PEARL GROUP LIMITED

Company Registration Number: 05282342

REPORT AND ACCOUNTS
For the year ended 31 December 2007

CONTENTS

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 2007.

Principal activities

The principal activity of the Group is the transaction of various classes of insurance business through its subsidiary companies: Pearl Assurance plc (formerly Pearl Assurance Limited), National Provident Life Limited, London Life Limited and NPI Limited. The Group has approximately 3.4 million (2006: 3.6 million) policies in force and £26.6 billion (2006: £26.8 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 Group is to be recognised as the best and most innovative manager of closed life assurance funds enabling increased value and better payouts for its policyholders.

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 its exposure to longevity risk by reassuring the pension annuity in payment liabilities of Pearl Assurance plc, London Life Limited and NPI Limited outside of the Group (see material developments 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 Asset, Liability and Investment Management Committee and Financial Risk Committee, which agrees 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 Group's capital resources.

DIRECTORS' REPORT (CONTINUED)

Material developments

As at 31 December 2007 the Group held a 25.93% equity investment in Resolution plc ("Resolution") via a 20.13% holding in Pearl Assurance plc and a 5.80% stake carried by Pearl Group Limited. Resolution is subject to an acquisition offer by Impala Holdings Limited ("Impala"), a 75% owned subsidiary of Pearl Group Limited, (see post balance sheet events below).

In recognition of the greater stability of the business, the conditions imposed in the controllers undertaking over the release of capital from regulated subsidiaries within the Pearl Group was released by the FSA during 2007. As announced in January 2007, distribution of the Pearl With Profits Fund inherited estate to policyholders commenced in July 2007 through enhancement to policyholder asset shares.

Reassurance treaties between the Pearl Group life companies and Opal Reassurance Limited, an external reassurer, were signed during the period. Under the terms of these agreements, which were effective from 1 January 2007, the pension annuity in payment liabilities of Pearl Assurance plc, NPI Limited and London Life Limited were reassured, thereby substantially removing longevity and investment risk from the life companies. The impact of these reassurance treaties has been reported in the 2007 results. A premium of £3,855m, was payable by the life companies but has been withheld and placed in collateral accounts in order to mitigate counterparty exposure. Pearl Group has therefore retained legal ownership of all assets and will continue to hold these assets on its balance sheet. The reassurer has a fixed charge over the assets. No profit or loss arose at inception of this transaction and the Pearl Group Limited consolidated result for the year did not accrue any significant profits or losses from these reassured policies.

Axial Investment Management Limited entered into Investment Services Agreements with the Pearl Group insurance companies, effective 1 July 2007 and commenced trading as a legal entity following an asset transfer from Pearl Group Services Limited. Pearl Group Limited owns 50.5% of Axial Investment Management Limited which continues to be classified as a subsidiary undertaking of Pearl Group Limited and has been consolidated in full into the 31 December 2007 results with the 49.5% external interest being recognised as a minority interest in the profit after tax and net assets of the Group.

In the second half of 2007 State Street Bank and Trust Company were appointed as a strategic partner of Pearl Group Limited to provide custody, accounting, securities lending, transition management and associated services for the Axial managed assets of the insurance subsidiaries of the Group. Transition from the previous provider has been completed during the year.

The Company and the Trustees of the Pearl Group Pension Scheme ("the Pension Scheme") entered into a contract during 2007 under which the Company will guarantee returns on the Pension Scheme's assets sufficient to ensure that there will be no funding shortfall by 30 June 2027. As an integral part in meeting the requirements of this contract, management of the assets of the Pension Scheme will move to Axial Investment Management Limited.

The Company will also provide the Pension Scheme with additional security by making payments into an escrow fund available to the Pension Scheme to meet any funding shortfall in the Pension Scheme at 30 June 2027. The balance in this escrow fund at 31 December 2007 was £10m (2006: £nil). To the extent that no such shortfall arises in 2027, monies in the escrow fund will be returned to the Company.

Performance during 2007

The Group generated a profit before exceptional items and taxation of £149m (2006: £180m) comprising a profit before tax of £119m from the long-term funds of the Group and a profit before tax of £30m from the Groups' shareholder assets. This profit comprises the emergence of recurring profits from the release of margins as policies run off and investment income on shareholder assets together with a number of largely offsetting one off items. These non-recurring items include losses suffered following the widening of credit spreads and the weakening of the commercial property market which have been offset by unrealised gains arising on the Group's equity investment in Resolution plc.

DIRECTORS' REPORT (CONTINUED)

Performance during 2007 (continued)

The consolidated statement of total recognised gains and losses includes losses of £2m (2006: £nil) for fair value adjustments on available for sale financial assets and £11m of actuarial losses (2006: gain of £9m) on the Pension Scheme.

The consolidated cash flow statement of the Group shows a net shareholder cash inflow of £1,158m available for investment during 2007 (2006: £38m outflow) reflecting the Groups equity investment in Resolution plc.

Dividends

The directors have declared and paid dividends of £33m during the year (2006: £199m).

Position as at 31 December 2007

The consolidated net assets of the Group at 31 December 2007 are £1,179m (2006: £1,108m). The increase in the year reflects the total recognised gains and losses arising in 2007 of £104m offset by the payment of dividends of £33m during the year.

Post balance sheet events

On 16 November 2007, the Boards of Pearl Group Limited and Resolution announced that they had agreed the terms of a recommended cash acquisition by Impala for the entire issued and to be issued share capital of Resolution. This acquisition was to be by way of a Court sanctioned scheme of arrangement under section 425 of the Companies Act (the "Scheme"). On 9 January 2008, the shareholders of Resolution voted in favour of accepting Impala's acquisition offer at an extraordinary general meeting of Resolution and also at a meeting convened by order of the Court. The completion of the acquisition remains subject to approval by the FSA of the change of control. It is anticipated that the acquisition will be effective in the second quarter of 2008.

Following the acquisition, Pearl Group Limited will become the largest specialist manager of in-force UK life funds, with an estimated 10.5 million customers and assets under management of £89 billion. The strategy of the enlarged group will continue to be to improve risk-adjusted financial returns for its policyholders and other stakeholders, to improve policyholder financial security and provide excellent service to its customers.

As at 31 December 2007 the Group held a 25.93% equity investment in Resolution via a 20.13% holding carried by Pearl Assurance plc and a 5.80% stake carried by Pearl Group Limited. The Group recognised a gain of £82m through the consolidated profit and loss account and a loss of £2m within the consolidated statement of total recognised gains and losses in relation to the revaluation of this investment during the year. Following completion, these gains/losses recognised in 2007 will be reversed in the Group accounts through the application of acquisition accounting in 2008.

Under the terms of the acquisition, Resolution shareholders will receive 720 pence in cash for each share held. As an alternative to receiving some or all of their consideration in cash, shareholders will be entitled to receive loan notes issued by Impala which will accrue interest at 1% below six month sterling LIBOR. This is anticipated to give a total fair value of consideration paid by Impala for the acquisition of Resolution of circa £4.98 billion.

As an integral part of the acquisition, Impala and Pearl Group Limited have entered into an agreement with Royal London under which, following the completion of the acquisition of Resolution, Royal London will acquire certain of Resolution's business and assets. The total consideration payable by Royal London in connection with this transaction is expected to be circa £1.3 billion. As these assets will be transferred at their fair value on completion, nil profit will arise in Impala on this transaction.

The holdings of Pearl Group Limited and Pearl Assurance plc will be transferred to Impala at fair value on completion with the result being that Resolution will become a 100% owned subsidiary of Impala as at that date with an anticipated net cost of investment (excluding acquisition costs) of circa £3.68 billion.

DIRECTORS' REPORT (CONTINUED)

Pension Scheme

Pearl Group Limited is the principal employer of the Pension Scheme which has been valued on an FRS17 basis as at 31 December 2007 with a surplus of £81m (2006: £14m). This year end surplus has not been recognised in the Company or in the consolidated balance sheet.

Key Performance Indicators ("KPIs")

The progress of the Group during the year is 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 resources 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 2007, the free assets on a Pillar 1 basis of Pearl Assurance plc, London Life Limited, National Provident Life Limited and NPI Limited were £515m (2006: £733m), £152m (2006: £177m), £68m (2006: £93m) and £148m (2006: £116m) respectively. The excess of capital over that required to be held by the Group in the IGD was £829m at the balance sheet date (2006: £713m).

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 2007 the Group reported profit after taxation of £114m (2006: £240m), and Pearl Group Limited paid dividends of £33m (2006: £199m). As at 31 December 2007, Pearl Group Limited had retained profits of £379m (2006: £255m), of which £210m (2006: £136m) 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.

Directors and their interests

The names of the directors as at the date of this report are set out on page 2.

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.

DIRECTORS' REPORT (CONTINUED)

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.

By order of the Board of Directors

G A Watson
Company Secretary
20 March 2008

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 "financial statements") of Pearl Group Limited for the year ended 31 December 2007 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 40. These financial statements 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 financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements 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 financial statements 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 financial statements.

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 financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, 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 financial statements 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 financial statements.

Opinion

In our opinion:

- the financial statements 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 2007 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.

Ernst & Young LLP
Registered Auditor
London
10 March 2008

CONSOLIDATED PROFIT AND LOSS ACCOUNT
Technical account for long-term business
For the year ended 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Gross premiums written	2.1	491	525
Outward reinsurance premiums		(3,858)	(4)
Earned premiums, net of reinsurance	2.2	(3,367)	521
Investment income	3	1,107	1,932
Other technical income	4.1	137	127
Total technical income		(2,123)	2,580
Gross claims paid		(2,191)	(2,402)
Reinsurers' share		309	1
Net claims paid		(1,882)	(2,401)
Change in the gross and net provision for claims		6	3
Claims incurred, net of reinsurance		(1,876)	(2,398)
Change in gross long-term business provision			
- Change in insurance contracts (note 24)		238	863
- Change in investment contracts with discretionary participation features (note 24)		696	610
Change in reinsurers' share		3,837	(9)
Change in long-term business provision		4,771	1,464
Change in technical provisions for linked liabilities, net of reinsurance		(264)	(417)
Change in technical provisions, net of reinsurance		4,507	1,047
Net operating expenses	1.1	(105)	(134)
Investment expenses and charges	3	(79)	(69)
Unrealised losses on investments	3	(215)	(762)
Other technical charges	1.2	(106)	(65)
Taxation credit/(charge) attributable to the long-term business	5.1	40	(16)
Transfer from/(to) the fund for future appropriations	23	40	(68)
Balance on the technical account – long-term business	2.8	83	115

All activities relate to continuing operations.

