FRS26, at 1 January 2006 the Group recognised accounting provisions for investment contracts of £25m (see accounting policies section for further details). The provision is expected to be utilised over the remaining life of the business.

28. Other creditors including taxation and social security**Group**

	31 Dec 06	31 Dec 05
	£m	£m
Corporation tax	36	94
Other creditors	236	246
	<u>272</u>	<u>340</u>

All creditors are expected to be settled within 12 months, with the exception of £34m which will be settled in instalments over the next 10 years. The carrying value amount of these liabilities is a reasonable approximation of their fair value.

29. Capital commitments**29.1 Capital commitments**

	31 Dec 06	31 Dec 05
	£m	£m
Other capital commitments for settlement after 31 December	50	8
Securities commitments	<u>228</u>	<u>269</u>

Securities commitments comprise commitments of Pearl to subscribe to private equity funds.

29.2 Annual commitments under non-cancellable land and building operating leases

The obligations under non-cancellable land and building operating leases fall due:

	31 Dec 06	31 Dec 05
	£m	£m
Within one year	2	2
In the second to fifth years inclusive	6	9
In more than five years	5	10
Total	<u>13</u>	<u>21</u>

NOTES TO THE ACCOUNTS (CONTINUED)

30. Contingent loans

Both NPLL and LLL have received contingent loans from their respective parent undertakings, NP Life Holdings Limited and Pearl Group Limited. The assets backing the loans are utilised to provide additional regulatory capital for the long-term funds. The amounts below represent the amounts that are expected to be recoverable from the long-term funds following the settlement of policyholder claims by those funds and were valued at an amount equal to the realistic valuation of the policyholder contingent loan liability. The carrying value of these loans is equal to the fair value.

The intra-Group contingent loans cancel on consolidation. However, since they are loans between shareholder and policyholder funds any change in the shareholder asset will affect Group profit. The increase in the loan provided to LLL principally comprises the impact from the confirmation of the treatment of the financing provided to the LLL's long-term funds on demutualisation bringing the classification in line with both the 2C Scheme and the PPFM, offset by strengthening annuitant longevity and other assumption changes. The inter relationship between the contingent loan of LLL and its long term business provision will continue to be the subject of regular dialogue with the FSA to ensure appropriate recognition of the need to treat customers fairly and the obligations set out in the PPFM.

The decrease in the loan to NPLL comprises the impact from strengthening annuitant longevity and reducing surrender rate assumptions in respect of certain products with guaranteed benefits.

The loans provided to NPLL are repayable in accordance with the Schedule 2c Scheme under which the business of NPI was transferred to NPLL. The loan to LLL is repayable in accordance with the Schedule 2c Scheme under which the business of AMP UK Branch was transferred to LLL. The balances at 31 December are as follows:

	31 Dec 06	31 Dec 05
	£m	£m
National Provident Life Limited	216	279
London Life Limited	154	106
	<u>370</u>	<u>385</u>

As a result of the adoption of FRS26, at 1 January 2006 the carrying value of the NPLL loan decreased by £4m and the carrying value of the LLL loan increased by £1m.

NOTES TO THE ACCOUNTS (CONTINUED)

31. Notes to the cash flow statement

31.1 Reconciliation of profit on ordinary activities to net cash inflow from operating activities:

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Profit on ordinary activities before non-operating exceptional items and taxation	180	238
Adjustments for financing expenses and items not involving movements of cash:		
Write back of negative goodwill	(4)	-
Decrease / (increase) in outstanding claims	24	(10)
Increase in debtors	(11)	(50)
Decrease in accrued interest and rent	1	-
Increase in prepayments	(4)	-
(Decrease) / increase in creditors	(23)	24
Increase / (decrease) in provisions	7	(28)
Decrease in accruals	(4)	(2)
(Decrease) / increase in technical provisions	(21)	2
Unrealised losses / (gains)	15	(93)
Movement in pension scheme liability	(11)	(14)
Profits relating to long-term business funds, excluding Pacific fund	59	68
Loan interest expense	58	42
Loan interest income	(10)	(4)
Cash outflow from Business Process Outsourcing	(4)	-
Net cash inflow from operating activities	<u>252</u>	<u>173</u>

31.2 Analysis of cashflows in respect of acquisitions and disposals

	31 Dec 06 £m	13.5 month period ended 31 Dec 05 £m
Cash and cash equivalents received / (paid) in respect of Life Services acquisition	2	(1,036)
Less: Cash and cash equivalent balances transferred as part of the Life Services acquisition	-	109
Less: Portfolio investments transferred as part of the Life Services acquisition	-	623
Net cash inflow / (outflow) from Life Services acquisition	<u>2</u>	<u>(304)</u>
Cash received for Virgin sale	20	20
Cash received for Business Process Outsourcing	55	-
Cash received for General Insurance sale	53	-
Cash received for Premier Pension Trustees Limited disposal	1	-
Less: Cash and cash equivalent balances transferred as part of Premier Pension Trustees Limited disposal	(1)	-
Net cash inflow / (outflow) from acquisitions and disposals	<u>130</u>	<u>(284)</u>

Prior to the acquisition of Life Services on 13 April 2005, Pearl Group Limited was a dormant company with no subsidiary undertakings and therefore all amounts reported in the consolidated cash flow statement relate either directly or indirectly to the acquired group.