CONSOLIDATED PROFIT AND LOSS ACCOUNT (CONTINUED)
Non-technical account
For the year ended 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Balance on the long-term business technical account			
Continuing operations	2.8	83	115
Taxation attributable to balance on long-term business technical account	5.1	36	50
Shareholders' pre-tax profit from long-term business		119	165
Investment income	3	87	60
Unrealised gains/(losses) on investments	3	8	(14)
Investment expenses and charges	3	(89)	(71)
Other income		32	50
Other charges	1.2	(8)	(10)
Profit on ordinary activities before exceptional items and taxation		149	180
Non-operating exceptional items			
Negative goodwill on acquisition of subsidiary undertakings		-	11
Profit on disposals	7	-	109
Profit on ordinary activities before taxation		149	300
Taxation charge on profit on ordinary activities	5.1	(35)	(60)
Profit on ordinary activities attributable to shareholders		114	240

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
For the year ended 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Profit for the financial year		114	240
Fair value adjustment on available for sale financial assets		(2)	-
Actuarial (losses)/gains on pension scheme	34.1	(11)	9
Tax on items taken directly to equity		3	(3)
Total recognised gains arising in the year		104	246

CONSOLIDATED BALANCE SHEET
Assets
At 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Intangible assets			
Goodwill	9	(76)	(82)
Present value of future profits (note 10.2)		68	74
Present value of acquired in force long-term business	10.1	8	8
Deferred origination costs	11	21	26
		21	26
Investments			
Land and buildings	12	460	441
Investments in joint venture			
- share of gross assets		468	-
- share of gross liabilities		(338)	-
- loans		18	-
	13.1	148	-
Investments in associates	13.2	693	600
Other financial investments	14.1	20,887	21,104
		22,188	22,145
Assets held to cover linked liabilities	16	3,963	4,182
Reinsurers' share of technical provisions			
Long-term business provision (note 24)		3,850	13
Claims outstanding		15	185
		3,865	198
Debtors			
Debtors arising out of direct insurance operations	17.1	14	18
Other debtors	17.2	88	83
		102	101
Other assets			
Tangible assets	18	4	-
Cash at bank and in hand		644	458
		648	458
Prepayments and accrued income			
Accrued interest and rent		255	287
Deferred acquisition costs	19	-	2
Other prepayments and accrued income		18	14
		273	303
Total assets		31,060	27,413

CONSOLIDATED BALANCE SHEET
Liabilities
At 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Capital and reserves			
Called up share capital	20.2	596	596
Profit and loss account	21	583	512
Equity shareholders' funds	21	1,179	1,108
Minority interest	22	2	-
Fund for future appropriations	23	316	356
Gross technical provisions			
Long-term business provision			
- Insurance contracts (note 24)		12,097	12,335
- Investment contracts with discretionary participation features (note 24)		6,894	7,590
Claims outstanding	25	135	308
		19,126	20,233
Technical provisions for linked liabilities	26	3,963	4,182
		23,089	24,415
Financial liabilities			
Derivative liabilities	15	311	111
Provision for other risks			
Deferred taxation	27.1	21	44
Other provisions	28	76	90
		97	134
Deposits received from reinsurers	14.2.1	3,647	-
Creditors			
Creditors arising out of direct insurance operations		1	1
Debenture loans	29.2	680	691
Amounts owed to credit institutions	29.3	328	291
Other creditors including taxation and social security	30	1,370	272
		2,379	1,255
Accruals and deferred income		40	34
Total liabilities		31,060	27,413

The accounts were approved by the Board of Directors on 20 March 2008 and signed on its behalf by:

Director

COMPANY BALANCE SHEET
At 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Fixed assets			
Investments	39.1	3,047	3,074
Current assets			
Debtors			
- due within one year	39.2	47	41
- due after more than one year		-	4
Investments	39.3	294	2
Cash at bank		33	13
		374	60
Creditors: amounts falling due within one year	39.4	(1,710)	(1,654)
Net current liabilities		(1,336)	(1,594)
Total assets less current liabilities		1,711	1,480
Creditors: amounts falling due after more than one year	39.5	(729)	(622)
Provisions for liabilities	39.7	(7)	(7)
Net assets		975	851
Capital and reserves			
Called up share capital	20.2	596	596
Profit and loss account	39.8	379	255
Equity shareholders' funds	39.8	975	851

The accounts were approved by the Board of Directors on 20 March 2008 and signed on its behalf by:

Director

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2007

	Notes	31 Dec 07 £m	31 Dec 06 £m
Operating activities			
Net cash inflow from operating activities	33.1	1,249	252
Returns on investments and servicing of finance			
Interest paid		(70)	(56)
Interest received		15	5
Net cash outflow from servicing of finance		(55)	(51)
Tax			
Group relief (paid)/received		(1)	18
Capital expenditure and financial investments			
New loan investments		-	(188)
Tangible fixed assets		(4)	-
Part disposal of subsidiary undertaking		2	-
Net cash outflow from capital expenditure and financial investments		(2)	(188)
Acquisitions and disposals			
Net cash inflow from acquisitions and disposals	33.2	-	130
Equity dividends paid			
Equity dividends paid		(33)	(199)
Net cash flows available for investment		1,158	(38)
Cash flows were invested as follows:			
Increase/(decrease) in cash holdings	33.6	58	(93)
Net purchases of investments	33.6	1,100	55
Net investment of cash flows		1,158	(38)

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.

The Group has adopted the requirements of FRS 29 “Financial Instruments: Disclosures” and the amendment to FRS 26 “Financial Instruments: Measurement Recognition and Derecognition” in its current accounts. The adoption of the amendment to FRS 26 has had no impact on the results of the Company or Group.

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 other financial investments 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 other financial investments 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 investment income within the technical account for long-term business.

General business

Basis of accounting

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. The result of the general insurance business is included within other technical income in the technical account for long-term business.

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.

ACCOUNTING POLICIES (CONTINUED)

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.

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.

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 of 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.

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 24.

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 provision 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. The principal assumptions are given in note 24.

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.

ACCOUNTING POLICIES (CONTINUED)

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

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.

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.

The fund for future appropriations (FFA) comprises the shareholders share of the inherited estate of the Group's 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 given in note 24.

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.

Revenue from investment contracts

Revenue from investment contracts comprises 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.

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 exceeds the value determined by reference to underlying assets, the difference is recognised as part of the long-term business provision.

ACCOUNTING POLICIES (CONTINUED)

Investment contracts without DPF (continued)

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.

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. Unrealised gains and losses on available for sale assets are recognised in the consolidated statement of total recognised gains and losses; realised gains and losses are transferred to 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.

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 from the Companies Act 1985 which requires 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.

ACCOUNTING POLICIES (CONTINUED)

Financial instruments

Financial assets - Group

Debt securities, equity securities and holdings in authorised collective investment schemes are measured at fair value and either designated as at fair value through profit and loss in accordance with the documented risk strategy of the Group or as available for sale. Gains and losses arising from changes in fair value on assets designated as at fair value through profit and loss are included in the consolidated profit and loss account. Gains and losses arising from changes in fair value on available for sale assets are initially recognised in the consolidated statement of total recognised gains and losses. On derecognition or impairment of available for sale assets, the cumulative fair value gains and losses previously reported through the consolidated statement of total recognised gains and losses is transferred to the consolidated profit and loss account.

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. Investments in loans to subsidiary undertakings are designated as loans and receivables and valued at amortised cost. 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. 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. Regular way purchases and sales of financial assets are accounted for at trade date. 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.

ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

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 given in note 24.

Tangible assets

Tangible assets are capitalised and depreciated by equal annual instalments over their estimated useful economic lives of between 1 and 5 years.

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 consolidated profit and loss account.

Expenses and assets are recognised net of the amount of VAT except where this tax is not wholly 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 the 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.

ACCOUNTING POLICIES (CONTINUED)

Foreign currencies

Transactions in currencies other than sterling 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 the resulting exchange adjustments are included within the technical account. For assets and liabilities held outside of the long-term funds any resulting exchange adjustments are taken to the non-technical account.

NOTES TO THE ACCOUNTS

1. Net operating expenses and other charges

1.1 Net operating expenses

	31 Dec 07 £m	31 Dec 06 £m
Acquisition costs:		
Commission	-	2
Other	-	3
Change in deferred origination costs (note 11)	5	4
Change in deferred acquisition costs (note 19)	2	2
Administrative expenses	98	123
	105	134

1.2 Other technical charges and other charges

	Technical account Long-term business		Non – technical account	
	31 Dec 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
Increase in contingent loan liabilities	4	47	-	-
Movement in present value of future profits on non participating business in the with profits fund (note 10.2)	6	4	-	-
Movement in deposits received from reinsurers	96	-	-	-
Other technical charges	-	14	-	-
Other charges	-	-	8	10
	106	65	8	10

1.3 Analysis of staff costs

Staff costs comprise:	31 Dec 07 £m	31 Dec 06 £m
Salaries and wages	29	29
Social security costs	3	3
Pension costs (note 34.1)	3	5
Total	35	37

1.4 Average employee numbers

The average number of employees of the Group during the year ended 31 December 2007 was 225 (31 December 2006 : 424).

1.5 Auditors' remuneration

	31 Dec 07 £m	31 Dec 06 £m
Fees payable to the Company's auditor for the audit of the Company's annual accounts	0.1	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	0.6	0.9
Other services pursuant to legislation	0.2	0.4
All other services	0.3	0.1
	1.2	1.6

NOTES TO THE ACCOUNTS (CONTINUED)

2. Segmental information – Long-term business

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

2.1 Analysis of gross premiums written

	31 Dec 07 £m	31 Dec 06 £m
Premiums from individuals	485	511
Premiums from group contracts	6	14
	491	525
Life business	127	162
Annuity business	5	4
Pension business	359	359
	491	525

2.2 Analysis of earned premiums, net of reinsurance

	31 Dec 07 £m	31 Dec 06 £m
Premiums from individuals	(3,369)	511
Premiums from group contracts	2	10
	(3,367)	521
Life business	124	157
Annuity business	5	5
Pension business	(3,496)	359
	(3,367)	521

Effective 1 January 2007, the Pearl Group life companies entered into reassurance arrangements with Opal Reassurance Limited, an external reassurer, under which the Group reassured its pension non – profit annuity in payment liabilities. The initial premium of £3,855m for the reassurance of this business is included in outward reinsurance premiums.

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

	31 Dec 07 £m	31 Dec 06 £m
Regular premiums	235	282
Single premiums	256	243
	491	525

Industrial branch premiums of £9m (2006 : £12m) are classified as regular premium with profits life business in the above analysis.

NOTES TO THE ACCOUNTS (CONTINUED)

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

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

	31 Dec 07 £m	31 Dec 06 £m
Non participating contracts	284	260
Participating contracts	207	265
	491	525

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.

2.5 Analysis of new gross written premiums

	31 Dec 07 £m	31 Dec 06 £m
Annuity business	5	4
Pension business	251	239
	256	243

2.6 New business annual premium equivalent

	31 Dec 07 £m	31 Dec 06 £m
Annual premium equivalent	26	24

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

	31 Dec 07 £m	31 Dec 06 £m
Single premiums	256	243
Non participating contracts	249	224
Participating contracts	7	19
	256	243

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)

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

2.8 Analysis of balance on technical account.

	31 Dec 07 £m	31 Dec 06 £m
Non-linked:		
Life and annuity business	11	34
Pension business	32	25
Shareholders' attributable assets	28	(3)
	71	56
Linked:		
Life business	2	33
Pension business	10	17
	12	50
Release of fair value adjustment for subordinated debt	-	9
Balance on technical account – long-term business	83	115

The reinsurance balance amounted to a credit to the long-term business technical account at 31 December 2007 of £127m (2006: charge of £9m).

3. Investment return

	Technical account Long-term business		Non-technical account	
	31 Dec 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
Income from loans and receivable at amortised cost	12	11	29	10
Income from financial assets at fair value through profit and loss	1,052	1,117	56	46
Income from other financial investments	1,064	1,128	85	56
(Loss)/income from participating interests	(39)	163	-	-
Income from land and buildings	7	11	-	-
Gains on realisation of investments	75	630	-	-
Net expected return on pension assets (note 34.1)	-	-	2	4
Investment income	1,107	1,932	87	60
Unrealised (losses)/gains	(215)	(762)	8	(14)
Investment management expenses and charges	(53)	(49)	-	(1)
Losses on realisation of investments	-	-	(3)	(2)
Interest expense on financial liabilities at amortised cost	(26)	(20)	(86)	(68)
Investment expenses and charges	(79)	(69)	(89)	(71)
Total investment return	813	1,101	6	(25)

NOTES TO THE ACCOUNTS (CONTINUED)

3. Investment return (continued)

Net (losses)/gains on financial assets at fair value through profit and loss included in total investment return are:

	Technical account Long-term business		Non-technical account	
	31 Dec 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
Assets designated upon initial recognition	(226)	87	30	(15)
Assets held for trading	108	(90)	(24)	1
	(118)	(3)	6	(14)

Interest expenses for financial liabilities not at fair value through profit and loss comprises:

	Technical account Long-term business		Non-technical account	
	31 Dec 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
Debenture loans	26	20	69	68
Other creditors	-	-	17	-
Technical provisions for linked liabilities (note 26)	264	417	-	-
Investment contracts with DPF	109	374	-	-
	399	811	86	68

The interest expense relating to financial liabilities at amortised cost in respect of investment contracts without DPF (Technical provisions for linked liabilities) is included in the long-term business technical account as the "Change in technical provisions for linked liabilities, net of reinsurance".

The interest expense in respect of investment contracts with DPF is calculated as the increase in the realistic liability for those contracts not attributable to amounts received from, or paid to, policyholders and is presented within the long-term business technical account under the heading "Change in long-term business provision".

4. Other income

4.1 Other technical income

	Technical account Long-term business	
	31 Dec 07 £m	31 Dec 06 £m
Investment contract income	54	55
Decrease in contingent loan liability	81	59
General business	-	-
Other	2	13
	137	127

NOTES TO THE ACCOUNTS (CONTINUED)

5. Taxation

5.1 Taxation

	Technical account Long-term business		Non-technical account	
	31 Dec 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
United Kingdom corporation taxation				
Current tax charge for the year	23	27	-	-
Adjustments for previous years	(38)	(28)	(7)	(4)
	(15)	(1)	(7)	(4)
Tax attributable to the balance on long-term business technical account	-	-	36	50
Total current taxation	(15)	(1)	29	46
Deferred taxation				
Origination and reversal of timing differences	(24)	19	2	8
Decrease in discount	(1)	(2)	-	-
Total charged to deferred taxation	(25)	17	2	8
Charged to staff pension scheme				
Origination and reversal of timing differences	-	-	4	6
Total deferred taxation	(25)	17	6	14
Total tax (credit)/charge	(40)	16	35	60

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)

5. Taxation (continued)

5.2 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 07 £m	31 Dec 06 £m
Profit on ordinary activities before taxation	149	300
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30%	45	90
Effects of:		
Non-taxable book losses on revaluation of long-term business	24	3
Non-taxable unrealised gains on investments	(25)	-
Non-taxable goodwill write back	(2)	(5)
Other disallowable expenses	3	5
Timing differences other than on long-term business	(7)	(16)
Adjustment to taxation charge in prior years	(7)	(4)
Current taxation losses surrendered for £nil value	1	-
Non taxable income	(3)	(27)
Current taxation charge for the year	29	46

6. Dividends

	31 Dec 07 £m	31 Dec 06 £m
Interim ordinary paid dividends: 5.60p per £1 share (2006: 33.39p per £1 share)	33	199

7. Exceptional items – profit on disposals

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

	31 Dec 07 £m	31 Dec 06 £m
Business Process Outsource	-	56
Premier Pension Trustees Limited	-	(2)
General Insurance	-	55
	-	109

NOTES TO THE ACCOUNTS (CONTINUED)

7. Exceptional items – profit on disposals (continued)

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 gave rise to a profit of £56m in that year. The tax effect in the non-technical account relating to this non-operating exceptional item in 2006 was 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 during 2006.

General Insurance

Agreement was reached with Lloyds TSB on 20 July 2006 for the transfer by 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 in 2006. The tax effect in the non-technical account relating to this non-operating exceptional item in 2006 was a tax charge of £17m.

8. Directors' emoluments

	31 Dec 07 £'000	31 Dec 06 £'000
Emoluments (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	2,080	2,838

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.

Highest paid director's remuneration:	31 Dec 07 £'000	31 Dec 06 £'000
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)	622	955

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.

NOTES TO THE ACCOUNTS (CONTINUED)

9. Goodwill

	£m
Cost	
At 1 January 2007 and 31 December 2007	(351)
Amortisation and impairment	
At 1 January 2007	269
Amortisation for the year	6
At 31 December 2007	275
Net book value	
At 31 December 2007	(76)
At 31 December 2006	(82)

10. Present value of future profits

10.1 Present value of acquired in force long-term business

	£m
Cost and Net book value	
At 1 January/31 December 2007	8

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

10.2 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 given in note 24.

During the year £6m (2006: £4m) of PVFP was released to the technical account for long-term business.

11. Deferred origination costs

	£m
At 1 January 2007	26
Decrease in period	(5)
At 31 December 2007	21

NOTES TO THE ACCOUNTS (CONTINUED)

12. Land and buildings

	Freehold £m	Long leasehold £m	Total £m
At 1 January 2007	144	297	441
Additions	-	2	2
Disposals	-	(24)	(24)
(Deficit)/surplus on revaluation	(14)	55	41
At 31 December 2007	130	330	460
Land and buildings at cost:			
At 31 December 2007	102	256	358
At 31 December 2006	102	267	369

All investment properties held by the Group were valued as at 31 December 2007, 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 £296m (2006: £262m) property reversions arising from sales of the NPI Extra Income Plan. The reversionary interest is valued as the NPI Limited and National Provident Life Limited ("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.

13. Investments in participating interests

13.1 Investments in joint venture

	Long-term business £m
At 1 January 2007	-
Additions (note 35(d))	148
At 31 December 2007	148

NOTES TO THE ACCOUNTS (CONTINUED)

13. Investments in participating interests (continued)

13.2 Investments in associates

	Long term business		Non long-term business	
	Share of capital and reserves	Loans	Loans	Total carrying value
	£m	£m	£m	£m
At 1 January 2007	320	253	27	600
Operating loss for the period after taxation	(39)	-	-	(39)
Distributions	(10)	-	-	(10)
Additions/(disposals)	149	(8)	1	142
Movements in the period	100	(8)	1	93
At 31 December 2007	420	245	28	693

14. Other financial investments

14.1 Other financial investments

The Group's other financial investments are summarised by measurement category as follows:

	31 Dec 07		31 Dec 06	
	Carrying value	Cost	Carrying value	Cost
	£m	£m	£m	£m
At fair value through profit and loss:				
Designated upon initial recognition	19,771	19,017	20,507	19,653
Derivative financial instruments – held for trading	612	158	376	172
Loans and receivables at amortised cost	221	221	221	221
Available for sale	283	285	-	-
Total other financial investments	20,887	19,681	21,104	20,046

NOTES TO THE ACCOUNTS (CONTINUED)

14. Other financial investments (continued)

14.1 Other financial investments (continued)

The other financial investments of the Group can be further analysed as:

	Note	31 Dec 07 Carrying value £m	31 Dec 07 Cost £m	31 Dec 06 Carrying value £m	31 Dec 06 Cost £m
Share and other variable yield securities and units in unit trusts		7,260	6,293	4,923	4,011
Debt securities and other fixed income securities		12,575	12,796	15,215	15,273
Deposits with credit institutions		219	213	369	369
Derivative assets	15	612	158	376	172
Loans and receivables at amortised cost		221	221	221	221
		20,887	19,681	21,104	20,046
Listed investments included above		18,107	17,609	19,784	18,803

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. 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. 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.

The amount of unrealised gains/(losses) relating to the change in fair value of financial investments determined using valuation techniques other than quoted market prices is £3m (2006: £138m) in the long-term business technical profit and loss account and £6m (2006: £(12)m) in the non-technical profit and loss account.

Included within other financial investments at 31 December 2007 is £10m (2006: £2m) held in escrow accounts by the Company for additional contributions into the Pearl Group Staff Pension Scheme.

14.2 Collateral

14.2.1 Premium withheld from reinsurers

Under the terms of the reassurance arrangements entered into with an external reassurer effective 1 January 2007, Pearl Assurance plc, NPI Limited and London Life Limited hold assets in collateral accounts over which the reassurer has a fixed charge.

The fair value of the assets thus held at 31 December 2007 is £3,647m (2006: £nil).

NOTES TO THE ACCOUNTS (CONTINUED)

14. Other financial investments (continued)

14.2 Collateral (continued)

14.2.2 Stock lending

During the year the Group, through Axial Investment Management Limited commenced a comprehensive stock lending programme. Under this programme, collateral is received to the value of at least 102% of the stocks lent.

The fair value of the collateral received at 31 December 2007 is £3,212m (2006: £4,965m).