NOTES TO THE ACCOUNTS (CONTINUED)

31. Notes to the cash flow statement (continued)

31.2 Analysis of cashflows in respect of acquisitions and disposals (continued)

On 27 April 2004, a loan from Pearl to Virgin Money Group Limited was sold to Virgin Management Limited for £90m. £20m of this consideration was received in the 13.5 month period ended 31 December 2005 and the final £20m of this consideration was received during the year.

31.3 Analysis of cash holdings included in the Consolidated Balance Sheet

	31 Dec 06 £m	31 Dec 05 £m
Cash at bank and in hand	458	349
Less: Cash on deposit not repayable on demand	(187)	(93)
Add: Deposits with credit institutions repayable on demand included within other financial investments	132	128
Total cash holdings (note 31.6)	<u>403</u>	<u>384</u>

31.4 Analysis of portfolio investments included in the Consolidated Balance Sheet

	31 Dec 06 £m	31 Dec 05 £m
Other financial investments	21,104	22,203
Add: Cash on deposit not repayable on demand (note 31.3)	187	93
Less: Deposits with credit institutions repayable on demand included within other financial investments (note 31.3)	(132)	(128)
Total portfolio investments (note 31.6)	<u>21,159</u>	<u>22,168</u>

31.5 Net portfolio investments (excluding long-term business)

	31 Dec 06 £m	31 Dec 05 £m
Purchase of portfolio investments	1,045	284
Sale of portfolio investments	(990)	(276)
Acquired shareholder assets	-	623
	<u>55</u>	<u>631</u>

NOTES TO THE ACCOUNTS (CONTINUED)

31. Notes to the cash flow statement (continued)

31.6 Movements in cash, portfolio investments and financing

	Portfolio investments £m	Cash holdings £m	Borrowings £m	Total £m
At 10 November 2004	-	-	-	-
Acquired shareholder assets (note 31.2)	623	109	-	732
Cashflow	8	190	(492)	(294)
Total shareholder cashflows	631	299	(492)	438
Acquired long-term business assets	21,482	310	(647)	21,145
Changes in long-term business	55	(225)	(1)	(171)
Total long-term movements	21,537	85	(648)	20,974
At 31 December 2005	22,168	384	(1,140)	21,412
Shareholder cash flows	55	(93)	-	(38)
Changes in long-term business	(1,084)	112	93	(879)
Changes in market value and exchange rate effects	20	-	-	20
Shareholder to long-term borrowings	-	-	65	65
At 31 December 2006	21,159	403	(982)	20,580

32. Staff pension scheme

As at 31 December 2006 the Group operated one pension scheme, the Pearl Group Staff Pension Scheme (the Scheme), for its employees. The Scheme is funded by payment of contributions to a separately administered trust fund. The Scheme's appointed investment managers are Henderson Global Investors, Fidelity Investments, Legal and General and Standard Life. The Scheme is subject to regular valuations by an independent qualified actuary. The Company is the principal employer of the scheme.

Up until 15 November 1999, the Scheme operated on a defined benefit basis for all members. From that date, a new money purchase section was established for new members of the Scheme. Pearl and London Life final salary members were offered membership of this new section, on special terms, in respect of future service in April 2000 and NPI final salary members in June 2001. If they declined they remained members of the defined benefit scheme.

With effect from 31 March 2005, the trustees agreed to split the pension scheme assets and liabilities between those relating to the Life Services business which remained in the Pearl Group Staff Pension Scheme, and those relating to the remainder of Henderson Group plc (which sold 100% of the issued share capital of Pearl Assurance Group Holdings Limited to Pearl Group Limited on 13 April 2005) which were transferred to the Henderson Group Pension Scheme. The results of the Pearl Group Staff Pension Scheme from the date of acquisition by Pearl Group Limited of 13 April 2005 until 31 December 2006 have been reflected in these Group accounts.

Throughout the period, the contribution rates to the scheme were 27.0%, 20.8% and 13.8% of pensionable earnings for final salary section members, hybrid (a mix of final salary and money purchase) members and pure money purchase members respectively. These contributions are paid annually at the end of the year.

At 31 December 2006, £16m (2005 : £23m) and £2m (2005 : £2m) are available within escrow accounts established by Henderson plc and the Company respectively on the sale of Life Services, which will be used during 2007 and 2008 to make additional contributions into the pension scheme.

NOTES TO THE ACCOUNTS (CONTINUED)

32. Staff pension scheme (continued)

The valuation used for the 31 December 2006 FRS17 accounting and disclosures has been based on the preliminary results of the actuarial valuation of the scheme as at 30 June 2006. The valuation used for the 31 December 2005 FRS17 accounting and disclosure has been based on the actuarial valuation at 10 December 2004. Both have been updated by Watson Wyatt to take account of the requirements of FRS 17 in order to assess the liabilities of the Scheme at these respective dates. The Scheme assets are stated at their market value at the respective dates.

32.1 The movement in the Scheme deficit during the period is as follows:

	Notes	31 Dec 06 £m	31 Dec 05 £m
Deficit in Scheme at 1 January 2006/13 April 2005		(32)	(34)
Movement during the year:			
Contributions received		11	13
Current service cost – final salary	32.2	(4)	(4)
Gain on curtailment	8	12	-
Net expected return on pension asset	32.2	4	11
Actuarial gain/(loss)	32.2	9	(18)
Surplus/(deficit) in Scheme at 31 December		<u>-</u>	<u>(32)</u>

In addition, the Group made contributions of £1m (2005 : £1m) to the money purchase section of the scheme.

32.2 The components of the pensions cost incurred are:

Analysis of amounts charged to operating profit:

	31 Dec 06 £m	31 Dec 05 £m
Current service cost – final salary	<u>4</u>	<u>4</u>
Analysis of the amount credited to investment income:		
Interest cost	84	62
Expected return on pension Scheme assets	(88)	(73)
Net credit to other finance income	<u>(4)</u>	<u>(11)</u>
Total operating credit	<u>-</u>	<u>(7)</u>

Analysis of the amount recognised in the Statement of Total Recognised Gains and Losses (STRGL):

	31 Dec 06 £m	31 Dec 05 £m
Actual gain less expected return on pension Scheme assets	(25)	(159)
Experience loss / (gain) arising on Scheme liabilities	33	(14)
Changes in assumptions underlying the present value of the Scheme liabilities	(21)	191
Impact of irrecoverable surplus	4	-
Actuarial (gain)/loss recognised in the STRGL	<u>(9)</u>	<u>18</u>

NOTES TO THE ACCOUNTS (CONTINUED)

32. Staff pension scheme (continued)

32.3 The financial assumptions used to calculate the scheme liabilities under FRS 17 are:

Valuation method	31 Dec 06 Projected unit	31 Dec 05 Projected Unit	13 Apr 05 Projected unit
Discount rate	5.20%	4.80%	5.50%
Inflation rate	3.10%	2.90%	2.90%
Rate of increase in pensionable salaries (aged related scale in addition)	4.60%	4.40%	4.40%
Rate of increase in pensions in payment (in excess of GMPs)	3.10%	2.90%	2.90%
Rate of increase in deferred pensions	3.10%	2.90%	2.90%

32.4 The assets in the Scheme and the expected rate of return are:

	Long term rate of return expected at			Value		
	31 Dec 06 %	31 Dec 05 %	13 Apr 05 %	31 Dec 06 £m	31 Dec 05 £m	13 Apr 05 £m
Equities	8.2	8.1	8.3	614	540	732
Property	6.3	6.4	6.8	193	185	156
Bonds	4.5	4.2	4.8	988	974	639
Cash and other	5.0	3.7	3.7	17	53	31
Total market value of defined benefit assets				1,812	1,752	1558
Present value of Scheme liabilities				(1,798)	(1,784)	(1,592)
Surplus/ (deficit) in the Scheme				14	(32)	(34)
Irrecoverable surplus				(14)	-	-
Related deferred tax asset				-	10	10
Net pension liability				-	(22)	(24)

32.5 Scheme experience gains and losses are as follows:

	31 Dec 06	31 Dec 05
Gain on Scheme assets		
Amount (£m)	(25)	(159)
Percentage of present value of Scheme assets	1.4%	9.1%
Experience loss/(gain) on Scheme liabilities		
Amount (£m)	33	(14)
Percentage of present value of Scheme liabilities	1.8%	0.8%
Total (gain)/loss recognised in the STRGL		
Amount (£m)	(9)	18
Percentage of present value of Scheme liabilities	0.5%	1.0%

NOTES TO THE ACCOUNTS (CONTINUED)

33. Subsidiary and associated undertakings

The principal subsidiaries and associated undertakings of the Group are as follows:

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
a) Insurance companies:		
London Life Limited	UK	Ordinary shares of £1
National Provident Life Limited	UK ‡	Ordinary shares of £1
NPI Limited	UK	Ordinary shares of £1
Pearl Assurance Limited	UK	'A' ordinary shares of 5 pence 'B' ordinary shares of £1
‡ Held by a subsidiary undertaking		
b) Non-insurance companies:		
Axial Investment Management Limited (formerly DBL Capital Management Limited) (investment management company)	UK	Ordinary shares of £1
London Life Holdings Limited (holding company)	UK	Ordinary shares of £1
London Life Linked Assurances Limited (see below)	UK ‡	Ordinary shares of £1
NP Life Holdings Limited (holding company)	UK ‡	'A' and 'B' ordinary shares of £1
NPI Finance plc (finance company)	UK ‡	Ordinary shares of £1
Pearl Assurance Group Holdings Limited (holding company)	UK	Ordinary shares of £1
Pearl Assurance (Unit Funds) Limited (see below)	UK ‡	Ordinary shares of £1
Pearl Assurance (Unit Linked Pensions) Limited (see below)	UK ‡	Ordinary shares of £1
Pearl Group Services Limited (service company)	UK	Ordinary shares of £1
PGS 2 Limited (finance company)	UK	Ordinary shares of £1
Mutual Securitisation plc (finance company)	ROI ‡	Quasi subsidiary
c) Associated undertakings:		
Henderson Caspar Property Fund (property fund)	Jersey ‡	50%
Henderson French Property Fund BV (property fund)	The Netherlands ‡	41%
Henderson UK Shop Fund (property fund)	Jersey ‡	48%
Moor House Limited Partnership (property partnership)	UK ‡	33%
Martineau Galleries Limited Partnership (property partnership)	UK ‡	17%

‡ Held by a subsidiary undertaking

NOTES TO THE ACCOUNTS (CONTINUED)

33 Subsidiary and associated undertakings (continued)

The information disclosed above is only in respect of those undertakings which principally affect the figures shown in the Group's accounts. There are a number of other subsidiary and associated undertakings whose business does not materially affect the Group's profits or the amount of its assets and particulars of these have been omitted in view of their excessive length.