14.2.3 Limited recourse bonds

The Group has pledged collateral of £146m (2006: £138m) to provide security to the holders of the National Provident Life Limited Recourse Bonds in issue (see note 29.2 (d)).

15. Derivatives

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

The fair values of derivative financial instruments are as follows:

	Derivative assets 31 Dec 07 £m	Derivative assets 31 Dec 06 £m	Derivative liabilities 31 Dec 07 £m	Derivative liabilities 31 Dec 06 £m
Forward currency	27	2	99	6
Credit default swaps	25	3	6	4
Interest rate swaps	389	171	189	100
Swaptions	147	117	-	-
Inflation swaps	14	83	-	1
Total return bond swaps	1	-	8	-
Equity options	9	-	9	-
	612	376	311	111

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

16. Assets held to cover linked liabilities

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

	31 Dec 07 Carrying value £m	31 Dec 07 Cost £m	31 Dec 06 Carrying value £m	31 Dec 06 Cost £m
At fair value through profit and loss	3,963	3,228	4,182	3,400
Listed investments included above	3,712	2,947	4,102	3,346

The carrying value is the fair value of these assets.

NOTE TO THE ACCOUNTS (CONTINUED)

17. Debtors

17.1 Debtors arising out of direct insurance operations

	31 Dec 07 £m	31 Dec 06 £m
Amounts owed by policyholders	14	18

All debtors are expected to be recovered within 12 months. The carrying value amount of these assets is a reasonable approximation of their fair value.

17.2 Other debtors

	31 Dec 07 £m	31 Dec 06 £m
Other debtors	88	83

All debtors are expected to be recovered within 12 months. The carrying value amount of these assets is a reasonable approximation of their fair value.

18. Tangible assets

	£m
Cost	
At 1 January 2007	-
Additions	4
At 31 December 2007	4
Depreciation	
At 1 January and 31 December 2007	-
Net book value	
At 1 January and 31 December 2007	4

19. Deferred acquisition costs

	£m
At 1 January 2007	2
Decrease in period	(2)
At 31 December 2007	-

NOTES TO THE ACCOUNTS (CONTINUED)

20. Share capital

20.1 Share capital authorised

	31 Dec 07 £m	31 Dec 06 £m
596,000,100 ordinary shares of £1 each	596	596

20.2 Share capital allotted

	31 Dec 07 £m	31 Dec 06 £m
Allotted, called up and fully paid equity shares:		
596,000,020 ordinary shares of £1 each	596	596

21. Reserves and reconciliation of movement in shareholders' funds

	Share capital £m	Profit and loss account £m	Shareholders' funds £m
At 1 January 2006	596	465	1,061
Profit after taxation for the year ended 31 December 2006	-	240	240
Dividends (note 6)	-	(199)	(199)
Actuarial gains on pension scheme	-	9	9
Tax on items taken directly to equity	-	(3)	(3)
At 31 December 2006	596	512	1,108
Profit after taxation for the year ended 31 December 2007	-	114	114
Dividends (note 6)	-	(33)	(33)
Fair value adjustment on available for sale financial assets	-	(2)	(2)
Actuarial losses on pension scheme	-	(11)	(11)
Tax on items taken directly to equity	-	3	3
At 31 December 2007	596	583	1,179

22. Minority interest

	£m
At 1 January 2007	-
Additions (note 39.1(a))	2
At 31 December 2007	2

NOTES TO THE ACCOUNTS (CONTINUED)

23. Fund for future appropriations

	31 Dec 07 £m	31 Dec 06 £m
At 1 January	356	288
Transfer (to)/from the technical account	(40)	68
At 31 December	316	356

The Group's with-profit funds are 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.

24. 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 validated to ensure 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 2007 was £42m (2006: £14m).

NOTES TO THE ACCOUNTS (CONTINUED)

24. Policyholder liabilities (continued)

24.1 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 Dec 2007	4.65%	4.62%	4.70%	4.68%	4.60%	4.45%	4.29%	4.16%	4.06%
31 Dec 2006	5.42%	5.15%	4.83%	4.71%	4.48%	4.25%	4.10%	3.98%	3.89%

Other assumptions

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

	31 Dec 07	31 Dec 06
Inflation:		
Retail price inflation	3.20%	3.20%
Expense inflation	3.2% - 4.20%	3.40% - 4.20%
Earnings inflation	4.70%	4.70%

Asset mix for assets backing asset shares at the valuation date:

	31 Dec 07	31 Dec 06
Gilts and cash	2.40% - 62.60%	21.54% - 68.20%
Corporate bonds	24.30% - 85.60%	24.20% - 63.11%
Equities	6.00% - 33.10%	0.28% - 35.50%
Property	7.10% - 17.20%	4.40% - 15.08%

	31 Dec 07	31 Dec 06
Mortality rate:		
Basic life assurance	55% AM/F80, 50% A67/70, 95% AM/F92, 75% AM/F80, 60% ELT14 Male all with adjustments	55% AM/F80, 95% AM/F92 Ultimate, 75% AM/F80 Ultimate, 60% ELT 14 Male all with adjustments
Pension business	65% AM/F80, 97.5% PM/FA00, 50% A67/70, 70% AM/F92, 75% AM/F80 all with adjustments	97.5% PMA00, 97.5% PFA00, 65% AM/F80, 70% AM/F92 Ultimate, 75% AM/F80 Ultimate all with adjustments
Pension annuity in payment	100% PMA00, 95% PFA00, 120% RM/FV92, 105.0% RMV00, 107.5% RFV00 all with adjustments	115% of RM/FV92,I with adjustments
Unitised with profits	75% AM/F80, 95% AM/F92 all with adjustments	75% AM/F80 Ultimate
Per policy expenses – regular premiums:		
Basic life assurance	£31.49 - £112.95	£29.88 - £106.17
Pension business	£20.28 - £471.45	£19.24 - £447.30
Unitised with profits	£31.90 - £80.20	£31.20 - £79.00

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

NOTES TO THE ACCOUNTS (CONTINUED)

24. Policyholder liabilities (continued)

24.1 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 £418m (2006: £458m) and in respect of other guarantees was £1,407m (2006: £1,401m).

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 £349m (2006: £420m).

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 £182m (2006: £155m).

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 £83m (2006: £79m).

24.2 Non participating business

Effective 1 January 2007, the Pearl Group life companies entered into reassurance arrangements with an external reassurer under which Pearl Assurance plc, NPI Limited and London Life Limited reassured their pension non – profit annuity in payment liabilities. From this date, the reassurer bears substantially all the risks and rewards of this business.

NOTES TO THE ACCOUNTS (CONTINUED)

24. Policyholder liabilities (continued)

24.2 Non participating business (continued)

Under the terms of this arrangement, the Group has a contingent liability of 80/130^{ths} for any increase in the treaty best estimate reserves resulting from mortality improvements. The maximum liability under the arrangement is £76m at 31 December 2007.

In order to protect the policyholders from large counterparty exposures, the initial premium payable has been withheld and placed in collateral accounts. The reassurer holds a fixed charge over the assets. The balance due under this arrangement at 31 December 2007 of £3,647m is shown within "Deposits received from reinsurer".

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 07	31 Dec 06
Interest rate:		
Basic life assurance	3.6% - 4.6%	3.8% - 4.7%
Pension annuity in payment	4.0% - 4.8%	4.7% - 5.2%
Unitised with profits	3.0% - 4.8%	3.1% - 3.9%
Mortality rate:		
Basic life assurance	100% AM/F92, 72%IML/IFL92, 60% AM/F80, 120% AM/F80 all with adjustments	100% AM/F92, 72%IML/IFL92, Year of use, all with adjustments
Pension business	100% AM/F92	65% AM/F80
Pension annuity in payment	97.5/100% RMV00/RFV00, 107.5/107.5% RMV92 90/85% PMA00/PFA00, 87.5% PM/FA00, 113% RM/FV92	105% - 110% RMV92, 100% - 108% RFV92, 87.5% PM/F00 all with adjustments
Unitised with profits	100% AM/F92 all with adjustment	100% AM/F92

Options and Guarantees

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

25. Claims outstanding

	31 Dec 07 £m	31 Dec 06 £m
General business	42	208
Life business	93	100
	135	308

Effective 31 December 2007 the novation of the general insurance Monarch liabilities was completed. Under the novation the Group's obligation to maintain the gross liability and corresponding reinsurance asset on the balance sheet is removed and this has consequently resulted in the release of £165m gross reserves.

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 9.0 years for 2007 (2006: 8.4 years). The provision has been discounted at an interest rate of 3.5% for 2007 (2006: 3.5%).

NOTES TO THE ACCOUNTS (CONTINUED)

25, Claims outstanding (continued)

The overall effect is to reduce the gross and net technical provisions for those classes of business referred to above at 31 December 2007 by £12m (2006: £8m) from £35m to £23m. The total amount of the investment return which corresponds to the unwinding of the discount is £1m (2006: £1m).

26. Technical provisions for linked liabilities

	£m
At 1 January 2007	4,182
Deposits collected	62
Payments made to policyholders of, and fees deducted from, investment contacts	(545)
Change in technical provisions for linked liabilities	264
At 31 December 2007	3,963

27. Deferred taxation

27.1 Provisions for taxation

Reconciliation of movements in deferred tax:

	31 Dec 07 £m	31 Dec 06 £m
At 1 January	44	19
(Release)/charge for the year:		
Technical account – long-term business	(25)	17
Non-technical account	2	8
At 31 December	21	44

27.2 Deferred taxation provisions

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

	31 Dec 07 £m	31 Dec 06 £m
Unrealised gains on investments	23	49
Deferred acquisition expenses	(2)	(4)
Capital allowances	(4)	1
Trading losses	-	(2)
Other short term timing differences	6	-
Total undiscounted	23	44
Total on a discounted basis	21	44

A deferred tax asset has been recognised in respect of long-term business acquisition expenses and capital allowance deductions 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. 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 27.3.

NOTES ON THE ACCOUNTS (CONTINUED)

27. Deferred taxation (continued)

27.3 Factors that may affect future taxation charges

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 07	31 Dec 06	31 Dec 07	31 Dec 06
	£m	£m	£m	£m
Capital and trading losses	8	16	6	4
Provisions and other timing differences	11	-	6	5
	19	16	12	9

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

- £11m (2006: £16m) arises on realised capital losses on chargeable securities and will be available to offset against realised chargeable gains of future years;
- £3m (2006: £nil) arises on trading losses and will be available to offset against trading profits of future years; and
- £17m (2006: £9m) 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.

28. Provisions

	Restructure	Leasehold properties	Staff related	Investment contracts	Other	Total
	£m	£m	£m	£m	£m	£m
At 1 January 2007	9	24	20	16	21	90
Amount utilised	(1)	(5)	(1)	(1)	(2)	(10)
Increase in provision	-	2	2	4	2	10
Unutilised amount reversed	(1)	(1)	(3)	(6)	(5)	(16)
Unwind of discount	-	1	1	-	-	2
At 31 December 2007	7	21	19	13	16	76

The restructure provision has been made for the costs of restructuring management and staffing across the Group. It is expected that most of this 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 7.1% (2006: 7.3%). The provision is expected to be utilised over the next 15 years.

Staff related provisions include £12m (2006: £13m) held in respect of healthcare costs for former employees. The healthcare cost provision has been calculated on assumptions of medical expense inflation of 10.5% (2006: 10.0%) and a valuation interest rate of 4.6% (2006: 4.4%).

Provisions in respect of investment contracts represent the excess of future costs over future charges on the Group's unit linked business, assessed at a product level. The discount rate used in calculating the provision is 5.0% (2006: 5.0%) and the provision is expected to run off over the remaining life of the business, estimated at 30 years.

NOTES TO THE ACCOUNTS (CONTINUED)

29. Financial liabilities at amortised cost

29.1 Total financial liabilities at amortised cost

	Notes	Carrying value 31 Dec 07 £m	Carrying value 31 Dec 06 £m	Fair value 31 Dec 07 £m	Fair value 31 Dec 06 £m
Technical provisions for linked liabilities	26	3,963	4,182	3,963	4,182
Debenture loans	29.2	680	691	683	702
Amounts owed to credit institutions	29.3	328	291	328	291
Deposits received from reinsurers	38.3.1	3,647	-	3,647	-
Other creditors including taxation and social security	30	1,370	272	1,370	272
Creditors arising out of direct insurance operations		1	1	1	1
		9,989	5,437	9,992	5,448

29.2 Debenture loans

	Carrying value 31 Dec 07 £m	Carrying value 31 Dec 06 £m	Fair value 31 Dec 07 £m	Fair value 31 Dec 06 £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	32	32
Limited recourse bonds 2012 7.39% (note d)*	70	81	70	84
Limited recourse bonds 2022 7.59% (note d)*	118	118	121	126
Total debenture loans	680	691	683	702

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.

(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.

(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.

(d) 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 (note 14.2.3).

NOTES TO THE ACCOUNTS (CONTINUED)

29. Financial liabilities at amortised cost (continued)

29.3 Amounts owed to credit institution

	Carrying value		Fair value	
	31 Dec 07	31 Dec 06	31 Dec 07	31 Dec 06
	£m	£m	£m	£m
Refinancing loan (note a)	328	291	328	291
Total amounts owed to credit institutions	328	291	328	291

Notes

(a) 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.

30. Other creditors including taxation and social security

	31 Dec 07	31 Dec 06
	£m	£m
Corporation tax	66	36
Investment broker balances	1,140	66
Other creditors	164	170
	1,370	272

31. Capital commitments

31.1 Capital commitments

	31 Dec 07	31 Dec 06
	£m	£m
Other capital commitments for settlement after 31 December	203	50
Securities commitments	648	228

Securities commitments comprise commitments of Pearl to subscribe to private equity funds and other unlisted assets.

NOTES TO THE ACCOUNTS (CONTINUED)

31. Capital commitments (continued)

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

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

	31 Dec 07 £m	31 Dec 06 £m
Within one year	2	2
In the second to fifth years inclusive	7	6
In more than five years	6	5
Total	15	13

32. Contingent loans

Both NPLL and London Life Limited ("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 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 07 £m	31 Dec 06 £m
National Provident Life Limited	135	216
London Life Limited	158	154
	293	370

NOTES TO THE ACCOUNTS (CONTINUED)

33. Notes to the cash flow statement

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

	31 Dec 07 £m	31 Dec 06 £m
Profit on ordinary activities before non-operating exceptional items and taxation	149	180
Adjustments for financing expenses and items not involving movements of cash:		
Write back of negative goodwill	(6)	(4)
Decrease in outstanding claims	170	24
Decrease / (increase) in debtors	10	(11)
(Increase) / decrease in accrued interest and rent	(1)	1
Decrease / (increase) in prepayments	1	(4)
Increase / (decrease) in creditors	1,131	(23)
(Decrease) / increase in provisions	(7)	7
Increase / (decrease) in accruals	1	(4)
Increase in deferred income	5	-
Decrease in technical provisions	(167)	(21)
Unrealised (gains) / losses	(2)	15
Movement in pension scheme	(11)	(11)
Profits relating to long-term business funds, excluding Pacific fund	(71)	59
Loan interest expense	76	58
Loan interest income	(29)	(10)
Cash outflow from Business Process Outsourcing	-	(4)
Net cash inflow from operating activities	1,249	252

33.2 Analysis of cashflows in respect of acquisitions and disposals

	31 Dec 07 £m	31 Dec 06 £m
Cash and cash equivalents received in respect of Life Services acquisition	-	2
Net cash inflow from Life Services acquisition	-	2
Cash received for Virgin sale	-	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 from acquisitions and disposals	-	130

On 27 April 2004, a loan from Pearl to Virgin Money Group Limited was sold to Virgin Management Limited for £90m. The final £20m of this consideration was received during 2006.

NOTES TO THE ACCOUNTS (CONTINUED)

33. Notes to the cash flow statement (continued)

33.3 Analysis of cash holdings included in the Consolidated Balance Sheet

	31 Dec 07 £m	31 Dec 06 £m
Cash at bank and in hand	644	458
Less: Cash on deposit not repayable on demand (note 33.4)	(70)	(187)
Add: Deposits with credit institutions repayable on demand included within other financial investments (note 33.4)	-	132
Total cash holdings (note 33.6)	574	403

33.4 Analysis of portfolio investments included in the Consolidated Balance Sheet

	31 Dec 07 £m	31 Dec 06 £m
Other financial investments	20,887	21,104
Add: Cash on deposit not repayable on demand (note 33.3)	70	187
Less: Deposits with credit institutions repayable on demand included within other financial investments (note 33.3)	-	(132)
Total portfolio investments (note 33.6)	20,957	21,159

33.5 Net portfolio investments (excluding long-term business)

	31 Dec 07 £m	31 Dec 06 £m
Purchase of portfolio investments	3,032	1,045
Sale of portfolio investments	(1,932)	(990)
	1,100	55

NOTES TO THE ACCOUNTS (CONTINUED)

33. Notes to the cash flow statement (continued)

33.6 Movements in cash, portfolio investments and financing

	Portfolio investments	Cash holdings	Borrowings	Total
	£m	£m	£m	£m
At 1 January 2006	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
Shareholder cash flows	1,100	58	-	1,158
Changes in long-term business	(1,380)	113	(26)	(1,293)
Changes in market value and exchange rate effects	78	-	-	78
At 31 December 2007	20,957	574	(1,008)	20,523

34. Staff pension scheme

As at 31 December 2007 the Group operated one pension scheme, the Pearl Group Staff Pension Scheme ("the Pension Scheme"), for its employees. The Pension Scheme is funded by payment of contributions to a separately administered trust fund. The Pension Scheme's appointed investment managers are Axial Investment Management Limited, Fidelity Investments, Legal and General and Standard Life. The Pension Scheme is subject to regular valuations by an independent qualified actuary. The Company is the principal employer of the Pension Scheme.

Up until 15 November 1999, the Pension 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 Pension 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 2007 have been reflected in these Group accounts.

Throughout 2007, the contribution rates to the Pension Scheme were 48.8% (2006: 27.0%), 19.1% (2006: 20.8%), and 12.4% (2006: 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 2007, £5m (2006: £16m) and £nil (2006: £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 2008 to make additional contributions into the Pension Scheme.

NOTES TO THE ACCOUNTS (CONTINUED)

34. Staff pension scheme (continued)

The Company and the Trustees of the Pension Scheme entered into a contract during 2007 under which the Company will guarantee returns on the Pension Scheme's assets sufficient to ensure that there will be no funding shortfall by 30 June 2027. On 30 June 2009 and every three years thereafter a valuation will be performed to determine the extent to which additional payments are required to be made in the Pension Scheme in so far as the target investment return has not been achieved. As an integral part in meeting the requirements of this contract, management of the assets of the Pension Scheme moved to Axial Investment Management Limited.

The Company will also provide the Pension Scheme with additional security by making payments into an escrow fund available to the Pension Scheme to meet any funding shortfall in the Pension Scheme at 30 June 2027. The balance in this escrow fund at 31 December 2007 was £10m (2006: £nil). To the extent that no such shortfall arises in 2027, monies in the escrow fund will be returned to the Company.

In addition, the Company will meet the administration expenses of the Pension Scheme from 30 June 2007.

The valuation used for the 2007 and 2006 FRS17 accounting and disclosures has been based on the results of the actuarial valuation of the Pension Scheme as at 30 June 2006. The valuation used for the 2005 FRS17 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 Pension Scheme at these respective dates. The Pension Scheme assets are stated at their market value at the respective dates.

34.1 The movement in the Pension Scheme surplus/(deficit) during the period is as follows:

	Notes	31 Dec 07 £m	31 Dec 06 £m
Deficit in Pension Scheme at 1 January		-	(32)
Movement during the year:			
Contributions received		11	11
Current service cost – final salary	34.2	(2)	(4)
Gain on curtailment		-	12
Net expected return on pension assets	34.2	2	4
Actuarial (losses)/gains	34.2.3	(11)	9
Surplus in Pension Scheme at 31 December		-	-

In addition, the Group made contributions of £1m (2006: £1m) to the money purchase section of the Pension Scheme.