On 1 October 2006 the long-term and shareholder funds of PAUF, PAULP and LLLA were transferred to NPI Limited under Part VII of the Financial Services and Markets Act 2000 which was approved by the High Court on 14 September 2006. These transactions have no impact on the Group accounts as they eliminate on consolidation.

34. Related party transactions

The Company's £1 ordinary shares are jointly owned by Sun Capital Investments Limited (SCIL) and Hera Investments One Limited (HIOL) with whom the Company entered into the following transactions:

	SCIL		HIOL	
	31 Dec 06	13.5 month period ended 31 Dec 05	31 Dec 06	13.5 month period ended 31 Dec 05
	£m	£m	£m	£m
Interest payable	(28)	(20)	(28)	(20)
Interest receivable	4	1	4	1
Dividends	(100)	(18)	(100)	(18)
	<u>(124)</u>	<u>(37)</u>	<u>(124)</u>	<u>(37)</u>

Balances outstanding were:

	SCIL		HIOL	
	31 Dec 06	31 Dec 05	31 Dec 06	31 Dec 05
	£m	£m	£m	£m
Fixed asset investments – loans	87	26	87	26
Subordinated loans	(230)	(230)	(230)	(230)
Debtors less (creditors)	(17)	(23)	(17)	(23)
	<u>(160)</u>	<u>(227)</u>	<u>(160)</u>	<u>(227)</u>

During the year £597,610 (2005: £421,257) was paid to Sun Capital Partners Limited, of whom W A McIntosh and H E M Osmond are directors, as shareholder monitoring fees. Also during the year £1,795,220 (2005: £842,513) was paid to TDR Capital LLP an investing entity as shareholder monitoring and investment management fees.

Included within the £44m of costs incurred by the Company in 2005 on the acquisition of Life Services (note 2.2) were amounts of £15.3m settled during the period with A K Gupta, W A McIntosh, H E M Osmond, Sun Capital Partners Limited and TDR Capital LLP in aggregate. Included within the £10m acquisition expenses included within the cost of investment in Pearl Assurance Group Holdings Limited were amounts of £1.3m settled during the 13.5 month period ended 31 December 2005 with W A McIntosh and H E M Osmond in aggregate.

NOTES TO THE ACCOUNTS (CONTINUED)**35. Contingent liabilities**

In the normal course of business, the Group is exposed to certain legal issues, which involve litigation and arbitration and as at the balance sheet date, the Group has a contingent liability in this regard.

36. Capital position statement*36.1 Capital position statement*

The purpose of the capital position statement is to set out the financial strength of the Group and to provide an analysis of the disposition and constraints over the availability of capital to meet risks and regulatory requirements. The capital position statement also provides a reconciliation of shareholders' funds to regulatory capital. The information set out below is analysed between the Group's with-profits funds, non-participating business, Life business shareholders' funds and its other activities. The contribution by NPLL to the Group's capital resources is initially included in the column headed "Life business shareholders funds", since it is owned by the Group's life business shareholder funds. An allocation of capital and loans from the Groups' life business shareholder funds to the Pearl with-profits fund is made representing capital resources to cover the capital resources requirement of the NPLL with profits fund. The non-participating business and other activities are shown in aggregate in the capital position statement. Virtually all activities of the Group relate to UK business.

The available capital resources in each part of the business are generally subject to restrictions as to their availability to meet requirements that may arise elsewhere in the Group. The principal restrictions are:

- With-profit funds (Pearl, LLL) – any available surplus held in each fund can only be used to meet the requirements of the fund itself or be distributed to policyholders and shareholders. With profits policyholders are entitled to at least 90% of the distributed profits while shareholders receive the balance. Any distribution to the shareholders would be subject to a tax charge, which is met by the fund in the case of Pearl.
- With-profit fund (NPLL) - any available surplus held in the fund can only be used to meet the requirements of the fund itself or be distributed to policyholders. Shareholders are not entitled to any distribution from this fund.
- Non-participating funds – any available surplus held in these funds are attributable to shareholders. Capital within the non-participating funds may be made available to meet capital requirements elsewhere in the Group subject to meeting the regulatory requirements of the fund and the company. Any transfer of surplus may give rise to a tax charge subject to availability of tax relief elsewhere in the Group.
- Pacific fund - The attributed assets, known as the Pacific fund, are an earmarked segment of the Pearl 0:100 long-term fund.

Internal funding arrangements

In addition to external funding sources, the Group has a number of internal loan arrangements in place, which allow the Group to provide capital support to other areas of the business. In addition to these internal loan arrangements, the Group has in place a number of internal reinsurance contracts, which are structured to manage the capital position between certain life funds.

Regulatory capital requirements

Each life fund within the Group is required to hold sufficient capital to meet the FSA's capital requirements. The regulatory capital requirement comprises amounts held in respect of expense, investment and insurance risks, called the Long-Term Insurance Capital Requirement. In 2005 all companies included an additional amount to cover specified stress tests, known as the Resilience Capital Requirement. The requirement to hold this additional capital amount was removed by the FSA in 2006 in respect of companies reporting under the FSA's realistic regime (i.e. Pearl, NPLL and LLL).