34.2 The components of the pensions cost incurred are:

34.2.1 Analysis of amounts charged to operating profit:

	31 Dec 07 £m	31 Dec 06 £m
Current service cost – final salary	2	4

NOTES TO THE ACCOUNTS (CONTINUED)

34. Staff pension scheme (continued)

34.2.2 Analysis of the amount credited to investment income:

	31 Dec 07 £m	31 Dec 06 £m
Interest cost	91	84
Expected return on Pension Scheme assets	(93)	(88)
Net credit to other finance income	(2)	(4)
Total operating credit	-	-

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

	31 Dec 07 £m	31 Dec 06 £m
Actual gain less expected return on Pension Scheme assets	(12)	(25)
Experience loss arising on Pension Scheme liabilities	30	33
Changes in assumptions underlying the present value of the Pension Scheme liabilities	(61)	(21)
Impact of unrecognised surplus	54	4
Actuarial loss/(gain) recognised in the STRGL	11	(9)

34.3 The financial assumptions used to calculate the Pension Scheme liabilities under FRS 17 are:

Valuation method	31 Dec 07 Projected unit	31 Dec 06 Projected unit	31 Dec 05 Projected unit
Discount rate	5.80%	5.20%	4.80%
Inflation rate	3.50%	3.10%	2.90%
Rate of increase in pensionable salaries (aged related scale in addition)	5.00%	4.60%	4.40%
Rate of increase in pensions in payment (in excess of GMPs)	3.50%	3.10%	2.90%
Rate of increase in deferred pensions	3.50%	3.10%	2.90%

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

	Long term rate of return expected at			Value		
	31 Dec 07 %	31 Dec 06 %	31 Dec 05 %	31 Dec 07 £m	31 Dec 06 £m	31 Dec 05 £m
Equities	8.4	8.2	8.1	581	614	540
Property	6.5	6.3	6.4	142	193	185
Bonds	4.8	4.5	4.2	1,160	988	974
Cash and other	4.8	5.0	3.7	(18)	17	53
Total market value of defined benefit assets				1,865	1,812	1,752
Present value of Pension Scheme liabilities				(1,784)	(1,798)	(1,784)
Surplus/ (deficit) in the Pension Scheme				81	14	(32)
Unrecognised surplus				(81)	(14)	-
Related deferred tax asset				-	-	10
Net pension liability				-	-	(22)

NOTES TO THE ACCOUNTS (CONTINUED)

34. Staff pension scheme (continued)

34.5 Pension Scheme experience gains and losses are as follows:

	31 Dec 07	31 Dec 06
Gain on Pension Scheme assets		
Amount (£m)	(12)	(25)
Percentage of present value of Pension Scheme assets	0.6%	1.4%
Experience losses on Pension Scheme liabilities		
Amount (£m)	30	33
Percentage of present value of Pension Scheme liabilities	1.7%	1.8%
Total loss/(gain) recognised in the STRGL		
Amount (£m)	11	(9)
Percentage of present value of Pension Scheme liabilities	0.6%	0.5%

35. 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 plc	UK	'A' ordinary shares of 5 pence 'B' ordinary shares of £1

‡ Held by a subsidiary undertaking

b) Non-insurance companies:

London Life Holdings Limited (finance company)	UK	Ordinary shares of £1
NP Life Holdings Limited (holding company)	UK ‡	'A' and 'B' ordinary shares of £1
Pearl Assurance Group Holdings Limited (finance company)	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
Axial Investment Management Limited (investment management company)	UK	51% Ordinary shares of £1

‡ Held by a subsidiary undertaking

NOTES TO THE ACCOUNTS (CONTINUED)

35. Subsidiary and associated undertakings (continued)

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
c) Associate 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%
Covent Gardent Limited Partnership (property partnership)	UK ‡	37%
Drago Real Estate Partners Limited (close-ended investment company)	Guersey ‡	24.71% ordinary shares of €0.01
Sant Topco Holding BV (holding company)	Luxembourg ‡	22.759% ordinary shares of €0.01

‡ Held by a subsidiary undertaking

d) Joint venture:

Tesco Property Limited Partnership (property partnership)	UK ‡	50%

‡ Held by a subsidiary undertaking

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.

36. Related party transactions

The Company has taken advantage of the exemption given by FRS8 to subsidiary undertakings, 90% or more of whose voting rights are controlled within the group, by not disclosing information on related party transactions with entities that are part of the Pearl Group Limited Group of companies.

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 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
Interest payable	(28)	(28)	(28)	(28)
Interest receivable	10	4	10	4
Dividends	(17)	(100)	(17)	(100)
	(35)	(124)	(35)	(124)

NOTES TO THE ACCOUNTS (CONTINUED)

36. Related party transactions (continued)

Balances outstanding were:

	SCIL		HIOL	
	31 Dec 07 £m	31 Dec 06 £m	31 Dec 07 £m	31 Dec 06 £m
Fixed asset investments – loans	87	87	87	87
Subordinated loans	(230)	(230)	(230)	(230)
Debtors less (creditors)	(12)	(17)	(12)	(17)
	(155)	(160)	(155)	(160)

On 15 May 2007, the Group became a holder of £56,700,000 of a £905,000,000 syndicated loan facility made available jointly to SCIL and HIOL. During the year interest receivable of £2,500,000 has been recognised and cash receipts for interest and capital of £2,000,000 and £1,900,000 respectively have been received in relation to the Group's element of the loan. The total balance of capital and interest outstanding at 31 December 2007 is £55,300,000.

During the year Sun Capital Partners Limited, of whom W A McIntosh and H E M Osmond are directors and TDR Capital LLP, of whom M Dale and S J Robertson are designated members received £1,666,056 (2006: £597,610) and £5,601,112 (2006: £1,795,220) respectively as shareholder monitoring fees and investment management fees.

During the year, the Pension Scheme, was charged £400,000 (2006: £Nil) and received £1,600,000 (2006: £Nil) from the Group for investment management fees and the reimbursement of administrative expenses respectively. Both of these amounts were outstanding at 31 December 2007.

On 4 July 2007, the Group purchased 79,522 shares in Drago Real Estate Partners Limited for consideration of €8,379,190. 44,695 of these shares were purchased for €4,709,470 from directors of Sun Capital Partners Limited including H E M Osmond and W A McIntosh.

On 20 November 2007, the Group purchased 16,200,000 shares in Sant Topco Holdings BV, a property investment portfolio holding company, for consideration of €121,000,000 financed in part through loans of €93,461,000 of which €92,413,000 were from directors of Sun Capital Partners Limited including H E M Osmond and W A McIntosh, TDR Capital LLP, of whom M Dale and S J Robertson are designated members, and Drago Real Estate Partners Limited. These loans were all interest free and were settled with shares of Sant Topco Holdings BV. Following this intermediary step, the Group has retained a holding of 22.8% in Sant Topco Holdings BV.

37. 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.

38. Risk Management

38.1 Risk and capital management objectives and policies

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.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.1 Risk and capital management objectives and policies (continued)

In pursuing these goals, the Group deploys financial assets and incurs financial liabilities. Financial assets principally comprise investments in equity securities, fixed interest investments, derivatives, trade and other receivables, and banking deposits. Financial liabilities comprise investment contracts, borrowings for financing purposes, trade and other payables.

The use of financial instruments naturally exposes the Group to the risks associated with them, chiefly, market risk, credit risk and liquidity risk. The Group's risk management policy establishes a framework for setting the financial risk profile for each life company and reporting on financial risk exposure. Responsibility for agreeing the financial risk profile rests with the board of each life company, given advice from investment managers, internal risk committees and the actuarial function. In setting the risk profile, the board of each life company will receive advice from the appointed investment managers and the relevant actuary as to the potential implications of that risk profile with regard to the probability of both realistic insolvency and of failing to meet the regulatory minimum capital requirement. The actuary will also advise the extent to which the investment risk taken is consistent with the Group's commitment to treat customers fairly.

Derivatives are used in a number of the Group's funds, within policy guidelines agreed by the Board of each life company and overseen by the Asset, Liability and Investment Management Committee ("ALIMCo") and the Financial Risk Committee. Derivatives are primarily used for efficient portfolio management or for risk hedging purposes.

More detail on the Group's exposure to financial risk is provided in note 38.3 below.

The Group is also exposed to insurance risk arising from its life assurance business. 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.

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

A further tool used by the Group for risk management is the regulatory requirement for the Group to carry out an Individual Capital Assessment ("ICA") in accordance with the FSA's General Prudential Sourcebook. The intention of the ICA is to estimate how much capital is required to reduce the risk of insolvency to a remote degree of probability. The ICA framework developed by the Group identifies the risks to which it is exposed and quantifies their impact on economic capital. The results are used to formulate an appropriate management response in the form of risk mitigation, where this is necessary.

During the period the Group continued to invest in developing its specialised asset and liability matching capabilities, which is focused on delivering more effective deployment of capital resources. The Group's existing processes for managing risk broadened but there have been no fundamental changes to the Group's processes for managing risk during the period.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The 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.

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.

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.

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. An additional amount to cover specified stress tests, known as the Resilience Capital Requirement, is required to be held by companies that are not subject to the FSA's realistic capital regime (i.e. NPIL).

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.

In the Group's with-profits funds, measurement of realistic liabilities, including options and guarantees, is determined using stochastic methods which take into account actions which are assumed to be taken by management in response to changes in market conditions. Any such capital management initiatives undertaken by the Group will be consistent with the Principles and Practices of Financial Management ("PPFM"). The most significant management actions assumed in the measurement of liabilities are in respect of changes to bonus rates or assumed asset mix in certain scenarios.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The capital position statement (continued)

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

Regulatory capital position statement

2007

	With profits Pearl £m	With profits LLL £m	Non participating £m	Life business shareholders' funds £m	Total life business £m	Other activities and consolidation adjustments £m	Group total £m
Shareholders' funds outside long-term fund	-	-	-	1,419	1,419	(568)	851
Shareholders' funds held in long-term fund	-	-	328	-	328	-	328
Total shareholders' funds at 31 December 2007	-	-	328	1,419	1,747	(568)	1,179
Adjustments onto a regulatory basis:							
FFA	306	10	-	-	316	-	316
Adjustment to assets	(23)	(4)	(40)	(650)	(717)	(150)	(867)
Adjustments to liabilities	1,201	71	(31)	(14)	1,227	-	1,227
Other adjustments	-	-	-	-	-	59	59
Other qualifying capital:							
Subordinated debt	65	-	-	(65)	-	460	460
Contingent loans	-	18	16	-	34	(34)	-
Allocation of group capital	156	-	-	(156)	-	-	-
Total available capital resources at 31 December 2007	1,705	95	273	534	2,607	(233)	2,374
Capital Requirement							
UK realistic basis							1,634
Other regulatory bases							223
							1,857
Excess capital over regulatory requirements							517
Assets in excess of market risk and counterparty exposure limits							312
Excess of available capital resources							829

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The capital position statement (continued)

Regulatory capital position statement

2006

	With profits Pearl £m	With profits LLL £m	Non participating £m	Life business shareholders' funds £m	Total life business £m	Other activities and consolidation adjustments £m	Group total £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
Adjustments onto a regulatory basis:							
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
Excess capital over regulatory requirements and excess of available capital resources							713

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The capital position statement (continued)

An analysis of the movement in available capital resources for the period 1 January 2007 to 31 December 2007 is shown below:

	With profits Pearl	With profits LLL	Non participating	Life business shareholders' funds	Total life business	Other activities and consolidation adjustments	Group total
	£m	£m	£m	£m	£m	£m	£m
Total available capital resources at 1 January 2007	1,774	115	229	776	2,894	(252)	2,642
Regular surplus	143	15	32	-	190	-	190
Investment return	58	(22)	19	14	69	-	69
Cost of bonus	(153)	(9)	-	-	(162)	-	(162)
Changes in methodology and assumptions:							
Longevity	(51)	-	(27)	-	(78)	-	(78)
Expenses	133	2	9	-	144	-	144
Persistency	(19)	-	-	-	(19)	-	(19)
Annuity pricing	50	-	-	-	50	-	50
Other	30	1	5	-	36	-	36
Management actions:							
Investment strategy	(234)	-	-	-	(234)	-	(234)
Investment in Resolution plc	-	-	-	(228)	(228)	(4)	(232)
Payments from Pearl Group Limited	-	-	-	-	-	(67)	(67)
New business and other factors:							
Intragroup capital movement	(16)	(1)	(13)	(12)	(42)	52	10
Change in internal capital	(19)	-	(14)	(3)	(36)	-	(36)
Other	9	(6)	33	(13)	23	38	61
Total available capital resources at 31 December 2007	1,705	95	273	534	2,607	(233)	2,374

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The 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 Pearl	With profits LLL	Non participating	Life business shareholders' funds	Total life business	Other activities and consolidation adjustments	Group total
	£m	£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 methodology and 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

The management actions that have had a significant impact on available capital resources during the period 1 January 2007 to 31 December 2007 are described below:

Investment strategy

Management have pursued an investment strategy within the with-profits fund of Pearl into assets which are zero-yielding under the regulatory peak, but offer improved longer term investment returns. In addition, these assets are exposed to higher investment expenses.

Investment in Resolution plc

As at 31 December 2007 the Group held a 25.93% equity investment in Resolution plc via a 20.13% holding carried by Pearl and a 5.80% stake carried by Pearl Group Limited. The Group recognised a gain of £82m through the consolidated profit and loss account and a loss of £2m within the consolidated statement of total recognised gains and losses in relation to the revaluation of this investment during the year before taking account of assets in excess of market risk and counterparty exposure limits.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The capital position statement (continued)

Payments from Pearl Group Limited

During the year, the Company paid dividends of £33m (2006: £199m) and provided further loans of £nil (2006: £123m) to its holding companies. A further £34m (2006: £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.

Sensitivity analysis

Insurance liabilities are sensitive to changes in risk variables, such as prevailing market interest rates, currency rates and equity prices, since these variations alter the value of the financial assets held to meet obligations arising from insurance contracts and changes in investment conditions also have an impact on the value of insurance liabilities themselves. Additionally, insurance liabilities are sensitive to the assumptions which have been applied in their calculation, 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. The most significant sensitivities arise from the following three sources:

Market 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

Mortality risk arises from differences between anticipated and actual volumes of deaths on assurance business or improvements in longevity for annuity business.

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.

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 a financial loss and a potential weakening of the capital position. When considering assumptions for persistency, thought needs to be given to the assumed behaviour of policyholders in relation to guarantees and options.

Analysis of policyholder liabilities

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.

NOTES ON THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The capital position statement (continued)

Analysis of policyholder liabilities

2007

	With-profits £m	Non participating £m	Total life business £m
With profits liabilities on a realistic basis:			
Options and guarantees	1,892	-	1,892
Other policyholder obligations	12,310	-	12,310
Total with-profits liabilities	14,202	-	14,202
Unit linked	4	3,959	3,963
Non-participating life assurance	302	4,487	4,789
Technical provisions in the balance sheet	14,508	8,446	22,954

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

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 £748m (2006: £518m) and £42m (2006: £38m) 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.

NOTES ON THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.2 The capital position statement (continued)

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

2007

	Pearl with-profits £m	LLL with-profits £m	NPLL £m	Total £m
Total shareholders' funds – held in long-term with-profits funds	-	-	-	-
Adjustments onto realistic basis:				
FFA	306	10	-	316
Adjustments to assets	(1)	-	93	92
Adjustments to liabilities	-	-	(23)	(23)
Shareholders' share in realistic liabilities	(305)	(10)	-	(315)
Working capital	-	-	70	70

2006

	Pearl with-profit £m	LLL with-profit £m	NPLL £m	Total £m
Total shareholders' funds – held in long-term with-profits funds	-	-	-	-
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

38.3 Financial risk analysis

38.3.1 Credit risk

Exposure to credit risk arises from counterparties failing to meet all or part of their obligations, from a reinsurer's inability to meet the obligations assumed under its reinsurance arrangements 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.

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.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.3 Financial risk analysis (continued)

38.3.1 Credit risk (continued)

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 following table provides information regarding the aggregate credit exposure, for debt securities and other fixed interest securities with external credit ratings, of the Group.

2007

	AAA	AA	A	BBB	BB	B	CCC	Non Rated	Carrying value
									£m
Debt securities and other fixed income securities	62.1%	7.2%	13.1%	8.0%	2.4%	3.1%	0.3%	3.8%	12,575

2006

	AAA	AA	A	BBB	BB	B	CCC	Non Rated	Carrying value
									£m
Debt securities and other fixed income securities	62.0%	8.3%	16.4%	6.3%	1.7%	3.1%	-	2.2%	15,215

The majority of over the counter derivatives are only entered into with approved counterparties, unless specific approval has been obtained by ALIMCo and the Financial Risk Committee, thus reducing credit risk on these instruments.

With regard to deposits with credit institutions, Group practice is to hold cash and deposits with financial institutions and in money market funds that have a rating of A1, P1 or higher.

The Group is exposed to concentrations of risk with individual reinsurers, due to the nature of the reinsurance market. The Group's largest reinsurance exposure at 31 December 2007 was to Opal Reassurance Limited and the reinsurance asset recoverable was £3,647m (2006: £117m to National Indemnity). In order to mitigate the credit risk arising from this exposure and to protect policyholders, the terms of the reassurance arrangements provide that the initial premium payable has been withheld and placed in collateral accounts. The Group operates a policy to manage its reinsurance counterparty risk and the impact from reinsurer default is measured regularly.

NOTES TO THE ACOUNTS (CONTINUED)

38. Risk management (continued)

38.3 Financial risk analysis (continued)

38.3.1 Credit risk (continued)

The following table gives information regarding the ageing of financial assets that are past due but not impaired and the carrying value of financial assets that have been impaired.

2007

	Neither past due nor impaired	0-30 days	30-90 days	>90 days	Impaired	Carrying value £m
Debt securities and other fixed income securities	100.0%	-	-	-	-	12,575
Deposits with credit institutions	100.0%	-	-	-	-	219
Derivative assets	100.0%	-	-	-	-	612
Loans and receivables at amortised cost	100.0%	-	-	-	-	221
Debtors	89.4%	4.3%	0.6%	5.7%	-	102
Accrued interest and rent	94.9%	3.5%	0.5%	1.1%	-	255
Cash at bank and in hand	100.0%	-	-	-	-	644

2006

	Neither past due nor impaired	0-30 days	30-90 days	>90 days	Impaired	Carrying value £m
Debt securities and other fixed income securities	100.0%	-	-	-	-	15,215
Deposits with credit institutions	100.0%	-	-	-	-	369
Derivative assets	100.0%	-	-	-	-	376
Loans and receivables at amortised cost	100.0%	-	-	-	-	221
Debtors	80.1%	10.3%	1.8%	5.7%	2.1%	101
Accrued interest and rent	90.0%	7.1%	1.5%	1.4%	-	287
Cash at bank and in hand	100.0%	-	-	-	-	458

There were no material financial assets that would have been past due or impaired had the terms not been renegotiated.

38.3.2 Market risk

Market risk is the risk of adverse financial impact due to fluctuations in the fair values or future cash flows of financial instruments whether arising from changes to interest rates, equity prices, property prices or foreign currency exchange rates.

Interest rate risk

Interest rate risk is the risk that the Group will sustain losses through adverse movements in interest rates due to the effect such movements have on the value of interest-bearing assets and on the value of future guarantees provided under certain contracts of insurance.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.3 Financial risk analysis (continued)

38.3.2 Market risk (continued)

Interest rate risk (continued)

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 the non participating funds. For participating business, some element of investment mismatching is permitted where it is consistent with the principles of treating customers fairly. The with-profit funds of the Group provide capital to allow such mismatching to be effected. In practice, the life companies 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.

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

With-profit business and non profit business within the with-profit 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-profit business the profit or loss arising from mismatches between such assets and liabilities is largely offset by increased or reduced discretionary policyholder benefits. The contribution of these funds to the Group result is determined primarily by either the shareholders' share of the declared annual bonus or by the shareholder's interest in any change in value in the contingent loans advanced to the NPLL and LLL with-profits funds.

In the non participating funds, policy liabilities are duration matched with primarily fixed interest securities, with the result that sensitivity to changes in interest rates is very low.

An increase of 1% in interest rates, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year and decrease in shareholder equity of £68m (2006: £26m). A decrease of 1% in interest rates, with all other variables held constant, would result in an additional profit after tax in respect of a full financial year an increase in shareholder equity of £79m (2006: £20m).

Equity and property price risk

Equity and property price risk is the risk that a reduction in the value of equities or property 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. The Group is exposed to equity price risk as a result of its holdings in equity investments and to property price risk as a result of its holdings of investment properties, either directly or indirectly via intermediate investment structures.

Equity and property price risk is managed through 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.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.3 Financial risk analysis (continued)

38.3.2 Market risk (continued)

Equity and property price risk (continued)

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

Equity and property investments are principally used as investments of the Group's with profits funds. The contribution of these funds to the Group result is determined primarily by either the shareholders' share of the declared annual bonus or by the shareholder's interest in any change in value in the contingent loans advanced to the NPLL and LLL with-profits funds. In addition the Group is exposed to equity price risk on its investment in Resolution plc.

A 10% decrease in equity/property prices, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year of £106m (2006: £36m) and a decrease in shareholder equity of £134m (2006: £36m). A 10% increase in equity/property prices, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year of £109m (2006: £36m) and an increase in shareholder equity of £137m (2006: £36m).

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 through appropriate monitoring and use of forward contracts to mitigate risk where this is beneficial.

Sensitivity of profit and shareholders' equity to fluctuations in currency exchange rates is not considered significant at 31 December 2006 and 31 December 2007, since unhedged exposure to foreign currency was relatively low.

38.3.3 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.

Financial markets have seen significant volatility during the latter half of the financial year as evidenced by the widening of credit spreads and the fall in demand of the commercial property market A very substantial proportion of the Group's assets are invested in listed securities such that liquidity risk is not a major issue. The Group has some appetite for illiquid assets, mainly for the with-profits funds, where there is appropriate compensation for the risk taken and where the matching liabilities are equally illiquid. Overall liquidity risk is low.