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.1 Capital position statement (continued)

For with profits funds, a further test is required which compares realistic excess capital with excess capital calculated on a regulatory basis. Where the realistic excess capital is less, that company is required to hold additional capital known as the With-profits insurance capital component ("WPICC") to cover the difference between both calculations. The realistic excess capital is calculated as the difference between each with profits fund's realistic assets and realistic liabilities with a further deduction, known as the risk capital margin ("RCM") to cover prescribed stress tests. The level of RCM is set such that sufficient capital is held to meet a series of prescribed adverse shocks, consisting of falls in equity and property values, changes in fixed interest yields, rises in defaults on corporate bonds and similar instruments and adverse persistency experience. Within these shocks, allowance is made for how management would respond, for example, through changes to bonus rates or asset mix.

The total regulatory capital requirement is deducted from the available capital resources to give excess capital on a regulatory basis.

Regulatory capital position statement

2006

	With- profits		Non-participating	Life business shareholders' funds	Total life business	Other activities and consolidation adjustments	Group total
	Pearl £m	LLL £m					
Shareholders' funds outside long-term fund	-	-	-	1,388	1,388	(574)	814
Shareholders' funds held in long-term fund	-	-	294	-	294	-	294
Total shareholders' funds at 31 December 2006	-	-	294	1,388	1,682	(574)	1,108
FFA	345	11	-	-	356	-	356
Adjustments to assets	(2)	(2)	(38)	(365)	(407)	(166)	(573)
Adjustments to liabilities	1,191	72	(30)	(7)	1,226	-	1,226
Other adjustments	-	-	-	-	-	65	65
Other qualifying capital:							
Subordinated debt	60	-	-	(60)	-	460	460
Contingent loans	33	34	3	(33)	37	(37)	-
Allocation of group capital	147	-	-	(147)	-	-	-
Total available capital resources at 31 December 2006	1,774	115	229	776	2,894	(252)	2,642
Capital Requirement							
UK realistic basis							1,679
Other regulatory bases							250
							1,929
Overall excess capital over regulatory requirements							713

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.1 Capital position statement (continued)

Regulatory capital position statement

2005

	With- profits		Non- partici pating	Life business share holders' funds	Total life business	Other activities and consolidation adjustments	Group total
	Pearl £m	LLL £m	£m	£m	£m	£m	£m
Shareholders' funds outside long-term fund	-	-	-	1,262	1,262	(700)	562
Shareholders' funds held in long-term fund	38	-	360	-	398	-	398
Total shareholders' funds at 31 December 2005	38	-	360	1,262	1,660	(700)	960
Adjustments onto a regulatory basis:							
FFA	269	19	-	-	288	-	288
Adjustment to assets	(1)	(8)	(47)	(311)	(367)	(180)	(547)
Adjustments to liabilities	868	63	(43)	(5)	883	-	883
Other adjustments	-	-	-	-	-	156	156
Other qualifying capital:							
Subordinated debt	130	-	-	-	130	472	602
Contingent loans	60	14	4	(60)	18	(18)	-
Allocation of group capital	97	-	-	(97)	-	-	-
Total available capital resources at 31 December 2005	1,461	88	274	789	2,612	(270)	2,342

Capital Requirement

UK realistic basis	1,533
Other regulatory bases	272

1,805**Overall excess capital over regulatory requirements****537**

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.1 Capital position statement (continued)

An analysis of the movement in available capital resources for the period 1 January 2006 to 31 December 2006 is shown below:

	With- profits		Non- partici- pating	Life business share- holders' funds	Total life business	Other activities and consolidation adjustments	Group total
	Pearl £m	LLL £m	£m	£m	£m	£m	£m
Total available capital resources at 1 January 2006	1,461	88	274	789	2,612	(270)	2,342
Regular surplus	207	30	40	-	277	-	277
Investment return	334	16	15	20	385	-	385
Cost of bonus	(125)	(11)	-	-	(136)	-	(136)
Changes in assumptions:							
Longevity	(82)	(10)	(44)	-	(136)	-	(136)
Expenses	(28)	(8)	34	-	(2)	-	(2)
Other	20	-	2	-	22	-	22
Management actions:							
Investment strategy	(20)	-	23	-	3	11	14
Business disposals	-	-	-	55	55	33	88
Corporate restructuring	-	-	26	-	26	35	61
Payments from Pearl Group Limited	-	-	-	-	-	(369)	(369)
Changes in regulatory requirements and similar external developments	-	-	57	-	57	-	57
New business and other factors:							
Intragroup capital movement	(42)	(1)	(206)	88	(161)	161	-
Change in internal capital	(47)	-	(4)	(96)	(147)	-	(147)
Other	96	11	12	(80)	39	147	186
Total available capital resources at 31 December 2006	1,774	115	229	776	2,894	(252)	2,642

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.1 Capital position statement (continued)

The management actions that have had a significant impact on available capital resources during the period are described below:

Investment strategy

During the year the Group has increased its exposure to equities in its with-profits fund principally Pearl, which has resulted in improved investment returns in the period. The requirement to capitalise all future investment expenses without allowance for enhanced future performance has however offset the investment return in the period. The Group's non profit funds have also benefited from changed investment strategy following a move into high yielding securities. Following the renegotiation of the IMAs between Henderson Global Investors Limited and the insurance subsidiaries of the Group on 30 June 2006, the Company received £11m.

Business disposals

Agreement was reached with Lloyds TSB on 20 July 2006 for the transfer by Pearl of the rights to renew existing General Insurance policies and to market General Insurance products to the Group's customers. A net upfront profit of £55m arose on this transaction in the life business shareholder funds.