Liquidity risk is managed by the Group through the monitoring of current assets to ensure there are sufficient readily realisable assets within the funds to settle liabilities.

NOTES TO THE ACCOUNTS (CONTINUED)

38. Risk management (continued)

38.3 Financial risk analysis (continued)

38.3.3 Liquidity risk (continued)

The following table provides a maturity analysis showing the remaining contractual maturities of the Group's undiscounted financial liabilities and associated interest:

2007

	1 year or less or on demand	1-5 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	£m
Debenture loans	85	187	323	74	-	-	289	958
Amounts owed to credit institutions	-	-	-	-	-	-	328	328
Derivative liabilities	119	27	124	20	10	243	-	543
Creditors arising out of direct insurance operations	1	-	-	-	-	-	-	1
Other creditors including taxation and social security	1,349	17	4	-	-	-	-	1,370
Investment contracts with discretionary participation features, included in long -term business provision	725	2,131	2,341	1,848	1,610	2,502	-	11,157

2006

	1 year or less or on demand	1-5 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	£m
Debenture loans	47	227	305	136	-	-	289	1,004
Amounts owed to credit institutions	-	-	-	-	-	-	291	291
Derivative liabilities	1	35	52	26	2	159	-	275
Creditors arising out of direct insurance operations	1	-	-	-	-	-	-	1
Other creditors including taxation and social security	238	29	5	-	-	-	-	272
Investment contracts with discretionary participation features, included in long- term business provision	771	2,372	2,608	2,043	1,803	2,525	-	12,122

38.4 Unit linked contracts

For unit linked contracts the Group matches all the liabilities with assets in the portfolio on which the unit prices are based. There is therefore no interest, price, currency or credit risk for the Group on these contracts.

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

NOTES TO THE ACCOUNTS (CONTINUED)

39. Company balance sheet notes

39.1 Fixed assets

	Note	31 Dec 07 £m	31 Dec 06 £m
Shares in subsidiary undertakings	39.1 (a)	2,687	2,723
Loans to subsidiary undertakings	39.1 (b)	4	-
Loans to external undertakings	39.1 (b)	174	174
Contingent loan	39.1 (b)	158	154
Other financial investments	39.1 (c)	24	23
Total fixed asset investments		3,047	3,074

(a) Shares in subsidiary undertakings

	£m
Cost	
At 1 January 2007	2,723
Additions	22
Disposals	(6)
At 31 December 2007	2,739
Provision for impairment	
At 1 January 2007	-
Charge for the year	(52)
At 31 December 2007	(52)
Net book value	
At 31 December 2007	2,687
At 31 December 2006	2,723

During 2007 under the terms of a price adjustment mechanism in the sale and purchase agreements of London Life Holdings Limited and London Life Limited, the consideration in respect of each acquisition was reduced by £17m.

On 10 December 2007 the Company made a capital contribution of £57m to Pearl Assurance plc.

During 2007 Pearl ISA Limited and UKLS Financial Services Limited were put into members voluntary liquidation and the share capital of £1m and £3m respectively was distributed to the Company.

On 25 April 2007 the Company sold 49.5% of its issued share capital in Axial Investment Management Limited to external parties at cost of £2m. No profit or loss arose on this transaction.

During 2007 Pearl Assurance Group Holdings Limited paid dividends to the Company, triggering an impairment of £52m.

NOTES TO THE ACCOUNTS (CONTINUED)

39. Company balance sheet notes (continued)

39.1 Fixed assets (continued)

(b) Loans

	Loan to subsidiary Note (i) £m	Loan to external undertakings Note (ii) £m	Contingent loan Note (iii) £m	Total £m
At 1 January 2007	-	174	154	328
Additions	4	-	-	4
Surplus on revaluation	-	-	4	4
At 31 December 2007	4	174	158	336
Cost				
At 31 December 2007	4	174	286	464
At 31 December 2006	-	174	286	460

(i) On the 1 July 2007, the Company provided two £2m loans to Axial Investment Management Limited with interest rates of 6 month LIBOR plus a margin of 1.25% and maturity dates of 1 July 2009 and 1 July 2012.

(ii) The £174m loan with Sun Capital Investment Limited and Hera Investment One Limited is a draw down on a £1.5 billion facility, accrues interest at a rate of 12% per annum and matures on 14 April 2014.

(iii) The contingent loan with London Life Limited has an interest moratorium until 31 December 2009. Interest will start accruing on this contingent loan after 1 January 2010. The loan has an indefinite term (see note 32).

(c) Other financial investments

	31 Dec 07 Carrying value £m	31 Dec 07 Cost £m	31 Dec 06 Carrying value £m	31 Dec 06 Cost £m
Ordinary shares	24	-	23	-

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.

NOTES TO THE ACCOUNTS (CONTINUED)

39. Company balance sheet notes (continued)

39.2 Debtors – due within one year

	31 Dec 07 £m	31 Dec 06 £m
Amounts due from Group undertakings	8	28
Other debtors	23	7
Prepayments and accrued income	16	6
	47	41

39.3 Current asset investments

	31 Dec 07 £m	31 Dec 06 £m
At 1 January	2	-
Additions	295	3
Disposals	(1)	(1)
Deficit on revaluation	(2)	-
At 31 December	294	2

During the year the Company acquired 39,777,537 shares in Resolution plc at a cost of £285m.

During the year the Company provided additional security to the Pension Scheme by making a £10m payment into an escrow fund (see note 34).

39.4 Creditors: amounts falling due within one year

	31 Dec 07 £m	31 Dec 06 £m
Amount owed to Group undertakings	1,267	1,421
Loans due to Group undertakings (note 39.6)	112	164
Other creditors	284	27
Accruals and deferred income	47	42
	1,710	1,654

39.5 Creditors: amounts falling due after more than one year

	31 Dec 07 £m	31 Dec 06 £m
Loans due to Group undertakings (note 39.6)	269	162
Loans due to external undertakings (note 39.6)	460	460
	729	622

NOTES TO THE ACCOUNTS (CONTINUED)

39. Company balance sheet notes (continued)

39.6 Loans

	31 Dec 07 £m	31 Dec 06 £m
£289 million 12% subordinated loans (note a)	289	289
£171 million 12% subordinated loans (note b)	171	171
Loans due to Group undertakings	381	326
	841	786

(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.

(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.

Payable as follows:	31 Dec 07 £m	31 Dec 06 £m
In one year or less, or on demand	112	164
In five years or more	729	622
	841	786

Nature of borrowings:	31 Dec 07 £m	31 Dec 06 £m
Fixed rate borrowings	478	478
Floating rate borrowings	334	279
Interest free borrowings	29	29
	841	786

39.7 Deferred taxation

Reconciliation of movements in deferred tax:

	31 Dec 07 £m	31 Dec 06 £m
At 1 January	7	-
Charge for the year:	-	7
At 31 December	7	7

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

	31 Dec 07 £m	31 Dec 06 £m
Unrealised gain	7	7
Total on an undiscounted and a discount basis	7	7

NOTES TO THE ACCOUNTS (CONTINUED)

39. Company balance sheet notes (continued)

39.8 Reserves and reconciliation of movement in shareholders' funds

	Share capital £m	Profit and loss account £m	Shareholders' funds £m
At 1 January 2006	596	79	675
Profit after taxation for the year ended 31 December 2006	-	369	369
Dividends (note 6)	-	(199)	(199)
Actuarial gains on pension scheme	-	9	9
Tax on items taken directly to equity	-	(3)	(3)
At 31 December 2006	596	255	851
Profit after taxation for the year ended 31 December 2007	-	167	167
Dividends (note 6)	-	(33)	(33)
Fair value adjustment on available for sale financial assets	-	(2)	(2)
Actuarial losses on pension scheme	-	(11)	(11)
Tax on items taken directly to equity	-	3	3
At 31 December 2007	596	379	975

The profit and loss account of the Company at 31 December 2007 includes £169m (2006: £119m) which is non-distributable.

40. Post balance sheet events

On 16 November 2007, the Boards of Pearl Group Limited and Resolution plc ("Resolution") announced that they had agreed the terms of a recommended cash acquisition by Impala Holdings Limited ("Impala"), for the entire issued and to be issued share capital of Resolution. This acquisition was to be by way of a Court sanctioned scheme of arrangement under section 425 of the Companies Act (the "Scheme"). On 9 January 2008, the shareholders of Resolution voted in favour of accepting Impala's acquisition offer at an extraordinary general meeting of Resolution and also at a meeting convened by order of the Court. The completion of the acquisition remains subject to approval by the FSA of the change of control. It is anticipated that the acquisition will be effective in the second quarter of 2008.

Following the acquisition, Pearl Group Limited will become the largest specialist manager of in-force UK life funds, with an estimated 10.5 million customers and assets under management of £89 billion. The strategy of the enlarged group will continue to be to improve risk-adjusted financial returns for its policyholders and other stakeholders to improve policyholder financial security and provide excellent service to its customers.

As at 31 December 2007 the Group held a 25.93% equity investment in Resolution via a 20.13% holding carried by Pearl Assurance plc and a 5.80% stake carried by Pearl Group Limited. The Group recognised a gain of £82m through the consolidated profit and loss account and a loss of £2m within the consolidated statement of total recognised gains and losses in relation to the revaluation of this investment during the year. Following completion, these gains / losses recognised in 2007 will be reversed in the Group accounts through the application of acquisition accounting in 2008.

NOTES TO THE ACCOUNTS (CONTINUED)

40. Post balance sheet events (continued)

Under the terms of the acquisition, Resolution shareholders will receive 720 pence in cash for each share held. As an alternative to receiving some or all of their consideration in cash, shareholders will be entitled to receive loan notes issued by Impala which will accrue interest at 1% below six month sterling LIBOR. This is anticipated to give a total fair value of consideration paid by Impala for the acquisition of Resolution of circa £4.98 billion.

As an integral part of the acquisition, Impala and Pearl Group Limited have entered into an agreement with Royal London under which, following the completion of the acquisition of Resolution, Royal London will acquire certain of Resolution's business and assets. The total consideration payable by Royal London in connection with this transaction is expected to be circa £1.3 billion. As these assets will be transferred at their fair value on completion, nil profit will arise in Impala on this transaction.

The holdings of Pearl Group Limited and Pearl Assurance plc will be transferred to Impala at fair value on completion with the result being that Resolution will become a 100% owned subsidiary of Impala as at that date with an anticipated net cost of investment (excluding acquisition costs) of circa £3.68 billion.