On 10 March 2006 the Group entered into a comprehensive BPO agreement with Diligenta Limited giving rise to a profit of £35m in the Company in the year. A further £21m of profit relating to this transaction emerged within Pearl Group Services and is excluded from the capital position statement as it is an ancillary insurance service undertaking.

On 12 June 2006 the Group sold the entire issued share capital of Premier Pensions Trustees Limited to JLT Benefit Solutions Limited and a loss on disposal of £2m was recognised.

Corporate restructuring

Movements in the non-participating business primarily include the additional available capital resources created from the transfer of long-term and shareholder funds of PAUF, PAULP and LLLA to NPI Limited under Part VII of the Financial Services and Markets Act 2000.

During the year, Pearl Group Services paid a dividend of £47m to the Company which has increased the available capital resources of the Company and a loan from Pearl Group Services Limited to UKLS Financial Services Limited was repaid in cash.

Payments from Pearl Group Limited

During the year, the Company paid dividends of £199m and provided further loans of £123m to its holding companies. A further £47m outflow of capital represents interest paid on the £460m subordinated loans from the holding companies offset by interest received on loans to these shareholders from the Company.

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.2 Realistic basis

The Group's with profits funds are subject to the FSA's realistic capital regime, under which liabilities to policyholders include both declared bonuses and the constructive obligation for future bonuses not yet declared. Under FRS 27 "Life Assurance" ("FRS 27") a further adjustment is made to exclude amounts, if any, attributable to shareholders in respect of future bonuses. Hence liabilities included in the balance sheet for the with profits funds do not include the amount representing the shareholders' share of future bonuses.

*Analysis of policyholder liabilities***2006**

	With profits £m	Non-participating £m	Total life business £m
With profits liabilities on a realistic basis:			
Options and guarantees	1,989	-	1,989
Other policyholder obligations	13,365	-	13,365
Total with-profits liabilities	15,354	-	15,354
Unit linked	5	4,177	4,182
Non-participating life assurance	316	4,255	4,571
Technical provisions in the balance sheet	15,675	8,432	24,107

2005

	With profits £m	Non-participating £m	Total life business £m
With profits liabilities on a realistic basis:			
Options and guarantees	1,970	-	1,970
Other policyholder obligations	14,578	-	14,578
Total with-profits liabilities	16,548	-	16,548
Unit linked	5	4,320	4,325
Non-participating life assurance	489	4,529	5,018
Technical provisions in the balance sheet	17,042	8,849	25,891

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.3 Realistic working capital

The realistic liabilities for Pearl and LLL have been determined taking account of the requirement in Actuarial Guidance Note 45 ("GN 45") to show zero working capital for a realistic basis with-profit fund that is closed to new business, on the basis that any working capital will be distributed to policyholders and shareholders over time. If this requirement were disregarded, the surplus capital over regulatory requirements would increase by £518m (2005: £356m) and £38m (2005: £43m) in Pearl and LLL respectively. The requirements of GN 45 have not been applied to NPLL in the determination of its regulatory liabilities since the governance of this fund is such that all working capital is available to policyholders.

An analysis of the realistic working capital of each of the Group's with-profit funds is shown below:

2006	Pearl with profit £m	LLL with profit £m	NPLL £m	Total £m
Total shareholders' funds – held in long-term with-profits fund	-	-	-	-
Adjustments onto realistic basis:				
FFA	345	11	-	356
Adjustments to assets	(1)	-	90	89
Adjustments to liabilities	-	-	(22)	(22)
Shareholders' share in realistic liabilities	(344)	(11)	-	(355)
Working capital	-	-	68	68
2005	Pearl with profit £m	LLL with profit £m	NPLL £m	Total £m
Total shareholders' funds – held in long-term with-profits fund	38	-	-	38
Adjustments onto realistic basis:				
FFA	269	19	-	288
Adjustments to assets	(3)	(3)	23	17
Adjustments to liabilities	-	-	(14)	(14)
Shareholders' share in realistic liabilities	(304)	(17)	-	(321)
Working capital	-	(1)	9	8

The movement in realistic working capital in NPLL has primarily arisen from the issue of £65m 8.75% subordinated unsecured notes (see note 26 (d)). The refinancing has achieved an optimum capital arrangement for NPLL, taking into account regulatory constraints and financing strain.

NOTES TO THE ACCOUNTS (CONTINUED)

36. Capital position statement (continued)

36.4 Capital risk management policies and objectives

In response to the FSA's Integrated Prudential Sourcebook for Insurers, which requires documentation of risk for each key area – market, liquidity, insurance and operational, the Group has developed an Individual Capital Assessment ("ICA") framework for identifying the risks to which it is exposed and quantifying their impact on economic capital. The ICA estimates how much capital is required to reduce the risk of insolvency to a remote degree of probability.

Management will maintain surplus capital in excess of the RCM and ICA to meet the FSA's prescribed requirements and to maintain an appropriate additional margin over this to absorb changes in capital resources, capital requirements and to provide appropriate cover for risk.

Management actions

Capital management initiatives undertaken by the Group will be consistent with the Principles and Practices of Financial Management ("PPFM"). The management actions that have had the most significant effect on available capital during the year have been described in 36.1 above.

Sensitivity analysis

Insurance liabilities are sensitive to changes in market conditions and any other assumptions which have been applied in their calculation, such as mortality and persistency rates. Sometimes allowance must also be made for the effect on future assumptions of management or policyholder actions in certain economic scenarios. This could lead to changes in assumed asset mix, or future bonus rates.

Guarantees and options

Liabilities for guarantees and options are sensitive to persistency rates. If persistency rates are lower than expected, this will lead to an increase in liabilities to cover the guarantees and options provided. When considering assumptions for persistency, thought needs to be given to the assumed behaviour of policyholders in relation to guarantees and options. These assumptions in turn are sensitive to investment return and interest rates.

Investment risk

If market conditions vary adversely from the assumed investment return and interest rates, then liabilities will increase. Where this increase is not offset by a corresponding change in asset values, there will be an overall reduction in available capital.

Mortality risk

Where long term trend differences in mortality, morbidity or persistency rates arise there will need to be a change in assumptions. This could require a strengthening or a release of reserves and the impact will differ depending upon policy type. For annuity contracts, an improvement in mortality leads to an increase in reserves and a reduction in capital. For term assurances, an improvement in mortality has a converse effect.

NOTES TO THE ACCOUNTS (CONTINUED)

37. Post balance sheet events

During January 2007 PGL announced that it will start to distribute the Pearl With Profits Fund inherited estate to policyholders. Distribution is anticipated to take place from July 2007 through enhancements to policyholder asset shares.

On 22 February 2007, reinsurance arrangements between the Pearl Group life companies and Opal Reassurance Limited ("Opal") were approved in principle by the relevant Boards of Directors of the Pearl Group life companies and it is anticipated that reinsurance treaties will be signed during the first half of 2007. These arrangements if finalised will result in the reinsurance of the pension annuity in payment liabilities of Pearl, NPI Limited and LLL to Opal and will be effective from 1 January 2007. The estimated value of these reassured liabilities at 31 December 2006 was £3.8bn.

On 21 December 2006, Pearl Group Limited entered into an agreement to sell 49% of its equity investment in Axial Investment Management (formerly DBL Capital Management Limited) for consideration of £2m subject to the satisfaction of certain criteria, creating nil profit or loss on disposal. It is anticipated that these criteria will be satisfied by the end of March 2007. The consideration for this transaction will be left outstanding as an interest bearing loan.

Letter of Representation

Ernst & Young LLP
1 More London Place
London
SE1 2AF

Dear Sirs

Pearl Group Limited and subsidiaries

This representation letter is provided in connection with your audit of the financial statements of the above group and company for the year ended 31 December 2006 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the group and company as of 31 December 2006 and of the results of its operations and its cash flows for the year then ended in accordance with United Kingdom accounting standards.

The financial statements have been considered and approved at a duly convened meeting of the Board of Directors at which the attention of the Board was drawn to their responsibilities in connection therewith. The undersigned were authorised to sign the balance sheet on behalf of the Board and to give you the assurances below. We acknowledge our responsibility for the fair presentation of the financial statements in accordance with United Kingdom accounting standards.

We confirm to the best of our knowledge and belief, the following representations:

(a) Availability of information

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the company have been properly reflected and recorded in the accounting records. All other records and related information have been made available to you, including the minutes of all directors' and shareholders' meetings which are a complete and authentic record of the proceedings at those meetings.

(b) Transactions with directors (or persons connected with them)

At no time during the year has the company or any company in the group had any arrangement, transaction or agreement to provide credit facilities (including loans, quasi-loans or credit transactions) for directors of the company (or persons connected with them) or to guarantee or provide security for such matters.

(c) Related parties and related party transactions

We have identified and disclosed to you all related parties. During the year the directors have identified and approved related party transactions and provided the information for disclosure of all transactions relevant to the company in the financial statements. They are not aware of any other matters which require to be disclosed under FRS 8 (Related Party Disclosures) or other requirements.

(d) Events after the balance sheet date

There have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or the inclusion of a note thereto. Should any such material events occur before the date of the AGM, we will advise you accordingly.

We have also reviewed events occurring in subsidiary undertakings, associates and joint ventures since the dates of their respective balance sheets and this enables us to conclude that nothing has occurred in those periods which necessitates a revision of the figures included in the group financial statements or inclusion of a note thereto.

(e) Going concern

The financial statements have been prepared on the going concern basis. In assessing the appropriateness of the going concern basis, we have taken account of all relevant information covering a period of at least twelve months from the date of approval of the financial statements.

We are satisfied that relevant disclosure has been made in the financial statements which enables them to give a true and fair view.

(f) Fair Value measurements and disclosures

The measurement methods, including the significant assumptions used, in determining fair values under United Kingdom accounting standards are reasonable in the circumstances, and appropriately reflect our intention and ability to carry out specific courses of action on behalf of the company where relevant to the fair value measurements or disclosures made in the financial statements.

(g) Compliance with law or regulations

We have disclosed to you all known actual or possible non-compliance with law or regulations, including the actual or contingent consequences which may arise from the non-compliance, whose effects should be considered when preparing the financial statements.

(h) Fraud and error

We acknowledge our responsibility for the design and implementation of internal control systems to prevent and detect fraud and error. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. We have disclosed to you all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity.

(i) Uncorrected misstatements

We believe that the effects of any unadjusted audit differences, summarised in the accompanying schedule, accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

(j) Contingent liabilities

Provision has been made where a material loss is expected to result from any litigation or claims against the group and company. Other contingent liabilities at the balance sheet date, none of which is expected to result in a material loss to the group or company or in commitments which it cannot meet, have been disclosed in the financial statements.

All significant matters which have been referred to solicitors have been disclosed to you.

(k) Retirement benefits

On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

(l) Distributable profits

There are no significant restrictions on our ability to distribute the retained profits of the group because of statutory, contractual, exchange control or other restrictions other than those indicated in the accounts.

(m) Intra-group profits

Necessary adjustments have been made to eliminate all material intra-group unrealised profits on transactions amongst parent, subsidiary undertakings and associated undertakings.

(n) Assets

None of the group's or company's non-current assets have suffered a long term decline in value to an amount less than the value at which it is stated in the balance sheet.

The current assets have a value, on realisation in the ordinary course of the group's and company's business, at least equal to the amounts net of related provisions at which they are stated in the accounts.

The group and company have satisfactory title to all owned assets included in the balance sheets and no assets which should have been included have been omitted. All mortgages or other liens outstanding against assets have been disclosed in the accounts.

(o) Liabilities

All material liabilities at the balance sheet date have been included in the accounts and reasonable provision has been made for liabilities which are known to exist but the amount of which cannot be accurately determined.

No provision is required in respect of any litigation or claims against the group or company or any other contingent liabilities at the balance sheet date, other than commitments disclosed in the accounts.

To the extent that deferred taxation has not been provided on timing differences, other than short term differences, the directors are able to foresee, on reasonable evidence, that no liability is likely to arise as a result of the reversal of timing differences for at least three years ahead and there is no indication that after this period the situation is likely to change so as to crystallise the liabilities.

(p) Transactions

No transactions which had the primary objective of altering the appearance of the accounts have been entered into during the period.

(q) No shortages and irregularities of a material amount were discovered during the year.

(r) Outward reinsurances

The reinsurance contracts provided to you by the group represent all of the group's agreements with respect to its ceding reinsurance activities, and there are no modifications, either written or oral, of the terms of the group's reinsurance contracts or additional reinsurance agreements that have not been provided to you.

All reported reinsurance recoverable amounts less allowances for uncollectible amounts are collectible; however the group remains primarily liable in the event that the reinsurers do not honour their obligations. We are unaware of any material adverse change in the financial condition of the group's reinsurers that might raise concern regarding their ability to honour their reinsurance commitments.

The group has determined that each of its reinsurance ceded contracts meets the criteria of Financial Reporting Standard 5 to be accounted for as reinsurance, and has been given appropriate accounting recognition and disclosure in the financial statements.

All reinsurance contracts with adjustable features (e.g. retrospectively rated premiums, contingent, sliding scale and profit commissions) have been analysed to determine that all adjustments in connection therewith have been properly recorded.

(s) Long term business provision

The long term business provision, including provisions for guaranteed annuity options, is calculated separately for each operation, complying with the reporting requirements of the Financial Services Authority's realistic capital regime as set out in the Insurance Prudential Source book for participating business or complying with the reporting requirements under the Insurance Prudential Sourcebook using a gross premium valuation method or a method at least as prudent as the gross premium method for non-participating business. The outcomes of calculation are best estimates, and the assumptions used in the calculations reflect the circumstances prevailing in each life operation. We believe that the data used in the calculation of the long term business provision is complete and accurate.

The provisions held in respect of guaranteed annuity options are a prudent assessment of the additional liability incurred under the option on a basis and method consistent with that used to value basic policy liabilities, and includes a prudent assessment of the proportion of policyholders who will choose to exercise the option.

We confirm that the above representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully



Finance Director

Chairman of the Audit Committee

Chairman



Secretary

28 March 2007.

SECTION 6 - SUMMARY OF AUDIT DIFFERENCES

Summary of audit differences

In the normal course of any audit, we identify differences between amounts we believe should be recorded in the financial statements and amounts actually recorded. These differences are classified as 'known' or 'judgemental'. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation. The table below sets out the known differences we have recorded.

Unrecorded audit differences	Assets	Liabilities	Income/ expenses
	Debit/ £'m	Debit/ £'m	Debit/ Current period
Known differences:			
<ul style="list-style-type: none"> • <i>Pearl 0:100</i> - Double-counting of provisions for one-off payments to Servco – now included as a creditor but actuarial reserves were not released 		1.7	(1.7)
<ul style="list-style-type: none"> • <i>London Life</i>: No allowance made for potential mismatching / reinvestment risk in respect of the assets backing sterling reserves and annuity business when calculating valuation interest rates. 		(1.5)	1.5
<ul style="list-style-type: none"> • <i>Pearl 90:10</i> - Under valuation of private equity investments due to not processing late valuation adjustments 	0.5		(0.5)
Judgemental differences:			
<ul style="list-style-type: none"> • <i>Pearl 90:10</i> - Application of an illiquidity factor to prices quoted on an active market, hence undervaluing certain investments believed to be inconsistent with IPEVC guidelines 	1.5		(1.5)
Balance sheet totals	2.0	0.2	
Income effect of unrecorded audit differences (before tax)			(2.2)
Less: Tax effect at current year marginal rate			0.7
Cumulative effect of unrecorded audit differences before turnaround effect			(1.5)
Turnaround effect. See note 1 below.			0
Cumulative effect of unrecorded audit differences, after turnaround effect			(1.5)